

TAX STRATEGY PATENTS:

**WHY THE TAX COMMUNITY SHOULD NOT
EXCLUDE THE PATENT SYSTEM**

by

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ABSTRACT

A relatively recent phenomenon of patents covering tax saving strategies has generated an overwhelmingly negative response from the tax community. This Article reviews current patent laws in the context of tax strategy patents and business method patents (of which tax strategy patents are a subset), and then analyzes the major concerns voiced by opponents of tax strategy patents. The Article suggests that the lack of searchable prior art and patent examiner expertise are temporary problems that can and will be adequately addressed by the Patent Office and the tax community.

In addition, while the tax community has put forth many thoughtful concerns regarding why tax strategies should be outside the realm of patentable subject matter, this Article contends that many of the concerns arise from either a misunderstanding of the patent laws, or dislike and fear of change, rather than from fundamental reasons to exclude tax strategies from patenting. The Article does, however, recommend some slight changes to the laws relevant to this area, including

- requiring patent applicants to base tax strategy patent applications on current tax laws, and to identify and explain the primary tax laws relevant to an alleged invention,
- reviewing all tax strategy patents under a strict obviousness standard based on the recent *KSR v. Teleflex* Supreme Court case, and
- amending the tax laws to make the use of patented tax strategies reportable transactions.

Minimizing the issuance of “bad” tax strategy patents will result in a patent system whose value to the public correlates with the value of the tax planning profession as a whole. Thus, interested parties should focus their efforts not on eliminating tax strategy patents, but on increasing the quality of issued patents and improving the tax laws under which any such patents would operate.

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I. INTRODUCTION

Imagine that every congressional tweak of tax laws¹ sets off a flurry of patent applications—companies and individuals race to the Patent Office in an attempt to capture patent protection for strategies made beneficial by new laws. Eventually, the stakes get so high that financial “wildcatters” and influential lobbyists apply for prophetic patents, hoping to capture patent protection for yet-to-be-determined changes in tax laws. Meanwhile, unscrupulous businesspersons advertise “patented” tax strategies that violate tax laws, misleading their clients into committing tax fraud. While overstated, the possibility of such scenarios has led a nervous tax community to investigate and discuss the patent system.

Many tax planners awoke abruptly to the issue of patented tax saving strategies in January 2006, when Wealth Transfer Group LLC sued John W. Rowe, Aetna Inc.’s executive chairman, alleging infringement of U.S. Patent No. 6,567,790 (“the ‘790 patent”).² According to its title, the ‘790 patent relates to a method of “[e]stablishing and managing grantor retained annuity trusts funded by nonqualified stock options.”³ While the case settled in March 2007,⁴ it highlights broad concerns associated with tax strategy patents.

The tax community’s reaction has been overwhelmingly negative toward tax strategy patents. Members of Congress, taking notice of the debate, have sought to limit tax strategy patents.⁵ Ironically, although patents concern the right to exclude,⁶ it is the tax community who seeks to exclude the patent

¹ This Article repeatedly refers to the Internal Revenue Code and related regulations and rules as simply “tax laws.”

² See Complaint at 1–2, *Wealth Transfer Group LLC v. Rowe*, No. 3:06-cv-00024 (D. Conn. Jan. 6, 2006).

³ U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

⁴ See Consent Final Judgment Regarding Settlement Agreement, *Wealth Transfer Group LLC v. Rowe*, No. 3:06-cv-00024 (D. Conn. Dec. 1, 1999).

⁵ See S. 681, 110th Cong. § 303 (2007) (seeking to prohibit a patent if “the invention is designed to minimize, avoid, defer, or otherwise affect the liability for Federal, State, local, or foreign tax”); H.R. 2365, 110th Cong. (2007) (seeking to prohibit damages or injunctions “against the taxpayer, the tax practitioner, or any related professional organization” who uses a tax planning method).

⁶ Although many think a patent gives its owner the right to make or use an invention, it actually gives the patent owner the right to exclude others from making or using the invention. See 35 U.S.C. § 271 (2000). Patent owners are often precluded from operating within their own patents, due, for example, to preexisting unexpired patents on components of the patented subject matter, on broader versions of the invention, or on methods needed to produce the

system from the tax strategy area. The antipathy toward tax strategy patents has evoked some surprising arguments from within the tax community, including that tax-savings ideas are socially wasteful;⁷ thus, calling much of the tax profession into question. The tax community has put forth many thoughtful concerns, but this Article contends that many of the concerns arise from either a misunderstanding of the patent laws, or dislike and fear of change, rather than from fundamental reasons to exclude tax strategies from patenting.

This Article analyzes many of the tax community's concerns and is divided into six main sections. The first four sections (Sections II–V) analyze tax strategy patents in light of the basics of patent law. Next, because tax strategy patents are closely related to “business method” patents, the fifth main section (Section VI) reviews some of the arguments against business method patents. Finally, the last main section (Section VII) reviews objections and concerns accompanying the rise of tax strategy patents that were not discussed in Sections II–V. This Article ultimately concludes that Congress, the courts, and the Patent & Trademark Office (“PTO”) should generally treat tax strategies like business methods. This Article suggests some minor modifications to the laws, including:

instituting a “state of the law” affidavit requiring patent applicants to base tax strategy patent applications on current tax laws and to identify and explain the primary tax laws relevant to an alleged invention;⁸

reviewing all tax strategy patents under a strict obviousness standard based on the recent *KSR v. Teleflex* Supreme Court

patented subject matter. *See id.*

⁷ STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., BACKGROUND AND ISSUES RELATING TO THE PATENTING OF TAX ADVICE, 25 (2006), available at <http://www.house.gov/jct/x-31-06.pdf> [hereinafter *JCT*] (stating that “no social gains from novel tax planning strategies exist as any gain to the user of the strategy is offset by losses to the Treasury, and therefore the resources devoted to producing and using such strategies represent a net loss to society.”); *Issues Relating to the Patenting of Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Ellen Aprill), available at <http://waysandmeans.house.gov/hearings.asp> (select “109th Congress”; click “Change Congress”; click “Hearing on Issues Relating to the Patenting of Tax Advice” hyperlink; then click “Ellen Aprill” hyperlink) [hereinafter *Hearing on Patenting Tax Advice*] (stating that tax strategy patents undesirably will cause a “reduction in federal tax revenues, generating revenue losses that would have to be made up from other sources”).

⁸ *See infra* Section VII.A.2.d.

case;⁹

requiring notifications to clients and prospective clients that patented tax strategies are not necessarily legal;¹⁰

mandating publication for all tax strategy patent applications (as opposed to only those that will also file for foreign patent protection) within 18 months from the application date;¹¹ and

amending the tax laws to make the use of patented tax strategies reportable transactions.¹²

II. PATENT LAW AS AN INCENTIVE FOR INNOVATION

Patents, rooted in the Constitution,¹³ grant the owner “the right to exclude others from making, using, offering for sale, or selling the invention” in the U.S.¹⁴ Most economists agree that, in theory, the patent system can promote technological progress (and thus benefit society) by creating incentives for individuals and businesses to engage in research and development. While individuals and businesses naturally desire technological progress, they will generally not engage in the optimal amount of research and development if, due to ease of copying by competitors, it is difficult to recover the R&D costs.¹⁵ Thus, the patent system trades the below optimal research and development investment for the economic inefficiencies of a limited monopoly in the form of a patent.

Patent law has four main requirements for obtaining a patent: the alleged invention must be (1) eligible subject matter, (2) useful, (3) new (novel), and (4) non-obvious. While this Article will discuss each of these requirements in detail, a brief introduction to the concepts will be beneficial. First, the eligible subject matter requirement excludes laws of nature, natural

⁹ See *infra* Section VII.A.2.b–c.

¹⁰ See *infra* Section IV.B.

¹¹ See *infra* Section VII.A.2.a.

¹² See *infra* Section VII.B.1.b.

¹³ U.S. CONST. art. I, § 8, cl. 8 (granting Congress the right “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to . . . inventors the exclusive Right to their . . . Discoveries.”).

¹⁴ 35 U.S.C. §§ 154, 271 (2000).

¹⁵ FED. TRADE COMM’N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY, ch. 1, p. 6 (2003) available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf> [hereinafter *FTC Report*] (citing ROGER E. SCHECHTER & JOHN R. THOMAS, INTELLECTUAL PROPERTY § 13.4.1, at 288 (2003)). Of course, businesses may employ other types of protection, including copyright and trade secret protection.

phenomena, abstract ideas, and pure algorithms. Second, the utility requirement ensures that an invention have a specific and substantial use, such that it is operable to provide a particular, real-world benefit. Third, the novelty requirement prevents patents on inventions that have previously been known or disclosed to the public. Fourth, the non-obviousness requirement ensures that the idea is “inventive,” as opposed to an obvious change to known ideas or inventions.

Tax strategy patents resemble so-called “business method” patents, which as their name implies, cover methods of achieving business objectives.¹⁶ Business method patents have long been the subject of criticism, and many argue that business methods should not be eligible for patenting. Because tax strategy patents are closely related to business method patents, the majority of arguments against business method patents apply with equal force to tax strategy patents. In addition, tax professionals and other critics specifically question whether tax strategies should receive patent protection.

III. TAX STRATEGIES AND BUSINESS METHODS AS ELIGIBLE SUBJECT MATTER FOR PATENTING

A. Introduction to Eligible Subject Matter

The PTO will grant utility patents based on applications¹⁷ falling into one of four eligible categories: processes (also referred to as methods¹⁸), machines, articles of manufacture, compositions

¹⁶ The PTO classifies patents and patent applications into classes and subclasses based on the technology field; the majority of business method patents fall under Class 705 (“DATA PROCESSING: FINANCIAL, BUSINESS PRACTICE, MANAGEMENT, OR COST/PRICE DETERMINATION”) and patents concerning tax reduction techniques fall into Subclass 36T of Class 705. USPTO.gov, Patent Classification Schedules, <http://www.uspto.gov/go/classification/uspc705/sched705.htm> (last visited Oct. 8, 2008).

¹⁷ Patents originate from applications filed with the PTO and generally expire twenty years after the application date. The PTO reviews patent applications for various technical requirements and compares a claimed invention to any known scientific information and technology, referred to as “prior art,” to determine whether the application deserves to issue as a patent. USPTO.gov, General Information Concerning Patents, <http://www.uspto.gov/web/offices/pac/doc/general/index.html> (last visited Oct. 8, 2008). Filing a patent application and prosecuting it to issuance can cost between \$10,000 and \$25,000 or more. See Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 Nw. U. L. REV. 1495, 1498 (2001).

¹⁸ Process (or method) patents generally cover a series of steps or actions, as

of matter, or any new and useful improvement thereof.¹⁹ Together, these four categories cover an expanse of eligible subject matter that includes “anything under the sun that is made by man.”²⁰

Ineligible subject matter includes laws of nature, natural phenomena, abstract ideas, and pure algorithms.²¹ The inability to patent pure algorithms would at first blush appear to preclude patents on computer programs, and thus, many business methods and tax strategies (which often *de facto* require a computer to implement). The Federal Circuit (the appellate court with exclusive jurisdiction for all patent appeals from district courts and the PTO), however, in a series of cases has held that algorithmic implementations may be patented if they are practically applied, such as, but not limited to, by programming them into a computer to provide a useful result.²² Thus, beginning in the 1990s, courts increasingly expanded the scope of eligible subject matter to include a variety of computer related inventions. Courts were more reluctant, however, to expand the scope of eligible subject matter to include patents on business methods.

opposed to the remaining categories which cover things having various components. DONALD S. CHISUM, *Glossary to CHISUM ON PATENTS* (Matthew Bender & Co., Inc. 2007). The distinction between method patents and machine patents has become somewhat blurred given the prevalence of patenting computer-implemented inventions, which one can either describe as a machine (which performs a series of steps in the form of calculations or operations) or a series of steps (performed on a machine). See Jeffrey R. Kuester & Ann K. Moceyunas, *Patents for Software-Related Inventions* (Mar. 1995) (unpublished manuscript, <http://www.kuesterlaw.com/swpat.html> (last visited Oct. 8, 2008)).

¹⁹ 35 U.S.C. § 101 (2000).

²⁰ *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980) (citation omitted).

²¹ *Chakrabarty*, 447 U.S. at 309 (1980); See *AT&T Corp. v. Excel Commc'ns, Inc.*, 172 F.3d 1352, 1356 (Fed. Cir. 1999).

²² See generally *Arrhythmia Research Tech., Inc. v. Corazonix Corp.*, 958 F.2d 1053 (Fed. Cir. 1992) (upholding a patent that incorporated an algorithm into a machine-processed analysis of electrocardiograph signals to help gauge the risk levels of ventricular tachycardia); *In re Alappat*, 33 F.3d 1526, 1544 (Fed. Cir. 1994) (holding that a programmed general purpose computer was eligible subject matter because it “is not a disembodied mathematical concept which may be characterized as an ‘abstract idea,’ but rather a specific machine to produce a useful, concrete, and tangible result.”); *AT&T Corp.*, 172 F.3d at 1357, 1361 (Fed. Cir. 1999) (confirming that claims need not be tied to a machine in order to be patentable subject matter); see also *Diamond v. Diehr*, 450 U.S. 175, 192–93 (1981) (holding that when the algorithm was incorporated in a useful process, the subject matter was statutory).

B. Business Methods as Eligible Subject Matter for Patenting

Having expanded the scope of eligible subject matter to include practical applications of algorithms, courts also had to decide whether “business” methods likewise constituted patentable subject matter. As mentioned above, business methods represent a broad class of inventions covering methods of achieving business objectives. Because tax strategy patents relate closely to business method patents, the history and debate surrounding business method patents bears directly upon tax strategy patents.

Even into the 1990s, courts and the PTO had an aversion to, and refused to grant, business method patents on the ground that they were outside the scientific or technological realm reserved for patent protection.²³ The tide turned in 1998 when the Federal Circuit officially legitimized business method patents with its holding in *State Street Bank & Trust Co. v. Signature Fin., Inc.*²⁴ The patent²⁵ in *State Street* involved a data processing system for implementing an investment structure, Hub and Spoke®, whereby mutual funds (Spokes) pool their assets in an investment portfolio (Hub) organized as a partnership.²⁶ The trial court rejected the patent as not eligible subject matter because it was directed to a mathematical algorithm²⁷ and because it was a business method.²⁸

The Federal Circuit reversed and specifically denounced the “ill-conceived” business method patent exception.²⁹ Thus, instead of worrying whether a method claimed in a patent application relates to a “business” method or some other method, courts and

²³ See John. J. Love, *Business Method Patents*, 7 RICH. J.L. & TECH. 8 (Symposium 2000), available at <http://www.richmond.edu/jolt/v7i2/love.html> (discussing the increased use of business method patents).

²⁴ *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

²⁵ U.S. Patent No. 5,193,056 (filed Mar. 11, 1991).

²⁶ The invention allowed an administrator to monitor, record, and calculate the data needed to maintain the partnership fund. The complex calculations needed to be performed quickly, and thus, *de facto* required a computer. While not necessarily characterized as a pure “tax strategy” patent, the ‘056 Patent organized the mutual funds as a partnership solely for the beneficial tax treatment. *State St.*, 149 F.3d at 1370–71 (Fed. Cir. 1998).

²⁷ *Id.* at 1375 (reversing the trial court’s “mathematical algorithm” rejection in light of *In re Alappat* and related cases).

²⁸ See *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 927 F. Supp. 502, 514–16 (D. Mass. 1996).

²⁹ *State St.*, 149 F.3d at 1375 (Fed. Cir. 1998).

the PTO should simply recognize that the invention is a “method” (by virtue of which it is eligible subject matter for patenting) and proceed to analyze the invention under the remaining statutory requirements.³⁰ Because the remaining statutory requirements of utility, novelty, and non-obviousness were not before the *State Street* court, it remanded the case without analyzing the ‘056 Patent under these requirements.³¹

While *State Street* involved a computer-implemented invention, business methods need not use a computer. Recently, the Board of Patent Appeals upheld a “pure” business method patent application as encompassing eligible subject matter.³² The patent applicant claimed a method of compensating a manager based not only on the manager’s individual performance within the company, but also on the performance relative to the overall industry.³³ Troubled by the fact that the claims did not recite any computer or machine-implemented steps, the patent examiner rejected the application because the invention as a whole was not in the “technological arts.”³⁴ In a rare precedential opinion (split 3–2), the Board summarily overturned the patent examiner’s decision, noting that the Supreme Court declined to adopt a “technological arts” test for determining eligible subject matter.³⁵ Absent a “technological arts” test,³⁶ the

³⁰ *Id.* at 1377.

³¹ After remand, the case settled. Douglas L. Price, *Assessing the Patentability of Financial Services and Products*, 3 J. HIGH TECH. L. 141, 151 n.85 (2004). The ‘056 Patent’s owner never litigated the ‘056 Patent again, perhaps in part out of fear that a court would invalidate the patent under other statutory requirements. For whatever reason, the ‘056 Patent’s owner allowed the patent to expire eight years early by failing to pay the maintenance fee required in 2005. U.S. PATENT TRADEMARK OFFICE, OFFICIAL GAZETTE, NOTICE OF EXPIRATION OF PATENTS DUE TO FAILURE TO PAY MAINTENANCE FEE (May 3, 1995) *available at* <http://www.uspto.gov/web/offices/com/sol/og/2005/week18/patexpi.htm>.

³² See generally *Ex parte* Lundgren, 2005 Pat. App. LEXIS 34 (Bd. Pat. App. & Interf. 2005).

³³ *Id.* at *1–3.

³⁴ *Id.* at *7.

³⁵ *Id.* at *10–11 (citing *Diamond v. Diehr*, 450 U.S. 175, 201 (1981) (Stevens, J. dissenting)).

³⁶ Not all commentators have abandoned a form of “technology” restriction to the eligible subject matter requirement. See, e.g., John R. Thomas, *The Patenting of the Liberal Professions*, 40 B.C. L. REV. 1139, 1172 (1999) (defining technology as “concerned with design, fabrication and transformation” of the physical world); Jay Dratler, Jr., *Does Lord Darcy Yet Live? The Case Against Software and Business-Method Patents*, 43 SANTA CLARA L. REV. 823, 845–47 (2003) (defining “technological risk” as a risk that a project may fail for reasons other than the market/commercial non-acceptance).

majority easily determined that the patent application constituted statutory subject matter in light of Federal Circuit precedent.³⁷ As in *State Street*, the Board did not analyze the patent application under the statutory requirements of novelty and non-obviousness.³⁸

C. Tax Strategies as Eligible Subject Matter for Patenting

While no case has yet considered whether tax strategy patents are eligible subject matter for patenting, *State Street* and its progeny clearly suggest that they are. Because tax strategy patents are generally a subset of business method patents, one would expect courts to uphold their eligibility unless good reason exists to distinguish them. As will be discussed *infra*, this Article argues that no strong reason exists to consider tax strategies as outside the realm of patentable subject matter.³⁹

IV. TAX STRATEGIES AND THE UTILITY REQUIREMENT

In addition to the eligibility requirement, an invention must have utility. Utility requires that an invention have a specific and substantial use such that it is operable to provide a particular, real-world benefit. Terms such as “specific utility,” “substantial utility,” and “operability” have been used by different authorities to define the boundaries of the utility requirement.⁴⁰ The exact terms used are less important than the substance behind them, and one should keep in mind that, generally speaking, in patent practice the utility requirement is easily met.⁴¹

In general, utility requires an invention to have “a significant

³⁷ *Ex parte* Lundgren, 2005 Pat. App. LEXIS at *6 (Bd. Pat. App. & Interf. 2005) (citing *AT&T Corp. v. Excel Commc’ns, Inc.*, 172 F.3d 1352, 1358 (Fed. Cir. 1999)).

³⁸ *See id.* at *7,11,106–08 (discussing how the Board’s analysis was focused on whether or not the claims were limited to the technological arts as statutorily required, and based on the subject matter as a whole). The patent application eventually issued as U.S. Patent No. 7,065,495 (issued June 20, 2006) was entitled “Method and apparatus for preventing oligopoly collusion.”

³⁹ *See infra* Section VII.B.

⁴⁰ *See* ROBERT L. HARMON, PATENTS AND THE FEDERAL CIRCUIT, § 2.3(a),(b) (8th ed. 2007); Utility Examination Guidelines, 66 Fed. Reg. 1092 *passim* (Jan. 5, 2001); *In re* Chilowsky, 229 F.2d 457, 462 (C.C.P.A. 1956).

⁴¹ *Juicy Whip, Inc. v. Orange Bang, Inc.*, 185 F.3d 1364, 1366 (Fed. Cir. 1999) (“The threshold of utility is not high: An invention is ‘useful’ under section 101 if it is capable of providing some identifiable benefit.”).

and presently available benefit to the public.”⁴² The term “significant” should not be read too broadly, and its main purpose is to preclude “throw-away” utilities, such as using a complex invention as a landfill.⁴³ Even games and novelties can meet the utility requirement.⁴⁴ Hence, one expects that every taxpayer would agree that an invention reducing tax obligations addresses a legitimate benefit sufficient to meet the utility requirement!⁴⁵ Note also that the utility requirement does not require the invention to be the best-working invention in its area.⁴⁶ Thus, a tax strategy patent need not reduce taxes to an absolute minimum, or even a large amount.

Related to the requirement that an invention must provide a presently available benefit to the public, is the requirement that a patent’s claims must be operable to achieve an intended result.⁴⁷ The operability requirement “applies primarily to claims with impossible limitations.”⁴⁸ Thus, a tax strategy that purports to lower a taxpayer’s obligations, but through oversight or mathematical error actually raises them, would not have utility. Other than a mathematical error, how might the utility

⁴² *In re Fisher*, 421 F.3d 1365, 1371 (Fed. Cir. 2005); *see also In re Dodson*, 292 F.2d 943, 947 (C.C.P.A. 1961).

⁴³ *Utility Examination Guidelines*, *supra* note 40, at 1098 (“This requirement excludes ‘throw-away,’ ‘insubstantial,’ or ‘nonspecific’ utilities, such as the use of a complex invention as landfill.”). *But see* Nathan Machin, Comment, *Prospective Utility: A New Interpretation of the Utility Requirement of Section 101 of the Patent Act*, 87 CAL. L. REV. 421, 433–34, 437–40 (March 1999) (describing potential nominal utilities, such as a paperweight, and highlighting the disincentives against claiming such nominal utilities).

⁴⁴ Patents having general utility include U.S. Patent No. 6,368,227 (filed Nov. 17, 2000) (a method for swinging on a swing); U.S. Patent No. 5,683,314 (filed Jan. 14, 1997) (a water activated hopscotch game); U.S. Patent No. 5,522,507 (filed Oct. 3, 1995) (a kit for enacting the tooth fairy fable); U.S. Patent No. 4,834,657 (filed May 20, 1988) (a “punishment wheel” for choosing a punishment for misbehaving children).

⁴⁵ As best stated by Judge Learned Hand, “[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934).

⁴⁶ *See Juicy Whip, Inc.*, 185 F.3d at 1366 (citing *Brenner v. Manson*, 383 U.S. 519, 534 (1966); *Brooktree Corp. v. Advanced Micro Devices, Inc.*, 977 F.2d 1555, 1571 (Fed. Cir. 1992); *Fuller v. Berger*, 120 F. 274, 275 (7th Cir. 1903)); *see also Custom Accessories Inc. v. Jeffrey-Allan Indus. Inc.*, 807 F.2d 955, 960 (Fed. Cir. 1986) (noting that an invention may not be as effective as an existing one, but may still be patentable).

⁴⁷ HARMON, *supra* note 40, at § 2.3(b).

⁴⁸ *Id.*; *see also CFMT, Inc. v. Yieldup Int’l Corp.*, 349 F.3d 1333, 1339 (Fed. Cir. 2003) (citing *Process Control Corp. v. HydReclaim Corp.*, 190 F.3d 1350, 1359 (Fed. Cir. 1999); *Newman v. Quigg*, 877 F.2d 1575, 1576 (Fed. Cir. 1989).

requirement affect tax strategy patents?

Much of the jurisprudence surrounding the utility requirement developed in response to certain mechanical, chemical, and biochemical discoveries.⁴⁹ As such, its applicability to tax strategy patents, which garner their usefulness in large part from positive law, remains unclear. For example, the oft-cited test developed in *In re Chilowsky* centers around the laws of science, not human-enacted statutes.⁵⁰ Under the *Chilowsky* framework, if the invention “can be readily understood and conforms to the known laws of physics and chemistry,” then it meets the utility requirement.⁵¹ If, however, the alleged utility “seems clearly to conflict with a recognized scientific principle,” such as a perpetual motion machine or a device for cold fusion, the patent applicant must present strong evidence to establish utility.⁵² On the other hand, if the invention is “of such a nature that it [cannot] be tested by any known scientific principles,” the applicant must demonstrate the utility of invention.⁵³ Based on *In re Chilowsky*, the PTO has adopted a similar test for reviewing patent applications.⁵⁴

⁴⁹ See, e.g., *Brenner v. Manson*, 383 U.S. 519, 529–30 (1966) (noting that the patentability of chemical processes have since accelerated); *In re Fisher*, 421 F.3d 1365, 1369–70 (Fed. Cir. 2005). For example, utility requires that the invention work for a particular purpose, rather than to a broad purpose achievable by a class of inventions, such as precluding a claim of utility for chemicals with no known use except as objects of tests to determine a more specific utility. Because patented tax strategies would seem to have a clear particular purpose, this aspect of the utility requirement would not seem to impact tax strategy patents much.

⁵⁰ *In re Chilowsky*, 229 F.2d 457, 462 (C.C.P.A. 1956).

⁵¹ *Id.* The utility requirement does not require that the inventor has actually built the invention, or that the invention works well. Rather, it only requires that the explanation of how the invention works makes logical sense in light of the laws of physics, chemistry, etc. As evidence that the invention need not be put into practice, consider the following issued patents: U.S. Patent No. 5,305,974 (filed July 23, 1991) (“A propulsion system for spaceships wherein a first electromagnetic projectile launcher (EMPL) accelerates ‘smart’ projectiles into space and on appropriate trajectories to rendezvous with a distant spaceship at some later time.”); U.S. Patent No. 5,058,833 (filed Mar. 6, 1990) (“A spaceship is provided with a freely spinning propeller mounted on the front end. The propeller significantly reduces resistance to flight and also deflects space particles which might otherwise slow the craft.”).

⁵² *Chilowsky*, 229 F.2d at 462 (C.C.P.A. 1956).

⁵³ *Id.* (citing *In re Perrigo*, 48 F.2d 965, 965 (C.C.P.A. 1931), in which the invention claimed “[t]he production and generation of an electromotive force from the accumulation of the ether waves of an unknown potential, from the general field of ether wave electric medium.”).

⁵⁴ See Utility Examination Guidelines, *supra* note 40, at 1098.

As mentioned, because the utility analysis, including the *Chilowsky* framework, has historically focused on scientific principles (e.g., physics and chemistry), it may have little impact on tax strategy patents, except to exclude those containing obvious mathematical errors. At least two scenarios could require an in-depth utility analysis for tax strategy patents or applications. First, applicants might purposefully misstate the tax laws, such as, by basing a strategy not on current tax laws, but on possible future tax laws. Second, applicants might rely on the current black-letter tax laws, but misinterpret or stretch the meaning of the law as in the case of an abusive tax shelter.

A. The Utility Requirement Might Prevent a Tax Strategy Patent Based on Misstated Black-Letter Law

Rent seeking and wildcatting applicants could apply for a tax strategy patent based on anticipated changes in the tax laws (i.e., a prophetic patent), ignoring current tax laws. “Rent seeking” refers to an entity that attempts to make money by manipulating the economic environment (e.g., by lobbying), rather than by making a profit through trade and industry.⁵⁵ Rent seeking applicants would, thus, apply for a prophetic patent, hoping to influence Congress to pass a law covered by their patent. The term “wildcatting” refers to early oil prospectors who drilled risky and expensive exploratory oil wells in regions not known to contain oil.⁵⁶ Wildcatter applicants would thus apply for prophetic patents hoping the law will change to cover their patent. In either case, applicants for such prophetic patents would not merely misinterpret the tax laws, but would purposefully base their applications on a possible future law.⁵⁷

Because the utility standard requires a presently-available benefit to the public, it can be argued that prophetic patents would fail the utility test. In other words, a patent application based on non-existent tax laws would not be operable in the “real” world. On the other hand, tax laws, unlike most scientific

⁵⁵ Economist.com, Research Tools, Economics Glossary, <http://www.economist.com/research/Economics/alphabetic.cfm> (search “rent-seeking”) (last visited Oct. 8, 2008).

⁵⁶ AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 1967 (4th ed. 2000).

⁵⁷ As discussed in Section VII.A.2.d, *infra*, prophetic patents in the tax strategy area should be prohibited to prevent the “capture” of an entire tax law and to remove the possibility of patent holders improperly influencing the government to adopt tax laws based on their patents.

“laws,” will change from time to time (and do so more often than many people would like). Given the mutability of tax laws relative to scientific laws, courts might find that the utility requirement does not preclude prophetic patents. The better answer, however, is to recognize that scientific “laws” do change as our understanding of science develops⁵⁸ and tax strategy patents should be treated no differently. Thus, a prophetic tax strategy patent or application based on a purposeful misstatement of statutory or black-letter law should not meet the utility requirement.

B. The Utility Requirement Would Likely Not Prevent a Patent Application Based on an Abusive Tax Strategy

In a second scenario, patent applicants might base applications on questionable interpretations of existing tax laws. As opposed to applicants who base their applications on possible future tax laws (discussed in the preceding sub-section), these applicants base their applications on existing tax laws, but stretch the meaning of those laws to achieve questionable tax strategies. Thus, the strategy is operable under existing tax laws, but may or may not be legal. While the distinction between the two scenarios may appear small, there is strong reason to believe that the utility requirement will not prevent applications based on abusive tax strategies.

Abusive strategies could potentially receive patent protection because an inquiry into utility will likely not consider whether an invention is against public policy or whether it is permissible under tax law. Once upon a time, society’s morals factored into the utility analysis,⁵⁹ but courts have since come full circle.⁶⁰

⁵⁸ For example, the classical understanding of the law of conservation of matter (i.e., that matter cannot be created or destroyed) was proved to be violated in special relativity, in which matter is converted to massless energy (Einstein’s famous $E = mc^2$).

⁵⁹ As stated by Judge Story, “[a]ll 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.” *Lowell v. Lewis*, 15 F. Cas. 1018, 1019 (D. Mass. 1817) (No. 8,568).

⁶⁰ *Juicy Whip, Inc. v. Orange Bang, Inc.*, 185 F.3d 1364, 1368 (Fed. Cir. 1999).

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

Thus, while Judge Story in 1817 opined that “a new invention to poison people, or to promote debauchery, or to facilitate private assassination, is not a patentable invention,”⁶¹ the PTO has since granted patents on toxins for toxicological warfare,⁶² gambling devices,⁶³ a board game that can be used as an alcoholic drinking game,⁶⁴ and a method of euthanizing a mammal.⁶⁵ In this regard, the Honorable Mark Everson, Commissioner of the IRS, stated that “[t]he grant of a patent for a tax strategy has absolutely no impact on [the] IRS’s determination of the effectiveness or the legitimacy of the strategy under tax law.”⁶⁶

The PTO agrees with the IRS’s position, as indicated by James Toupin, General Counsel at the PTO, in his testimony before the House Committee on Ways and Means: “[T]he Federal Circuit [Court of Appeals] has stated that there is no clear provision that allows the USPTO to reject an invention solely on the grounds that the invention may be against public policy.”⁶⁷ Thus, the PTO and the IRS consider tax strategies in respective administrative vacuums, and one agency’s ruling does not affect the other.

Despite the PTO’s and IRS’ stated positions, many fear that the average tax strategy consumer may fail to appreciate the distinction between patentability and legality.⁶⁸ Unknowing

deception in the sale of food products.

Id.

⁶¹ *Lowell*, 15 F. Cas. at 1019.

⁶² U.S. Patent No. 3,060,165 (issued Oct. 23, 1962) (covering a method of making ricin, a toxin that inhibits protein synthesis and considered the world’s most potent plant toxin) (on file with author).

⁶³ *Ex parte* Murphy, Sagan, Rosenthal, and Ostrowski, 200 U.S.P.Q. (BNA) 801, 802 (B.P.A.I. 1977) (“[W]hile some may consider gambling to be injurious to the public morals and the good order of society, we cannot find any basis in 35 U.S.C. 101 or related sections which justify a conclusion that inventions which are useful only for gambling ipso facto are void of patentable utility.”).

⁶⁴ U.S. Patent No. 5,690,333 (filed July 30, 1996).

⁶⁵ U.S. Patent No. 5,290,775 (filed June 3, 1991).

⁶⁶ *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Hon. Mark Everson, Commissioner of the Internal Revenue Service).

⁶⁷ *Id.* (Statement of James Toupin, PTO General Counsel) (citing as examples, a patent on a method of making drinking alcohol that issued during prohibition, a patent on a radar detector that is illegal in some jurisdictions, and a patent on a method of preparing ricin toxin useful for toxicological warfare).

⁶⁸ *See, e.g.*, Charles F. Wieland III & Richard S. Marshall, *Tax Strategy Patents—Policy and Practical Considerations*, 35 No. 5 BNA TAX MGMT. COMPENSATION PLAN. J., 123, 130–31 (2007); Am. Inst. of Certified Pub. Accountants, *Analysis and Legislative Proposals Regarding Patents for Tax Strategies*, (Feb. 28, 2007), available at

consumers, impressed by an advertisement of a patented strategy,⁶⁹ may assume that the strategy is legitimate, when in reality, it contravenes tax laws and subjects the consumer to liability. While Congress has broad power to declare particular types of technologies unpatentable,⁷⁰ it probably need not take such drastic measures for tax strategy patents.

Instead, the PTO and IRS could, as a first step, require purveyors of patented strategies to provide clients and prospective clients an official notice that a patented strategy is not necessarily legal. The notice would be similar in concept to “black box” type warnings on drugs and cigarette packages. Of course, because tax strategies are not generally sold or advertised in containers like drugs and cigarettes, tax practitioners would need to provide notices in conjunction with patented tax advice in a manner similar to how doctor offices provide privacy notices (and require acknowledgment thereof). Assuming wealth is an indicator of sophistication in tax practices, wealthy and sophisticated consumers of tax planning advice, who would appear to be the vast majority of the beneficiaries of tax strategies eligible for patenting,⁷¹ would likely understand such warnings. Even less sophisticated consumers would arguably comprehend a plainly written warning, or at least have a chance to inquire further.

Perhaps an unscrupulous opportunist will one day con

<http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm> [hereinafter *AICPA*].

⁶⁹ The Wealth Transfer Group, Inc. advertises prominently on its home page as follows: “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, <http://www.wealth-transfer.com> (last visited Oct. 8, 2008).

⁷⁰ *Cf.* 42 U.S.C. § 2181(a) (2000) (excluding patent protection “for any invention or discovery which is useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon”); *see also* S. 681, 110th Cong. § 1 (2007) (seeking to prohibit a patent if “the invention is designed to minimize, avoid, defer, or otherwise affect the liability for Federal, State, local, or foreign tax”) *available at* <http://www.govtrack.us/congress/legislation.xpd> (Select “Search” hyperlink; then enter “S. 681;” then select “Full Text” hyperlink of “Bill Text;” then select “Download PDF”).

⁷¹ Tax strategies available to the less wealthy are more likely to be obvious (*see* Section V.B, *infra*) because they will involve routine methods based on clear provisions from the tax laws. Less wealthy individuals will likely rely on the standard deduction, obviating the need for creative tax strategies, or will be unwilling to pay for professional tax advice for creative tax strategies. Even if a “good” (i.e. non-obvious and not illegal) patent issues on an idea with broad applicability, ideas with broad applicability would appear to be the ones society should most want to encourage, at least from the taxpayer’s perspective.

innocent consumers with an illegal patented strategy, but stiff penalties against such purveyors would decrease abuse. In addition to penalties already in place,⁷² a patent for an illegal strategy should be declared unenforceable. An owner of a patent for an illegal tax strategy could not only lose the patent (and the costs associated with obtaining it), but could also be subject to disgorging profits and even criminal penalties.

V. NOVEL AND NON-OBVIOUS TAX STRATEGY PATENTS DESERVE PATENT PROTECTION

Having reviewed the first two patent law requirements of eligible subject matter and utility, this Article turns now to the final two primary requirements of novelty and non-obviousness. Since the Federal Circuit's *State Street* decision officially legitimized business methods as eligible subject matter, business method patent applications have risen from 1,500 in 1998 to around 7,000–8,000 applications per year in the last few years.⁷³ Similarly, patents granted on business methods increased from about 400 in 1998 to about 1,000 per year in the last few years.⁷⁴ While the number of tax strategy patent applications is not published information, there are about sixty issued tax strategy patents as of July 2006.⁷⁵ The increased number of business method patents has led critics to argue that the PTO is allowing too many non-deserving patents for business methods and tax strategies.

Such criticisms relate to the concepts of novelty and non-obviousness, which in turn relate to the concept of “prior art.”

⁷² IRS.gov, Civil and Criminal Penalties—Abusive Tax Schemes, <http://www.irs.gov/compliance/enforcement/article/0,,id=106461,00.html> (last visited Oct. 8, 2008).

⁷³ *Hearing on Patenting Tax Advice*, *supra* note 7 (Statement of J. Toupin, PTO General Counsel).

⁷⁴ CATALINA MARTINEZ & DOMINIQUE GUELLEC, OVERVIEW OF RECENT TRENDS IN PATENT REGIMES IN UNITED STATES, JAPAN AND EUROPE 3 (2003), <http://www.oecd.org/dataoecd/14/32/11728593.pdf>.

⁷⁵ *Hearing on Patenting Tax Advice*, *supra* note 7 (Statement of J. Toupin, PTO General Counsel). The PTO has yet to publish the number of tax strategy patent applications, but a rough estimate can be made by counting the number of published tax strategy patent applications. This number, however, will exclude both those applications that have been pending for less than 18 months and those for which a request for non-publication has been filed (which may only be filed if the applicant agrees not to file any foreign applications based on the U.S. application). Generally speaking, applications for tax strategies began to increase in 2003, and there has been a steady flow of applications since then.

The novelty and non-obviousness requirements generally prevent someone from patenting an invention that has been previously known or publicly used. Patent law refers to such previous knowledge or use of a purported invention as “prior art.” Prior art consists of any prior public disclosure of the invention, such as prior patents, publications (including articles, books, internet postings, published laws and bills, advertisements, etc), or public uses.

A. Novelty

Prior art will destroy a patent claim’s novelty⁷⁶ (i.e., will anticipate the patent claim) if any one piece of prior art teaches each and every limitation⁷⁷ of the claimed invention.⁷⁸ Under Section 102 of the patent laws, “art” must have been available within certain statutory time frames to qualify as “prior” art under the novelty and non-obviousness standards.⁷⁹ Generally speaking, art may qualify as prior art in two primary ways.⁸⁰ First, under Section 102(a), art will qualify as prior art if it was

⁷⁶ 35 U.S.C. § 102, which covers novelty, states in most relevant part:

A person shall be entitled to a patent unless—

(a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or

(b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States

35 U.S.C. § 102 (2000).

⁷⁷ The patent claims, which appear as numbered paragraphs at the end of a patent, define the metes and bounds of the invention and govern the right to exclude others from making the invention. *See, e.g.*, *SRI Int’l v. Matsushita Elec. Corp. of Am.*, 775 F.2d 1107, 1121 (Fed. Cir. 1985) (“It is the *claims* that measure the invention.”). Claims consist of one or more limitations (also called elements), with each element usually separated by a semi-colon. ROBERT C. FABER, *LANDIS ON MECHANICS OF PATENT CLAIM DRAFTING* §§ 2:7, 2:8 (Practicing Law Institute, 5th ed. 2006). For example, a (very rudimentary and non-novel) claim to a method for compensating a sales employee could comprise three limitations: (1) providing a base compensation for an employee; (2) measuring the employee’s sales against a target quota; and (3) providing a bonus compensation in proportion to the employee’s sales exceeding the quota.

⁷⁸ *Scripps Clinic & Research Found. v. Genentech, Inc.*, 927 F.2d 1565, 1576 (Fed. Cir. 1991).

⁷⁹ *See* 35 U.S.C. § 102 (2000) (requiring either (a) that the invention was patented or described in a printed publication before the applicants invention or (b) that the invention was patented or described in a printed publication or in public use or on sale more than one year prior to the date of the application for patent.).

⁸⁰ *See id.*

(a) publicly known or used by others in the U.S. or (b) published (i.e., in a patent, journal, on the internet, etc.) anywhere in the world before the date of *invention* by the patent applicant.⁸¹ The date of invention, while sometimes difficult to place, is described as the date by which the inventor had both conceived of the invention and reduced it to practice.⁸²

Second, under Section 102(b), art will qualify as prior art if it was (a) in public use or on sale in the U.S. or (b) published anywhere in the world *more than one year* before the United States *patent application filing date*.⁸³ The patent application filing date is a fixed date determined by when the applicant submits the application to the PTO.⁸⁴ The reason for the separate provisions (102(a) and (b)) is somewhat unique to U.S. patent law. The purpose of 102(b) is to provide applicants with a one-year window from the time of their (or anyone's) public disclosure of the invention until they must apply for a patent, so that they may test the commercial viability of the invention before spending money applying for a patent.⁸⁵

For example, Inventor A may invent something on January 1,

⁸¹ 35 U.S.C. § 102(a)(2000) (emphasis added).

⁸² *Mahurkar v. C.R. Bard, Inc.*, 79 F.3d 1572, 1576–78 (Fed. Cir. 1996).

⁸³ 35 U.S.C. § 102(b) (2000) (emphasis added).

⁸⁴ *See id.*; *see also* 1 DONALD S. CHISUM, CHISUM ON PATENTS: A TREATISE ON THE LAW OF PATENTABILITY, VALIDITY AND INFRINGEMENT § 3.08 (2007).

⁸⁵ *See, e.g., Seal-Flex, Inc. v. Athletic Track and Court Construction*, 98 F.3d 1318, 1322 (Fed. Cir. 1996), *further appeal*, 172 F.3d 836 (Fed. Cir. 1999) (per curiam)

The on-sale bar of § 102(b) represents a balance of the policies of allowing the inventor a reasonable amount of time to ascertain the commercial value of an invention, while requiring prompt entry into the patent system after sales activity has begun. . . . Thus the statute limits the period of commercial sale or offers of sale of an invention to one year, before the patent application must be filed or be forever barred.

Id.

Most countries, including those in the European Union, do not provide a one-year window for commercial testing. *See, e.g.,* DONALD S. CHISUM, CHISUM ON PATENTS: A TREATISE ON THE LAW OF PATENTABILITY, VALIDITY AND INFRINGEMENT, VOLUME 2, at § 6.02 (Deneil C. Targowski ed., 2007)

[Some] other countries . . . do not have a comparably liberal provision. Both the Strasbourg Convention on the harmonization of European national patent laws and the European Patent Convention define prior art to include 'everything made available to the public by means of a written or oral description' before the effective filing date, which includes a pre-filing disclosure by the applicant-inventor. Article 55(1) of the latter convention provides a very restricted six-month grace period applicable only to registered international exhibitions and disclosures that result from a breach of a confidential relationship.

Id. (citations omitted).

2006, then publicly use it in the U.S. on August 1, 2006, and then apply for a patent on August 1, 2007.⁸⁶ Under these facts, prior art under 102(a) must be publicly available before January 1, 2006 (the date of invention), while prior art under 102(b) must be available before August 1, 2006 (one year before the application date).

Some critics have misunderstood Section 102(b) to provide an opportunity for a patent applicant to capture⁸⁷ or base inventions primarily on a new tax law once it is published.⁸⁸ The argument asserts that applicants could read a new tax law and apply for a patent capturing that law as long as they do so within a year of the publication of the law.⁸⁹

Consider, for example, Applicant T learning of a new tax law published on January 1, 2006. Applicant T applies for a patent on August 1, 2006. Some critics seem concerned that because T applied for a patent before January 2, 2007, the published law will not invalidate the application. While it is true that 102(b) will not invalidate the application based on the publication of the law,⁹⁰ fears of widespread capturing of tax laws are unfounded because Section 102(a) would prevent someone from patenting the recitation of the law.⁹¹ Under Section 102(a), the issued law (not to mention the draft bill, etc.) serves as prior art because it pre-dates the applicant's "invention" date.⁹²

⁸⁶ If the inventor waited until August 2, 2007, the August 1, 2006, prior public disclosure would represent invalidating prior art under 102(b).

⁸⁷ By "capturing" the law, I understand critics to refer to a patent whose claims are merely a recitation of a law or are the only realistic way to comply with or implement the law, not a patent covering a specific "loophole."

⁸⁸ See, e.g., *AICPA*, *supra* note 68; *JCT*, *supra* note 7, at 26

However, while the first inventor defense protects a veteran tax practitioner with regard to long-standing tax planning structures, it will not protect a tax practitioner who develops a new tax structure based upon a change in the tax law against a patent-holder who filed a patent application on the same structure within a year or less of the tax law change that rendered the structure possible or desirable.

⁸⁹ See *JCT*, *supra* note 7, at 26 (discussing the one-year element of the first inventor defense).

⁹⁰ Of course, prior drafts of the bill, committee reports, and news of its enactment would predate the actual issuance of the law and could qualify as prior art if publicly available.

⁹¹ Prior art under Section 102(a) will also serve as prior art under Section 103 (regarding obviousness). See *infra* note 94 (listing the elements of the obviousness inquiry). In addition, Section 102(f) prevents patents when the applicant "did not himself invent the subject matter sought to be patented." 35 U.S.C. § 102(f) (2000).

⁹² It is theoretically possible for an applicant to anticipate a change in the

B. Non-obviousness

While one demonstrates an invention's lack of novelty with one (and only one) piece of prior art, one demonstrates obviousness by providing any *combination* of prior art pieces that together would render the claimed invention obvious to a person having ordinary skill in the relevant art⁹³ at the time the invention was made.⁹⁴ Just about anything qualifying as prior art under Section 102 also qualifies as prior art under Section 103. An obviousness inquiry may not rely on hindsight bias, and must only consider the state of the art at the time of the invention.⁹⁵

In the area of tax strategy patents, the obviousness doctrine will have many applications, such as when changes in one or more laws or regulations interrelate with other tax laws.⁹⁶ In such a situation, each of the laws and regulations relating to the invention will qualify as prior art (absent a prophetic patent application). For example, consider how a change in a related law affects a tax vehicle called a Grantor Retained Annuity Trust

law and apply for a "prophetic" patent, hoping that the law will go in the direction of the application. *See infra* Section VII.A.2.d (discussing the problems with prophetic patents and proposing a solution).

⁹³ A person having ordinary skill in the art is a hypothetical person (as opposed to the actual inventor) who has the capability of understanding the technology in the pertinent art. *Life Techs., Inc. v. Clontech Labs., Inc.*, 224 F.3d 1320, 1325 (Fed. Cir. 2000). For example, a person skilled in the relevant art for a tax strategy patent might be a professional tax planner.

⁹⁴ 35 U.S.C. § 103, which covers obviousness, states in pertinent part: A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.

35 U.S.C. § 103(a) (2000).

⁹⁵ When determining whether a claimed invention is obviousness, a court engages in several factual inquiries: (1) what is the scope and content of the prior art; (2) what are the differences between the prior art and the claims at issue; and (3) what is the level of ordinary skill in the pertinent art, and (4) any secondary considerations favoring non-obviousness such as failure of others, commercial success, and long-felt but unsolved need. *Graham v. John Deere Co.*, 383 U.S. 1, 17–18 (1966); *see also* *KSR Int'l Co. v. Teleflex Inc.*, 127 S. Ct. 1727, 1734 (2007) (quoting *Graham v. John Deere Co.*, 383 U.S. 1, 17–18 (1966)).

⁹⁶ *See* William A. Drennan, *The Patented Loophole: How Should Congress Respond to this Judicial Invention?*, 59 FLA. L. REV. 229, 299 (2007) (stating that because "[t]ax planning opportunities are made possible by tax rules (or absence of a rule)[,] . . . [w]hen a tax rule is released, tax practitioners at the large accounting firms, law firms, and other tax professionals might pour over the new rules in search of opportunities.").

(“GRAT”).

A GRAT is an irrevocable trust where the grantor transfers assets to the trust and is paid an annuity from the trust, and the conditions of the GRAT must conform to various tax laws, including Treasury Regulation § 25.2702–3.⁹⁷ At the end of the GRAT term, the remaining assets are distributed to designated beneficiaries and can avoid estate taxation.⁹⁸ While GRATs have existed for years and were funded by a variety of assets, for many years it was not possible to fund them with nonqualified stock options⁹⁹ because the options were considered non-transferable.¹⁰⁰

Now suppose the law changed to permit transfer of nonqualified stock options. Would it be obvious to use the nonqualified stock options to fund a GRAT? That was essentially the question faced by the PTO when it examined the application that became U.S. Patent No. 6,567,790.¹⁰¹ The application, filed in 1999, stated that GRATs had existed for years, and that a change in Rule 16b-3 of the Security and Exchange Commission regulations allowed nonqualified stock options to be transferred, including to trusts.¹⁰² Nevertheless, the PTO granted a patent on the application without a single rejection over prior art.¹⁰³

Many tax professionals bemoan the patent as an example of

⁹⁷ Treas. Reg. § 25.2702–3 (2007).

⁹⁸ U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

⁹⁹ A stock option is the right to purchase a specific number of shares at a fixed price for a predetermined period of time. BLACK'S LAW DICTIONARY 1459 (8th ed. 2004). A nonqualified stock option is an option that does not receive preferential tax treatment and is considered the equivalent of cash compensation. BLACK'S LAW DICTIONARY 1459 (8th ed. 2004).

¹⁰⁰ Joseph E. Bachelder, *The SEC's New Rule 16b-3*, N.Y. L. J. (Jul. 31, 1996); See U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) [hereinafter *The '790 Patent*].

¹⁰¹ See U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) [hereinafter *The '790 Patent*]. Claim 1 of the '790 patent reads in part:

A method for minimizing transfer tax liability . . . comprising: establishing a Grantor Retained Annuity Trust (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.

Id.

¹⁰² *Id.*

¹⁰³ See generally U.S. Patent No. 6,567,790 (filed Dec. 1, 1999), available at <http://portal.uspto.gov/external/portal/pair> (follow on-screen security instructions; then search by “patent number,” inputting patent number “6,567,790”; then follow “Transaction History” hyperlink) (showing '790 patent's transaction history which lists no rejections).

the inadequacy of the PTO. While this author has not studied the patent closely, a superficial review of the patent's first claim left me sympathetic to tax professionals' concerns regarding validity. Interestingly, however, in the lawsuit involving the '790 Patent, the defendant filed its motion for summary judgment based on a theory of non-infringement, not on a theory of obviousness, perhaps indicating that it did not have a strong obviousness argument.¹⁰⁴ Of course, the reason for filing a motion based on non-infringement may have been pure litigation strategy, and a motion regarding validity may have been forthcoming. Whether the change in the law itself and/or additional prior art renders the '790 Patent invalid will have to wait because the parties agreed to settle the dispute in March 2007.¹⁰⁵ Nevertheless, the *Wealth Transfer* case serves as a good introduction to the criticisms surrounding business method and tax strategy patents.

VI. REMEMBERING THE PAST: CRITICISMS OF BUSINESS METHOD PATENTS

With the Federal Circuit's strong declarations that business methods are eligible for patenting, many critics shifted their focus to the PTO's perceived failure to adequately analyze business method patents in light of the requirements of novelty and non-obviousness.¹⁰⁶ That is, these critics argue that the PTO issues too many poor quality patents.¹⁰⁷ Other critics, however, continue to maintain that business method patents, as a class of inventions, should not be eligible for patenting as a matter of public policy. This Section analyzes both categories of arguments as they relate to business method patents, providing background for a later discussion of similar concerns relating to tax strategy

¹⁰⁴ See Dr. Rowe's Memorandum in Support of his Motion Pursuant to Rule 56(b), Fed. R. Civ. P., for Summary Judgment of Non-Infringement, *Wealth Transfer Group LLC v. Rowe*, No. 3:06cv00024, (D. Conn. Nov. 3, 2006).

¹⁰⁵ Consent Final Judgment Regarding Settlement Agreement, *Wealth Transfer Group LLC v. Rowe*, No. 3:06-cv-00024 (D. Conn. filed Dec. 1, 1999).

¹⁰⁶ See, e.g., Andrew Kopelman, Note, *Addressing Questionable Business Method Patents Prior to Issuance: A Two-Part Proposal*, 27 *CARDOZO L. REV.* 2391, 2391 n.1 (2006) (citing, *inter alia*, David Streitfeld, Note: *This Headline is Patented*, *L.A. TIMES*, Feb. 7, 2003, at 1; Gary L. Reback, *Patently Absurd*, *FORBES*, June 24, 2002, at 44 (magazine); James Gleick, *Patently Absurd*, *N.Y. TIMES*, Mar. 12, 2000, 6 (Magazine), at 44; Dennis S. Karjala, *Distinguishing Patent and Copyright Subject Matter*, 35 *CONN. L. REV.* 439, 443 n.19 (2003)).

¹⁰⁷ Kopelman, *supra* note 106, at 2391.

patents.

A. *Quality of Patents Issued by the PTO*

As stated above, some critics agree that certain business method inventions may, in theory, be worthy of patent protection, but they argue that the PTO issues too many patents for obvious or non-novel concepts. One can easily point to numerous absurd patents that have been issued over the years. Particularly evocative examples (not all of which are business methods) include patents for a method of selling merchandise to golfers in conjunction with golf car rentals,¹⁰⁸ a method of swinging on a swing,¹⁰⁹ a method of swinging a golf club,¹¹⁰ a method of exercising a cat with a laser,¹¹¹ an internet reverse auction method (Priceline.com),¹¹² and a method for allowing internet shoppers to buy using only “one-click” of the mouse (Amazon.com).¹¹³ Critics highlight these and other patents as proof of a flawed patent system, and point to three general categories of alleged shortcomings: (1) shortcomings at the patent application examination stage, (2) shortcomings in the patent laws, and (3) shortcomings external to the patent system.

1. Shortcomings and Solutions at the Patent Application Examination Stage

Some suggest that patent examiners lack adequate training and resources to analyze business method patents because business methods, being different from the stereotypical mechanical widget, present unique challenges to examiners with science and engineering, as opposed to business backgrounds.¹¹⁴

¹⁰⁸ U.S. Patent No. 6,457,317 (filed Jan. 22, 2001).

¹⁰⁹ U.S. Patent No. 6,368,227 (filed Nov. 17, 2000).

¹¹⁰ U.S. Patent No. 7,112,150 (filed Jul. 8, 1999).

¹¹¹ U.S. Patent No. 5,443,036 (filed Nov. 2, 1993).

¹¹² U.S. Patent No. 5,794,207 (filed Sept. 4, 1996).

¹¹³ U.S. Patent No. 5,960,411 (filed Sept. 12, 1997); *see also* Amazon.com, Inc. v. Barnesandnoble.com, Inc., 239 F.3d 1343 (Fed. Cir. 2001) (litigating the ‘411 Patent). The *Amazon.com v. Barnesandnoble.com* lawsuit settled under confidential terms. *Technology Briefing, Internet: Online Booksellers End Dispute*, N.Y. TIMES, Mar. 8, 2002. The PTO granted a reexamination request (reexamination number 90/007,946) for the ‘411 Patent on May 12, 2006, which is still pending as of August, 2007. U.S. Patent No. 5,960,411 (filed Sept. 12, 1997), available at <http://portal.uspto.gov/external/portal/pair> (follow on-screen security instructions; then search by “Control Number” inputting control number “90/007,946”).

¹¹⁴ *See* Kopelman, *supra* note 106, at 2393–94, 2419; *see also* JCT, *supra* note

Of course, business methods do differ from mechanical widgets, but one should have confidence that the PTO, charged with constantly evaluating the newest and most cutting-edge ideas and innovations, will be able to adapt and quickly gain expertise in a new area. Stated differently, while business methods (PTO class 705)¹¹⁵ differ from mechanical widgets this should not be disconcerting inasmuch as the PTO evaluates inventions from diverse technology areas, including Apparel (Class 002);¹¹⁶ Chemistry/physical processes (Class 23);¹¹⁷ Plant husbandry (Class 47);¹¹⁸ Sugar, starch, and carbohydrates (Class 127);¹¹⁹ Liquid purification or separation (Class 210);¹²⁰ Electronic digital logic circuitry (Class 326);¹²¹ Bee culture (Class 449);¹²² Drugs (Class 514);¹²³ Nuclear Technology (Class 976);¹²⁴ and

7, at 27.

¹¹⁵ U.S. PATENT AND TRADEMARK OFFICE, AUTOMATED FINANCIAL OR MANAGEMENT DATA PROCESSING METHODS (BUSINESS METHODS), Sec. III at 5, *available at* <http://www.uspto.gov/web/menu/busmethp/whitepaper.pdf> (white paper version 1.43). To organize the vast array of patents and technical documents in its databases, the PTO classifies patents and patent applications into classes and subclasses based on the technology field. *See* LESTER HORWITZ, MANUAL OF PATENT EXAMINING PROCEDURE § 902.01 (8th ed. Aug. 2001).

¹¹⁶ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: APPAREL, (Feb. 2006), *available at* <http://www.uspto.gov/web/patents/classification/uspc002/defs002.htm>.

¹¹⁷ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: CHEMISTRY: PHYSICAL PROCESSES (Dec. 2000), *available at* <http://www.uspto.gov/go/classification/uspc023/defs023.htm>.

¹¹⁸ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: PLANT HUSBANDRY, (July 2005), *available at* <http://www.uspto.gov/go/classification/uspc047/defs047.htm>.

¹¹⁹ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: SUGAR, STARCH, AND CARBOHYDRATES, (Dec. 2000), *available at* <http://www.uspto.gov/go/classification/uspc127/defs127.htm>.

¹²⁰ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: LIQUID PURIFICATION OR SEPARATION, (Oct. 2006), *available at* <http://www.uspto.gov/web/patents/classification/uspc210/defs210.htm>.

¹²¹ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: ELECTRONIC DIGITAL LOGIC CIRCUITRY, (Aug. 2005), *available at* <http://www.uspto.gov/web/patents/classification/uspc326/defs326.htm>.

¹²² UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: BEE CULTURE, (Dec. 2000), *available at* <http://www.uspto.gov/go/classification/uspc449/defs449.htm>.

¹²³ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: DRUG, BIO-AFFECTING AND BODY TREATING COMPOSITIONS (Mar. 2007), *available at* <http://www.uspto.gov/web/patents/classification/uspc514/defs514.htm>.

¹²⁴ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: NUCLEAR TECHNOLOGY, (Dec. 2000), *available at* <http://www.uspto.gov/web/patents/classification/uspc976/defs976.htm>.

Nanotechnology (Class 977).¹²⁵

Every time a subject area has generated new patent applications, the PTO has eventually adapted to evaluate that technology or idea, whether by training existing examiners or by hiring new examiners with the pertinent expertise.¹²⁶ Due in part to a lack of resources, the process of adaptation may not be immediate, but most people agree that the PTO should have more funding to allow proper examiner training and patent application analysis.¹²⁷ In any event, the PTO revamped its procedures for examining business method patents in the year 2000,¹²⁸ and hired more examiners having significant business expertise, increasing the number of business method patent examiners from 12 in 1997 to more than 100 in 2006.¹²⁹ Further, the PTO updated its electronic databases to include more non-patent literature (NPL) relevant to business method patent applications.¹³⁰ Finally, it created partnerships with industry associations and corporate entities to review and discuss developing concerns.¹³¹

The PTO's business method patent initiative, a rare instance of a single class of inventions getting individualized attention, was not without results. Before the initiative, the allowance rate for business method patents in FY 2000 was 55%, compared to an overall allowance rate of about 67% of patents during a similar time frame.¹³² After the initiative, the allowance rate decreased to 45% in FY 2001 and to 30–35% in FY 2002.¹³³ The decrease

¹²⁵ UNITED STATES PATENT AND TRADEMARK OFFICE, CLASSIFICATION DEFINITIONS: NANOTEHCNOLOGY (Oct. 2007), *available at* <http://www.uspto.gov/go/classification/uspc977/defs977.htm>.

¹²⁶ U.S. PATENT AND TRADEMARK OFFICE, AUTOMATED FINANCIAL OR MANAGEMENT DATA PROCESSING METHODS (BUSINESS METHODS) IV.B–C <http://www.uspto.gov/web/menu/busmethp/class705.htm> (last visited Oct. 8, 2008) [hereinafter U.S. PATENT AND TRADEMARK OFFICE].

¹²⁷ *See FTC Report, supra* note 15, at 10, 12.

¹²⁸ *See* U.S. PATENT AND TRADEMARK OFFICE, *supra* note 126, at Sec. IV.

¹²⁹ *Id.*; Wynn W. Coggins, Group Director, Tech. Ctr. 3600, Update on Business Methods for the Business Methods Partnership Meeting slide 11 (June 19, 2007), <http://www.uspto.gov/web/menu/pbmethod/partnership.pps> (last visited Oct. 8, 2008).

¹³⁰ *See* U.S. PATENT AND TRADEMARK OFFICE, *supra* note 126, at Sec. IV.

¹³¹ *See id.* at Sec. VI.

¹³² MIKU H. MEHTA & LAURA MOSKOWITZ, BUSINESS METHOD PATENTS IN THE UNITED STATES: A JUDICIAL HISTORY & PROSECUTION PRACTICE, 13, *available at* <http://www.ngb.co.jp/english/news/2004/200405.pdf> (unpublished manuscript, on file with the Albany Law Journal of Science & Technology).

¹³³ *Id.*

continued, and in 2006 and mid-year FY 2007, the allowance rate for business method applications was approximately 20%, compared to the overall patent allowance rate of approximately 50% during the same time.¹³⁴ Thus, the PTO's initiative appears to have addressed a legitimate concern, and demonstrated the PTO's responsiveness to new issues.

Through years of analyzing cutting-edge technologies and through the business method patent initiative, the PTO has shown an ability to adapt and improve itself to address new areas of inventive activity. Assuming the PTO receives adequate funding and retains good examiners, one would expect the PTO to continue to provide adequate review of business method applications. In fact, some have argued that the quality of business method patents in the late 1990s was equal to or better than that of the general patent pool.¹³⁵

2. Shortcomings and Solutions in the Patent Laws

The second category of criticisms against business method patents is that the patent laws do not institute adequate screening of business method patent applications to divide the patentable from the un-patentable. Much has already been written about how to change the patent laws and rules, both for patents in general¹³⁶ and for business method patents in particular.¹³⁷

Currently, business method patents are evaluated in almost

¹³⁴ Coggins, *supra* note 129, at slide 8; U.S. PATENT AND TRADEMARK OFFICE, PATENT PUBLIC ADVISORY COMMITTEE, ANNUAL REPORT 13 (2007), available at http://www.uspto.gov/go/com/advisory/reports/ppac_2007annualrpt.pdf.

¹³⁵ John R. Allison & Emerson H. Tiller, *The Business Method Patent Myth*, 18 BERKELEY TECH. L.J. 987, 1004 (2003) (noting that business method patents in the late 1990's "may have been better than average" compared to the general patent population).

¹³⁶ See, e.g., *FTC Report*, *supra* note 15, at 3, 4; *A Section White Paper: Agenda for 21st Century Patent Reform*, 2007 A.B.A. SEC. INTELL. PROP. LAW 1, available at <http://www.abanet.org/intelprop/home/PatentReformWP.pdf> [hereinafter *IPL White Paper*]; Joseph Farrell & Robert P. Merges, *Incentives to Challenge and Defend Patents: Why Litigation Won't Reliably Fix Patent Office Errors and Why Administrative Patent Review Might Help*, 19 BERKELEY TECH. L.J. 943, 946 (2004); Carl Shapiro, *Patent System Reform: Economic Analysis and Critique*, 19 BERKELEY TECH. L.J. 1017 (2004).

¹³⁷ See Kopelman, *supra* note 106, at 2393-95; Robert P. Merges, *As Many As Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 BERKELEY TECH. L.J. 577, 584-87 (1999).

the same manner as other applications.¹³⁸ One can argue, however, that business method patents should be analyzed more rigorously for obviousness than other types of patent applications because business methods encounter less technological impedances than, for example, the mechanical widget.¹³⁹ A rigorous review of business method patents for obviousness need not require a change in the patent laws, but rather may take the form of more subtle judicial analysis, such as has been suggested by some to already exist.¹⁴⁰

Along the lines of judicial analysis, the recent Supreme Court decision in *KSR*¹⁴¹ may make it more difficult for business method patents to overcome the obviousness hurdle. Before the *KSR* decision, courts and the PTO generally would not combine two or more references to render a patent claim obvious unless the prior art contained an explicit “teaching, suggestion, or motivation” (“TSM”) for the combination.¹⁴² The *KSR* court, however, overruled the Federal Circuit’s “rigid” application of the TSM test, noting that a court “need not seek out precise teachings directed to the specific subject matter of the challenged claim.”¹⁴³

The *KSR* court repeatedly emphasized that market forces can prompt variations of known concepts and stated that “[i]n many fields it may be that there is little discussion of obvious techniques or combinations, and it often may be the case that market demand, rather than scientific literature, will drive design trends.”¹⁴⁴ The concept of market forces providing motivation to combine prior art would appear to relate particularly powerfully to business method patents, given that business methods will be driven proportionally more by market

¹³⁸ In one exception, as part of the PTO’s business method patent initiative, the PTO mandated secondary examination for all allowed applications to ensure proper prior art searching and analysis. See U.S. PATENT AND TRADEMARK OFFICE, *supra* note 126, at Sec. V.

¹³⁹ See Jay Dratler, Jr., *Does Lord Darcy Yet Live? The Case Against Software and Business-Method Patents*, 43 SANTA CLARA L. REV. 823, 843–49 (arguing that inventions involving technological risk, rather than economic or market risk, are truly deserving of patents).

¹⁴⁰ Dan L. Burk & Mark A. Lemley, *Is Patent Law Technology-Specific?*, 17 BERKELEY TECH. L.J. 1155, 1167 (2002) (stating that “there is some reason to believe that the court is imposing a rather strict standard” in reviewing software patents for obviousness).

¹⁴¹ *KSR Int’l Co. v. Teleflex Inc.*, 127 S. Ct. 1727 (2007).

¹⁴² See *id.* at 1730.

¹⁴³ *Id.* at 1741.

¹⁴⁴ *Id.*

forces, rather than by scientific or technological advancement. Thus, the *KSR* decision may provide a platform from which courts and the PTO can scrutinize business method patents in a manner better correlating to one having ordinary skill in the relevant art.

3. Shortcomings and Solutions External to the Patent System

The third category of criticisms against business method patents concerns problems external to the PTO and the patent laws. The primary criticism in this regard is that business method patents, unlike other technologies, lack adequate sources of searchable prior art, and thus, the PTO issues non-innovative patents.¹⁴⁵ Some claim that the lack of prior art in the business method area should render the class of inventions non-patentable for public policy reasons.¹⁴⁶ The temporary lack of searchable prior art, however, should not bar patents for business methods, because it is technologically feasible and socially desirable to increase the sources of searchable prior art.

Increasing sources of searchable prior art is technologically feasible because businesses can increase both the amount and quality of their publications relating to business methods. Further, as mentioned in relation to the PTO's business method patent initiative,¹⁴⁷ the PTO can create, improve, and maintain quality business method prior art databases through industry collaboration. Finally, third party competitors can increase the PTO's prior art awareness by submitting prior art for PTO review under Rule 99 submissions¹⁴⁸ and reexaminations.¹⁴⁹

¹⁴⁵ See, e.g., Kopelman, *supra* note 106, at 2398–2401 (2006); Julie E. Cohen, *Reverse Engineering and the Rise of Electronic Vigilantism: Intellectual Property Implications of "Lock-Out" Technologies*, 68 S. CAL. L. REV. 1091, 1178 (1995) (“[I]n the field of computers and computer programs, much that qualifies as prior art lies outside the areas in which the PTO has traditionally has looked.”).

¹⁴⁶ See Larry A. DiMatteo, *The New "Problem" of Business Method Patents: The Convergence of National Patent Laws and International Internet Transactions*, 28 RUTGERS COMPUTER & TECH. L.J. 1, 22–26, 40–41 (2002).

¹⁴⁷ See *supra* Part VI.A.1.

¹⁴⁸ Third-party prior art submissions under 37 C.F.R. § 1.99 are filed during the examination stage of a patent application and must: (1) be filed within 2 months of a patent application's publication; (2) include a fee (currently \$180.00 pursuant to section 1.17(p)); (3) include a list and a copy of (up to 10) patents or publications (including any necessary English language translations). See 37 C.F.R. §§ 1.17(p), 1.99 (2007). Further, a submission under Rule 99 “shall not include any explanation of the patents or publications, or any other information.” *Id.*

Increasing available prior art benefits society because it helps prevent low quality patents and because the public can use, improve upon, and build upon known art.

B. Should Business Methods Be Eligible Subject Matter for Patenting?

Regarding the argument that businesses do not need the patent system's incentives, this Article offers only two brief comments. First, while the business world has many incentives to innovate apart from the patent system, whether the patent system brings the level of innovation to a more optimal point is an empirical question, and it would be interesting to consider empirical research on the question. Second, even assuming businesses do not "need" the patent system's incentives to spur innovation, the patent system offers another basic societal benefit: public dissemination of ideas and innovation.¹⁵⁰ The *quid pro quo* of the monopoly grant is a patentee's public disclosure of the invention. Such disclosure fosters additional innovation because others may analyze, build upon, or design around another's patent. Given critics' concerns over lack of adequate prior art for business methods, a strong argument can be made that the public disclosure fostered by the patent system will spur innovation in the business method area because patents (and any attendant increased published art) would serve both as prior art to other patent applications and as a written record of the state of the art.

VII. A FAMILIAR SONG: CRITICISMS OF TAX STRATEGY PATENTS

As mentioned, the *Wealth Transfer* case¹⁵¹ has accented a previously obscure niche in the patent field. Not surprisingly, because tax strategy patents resemble business method patents, many criticisms of the latter carry over to the former. This Section analyzes arguments that the PTO issues tax patents of

¹⁴⁹ Reexamination requests (which may be *ex parte* or *inter partes*), unlike Rule 99 submissions, are filed at any time after a patent has issued and must include detailed explanations of how the prior art raises a substantial new question of patentability. See 35 U.S.C. §§ 302, 311; 37 C.F.R. §§ 1.510, 1.915. The fee for a reexamination request is much larger than for a Rule 99 submission, and is currently \$2,520 for an *ex parte* request and \$8,800 for an *inter partes* request. 37 C.F.R. § 1.20(c)(1)–(2).

¹⁵⁰ See, e.g., *FTC Report*, *supra* note 15, at Executive Summary at 2.

¹⁵¹ See *supra* Section I (discussing the *Wealth Transfer* case).

poor quality and that tax strategies should not be eligible subject matter for patenting.

A. Quality of Patents Issued by the PTO

The '790 patent (involved in the *Wealth Transfer* case) has drawn howls and jeers from the tax community because of its perceived obviousness or lack of novelty.¹⁵² As described in Section V.B, *supra*, such criticisms for that particular patent may be warranted. Obviously, one bad patent should not ruin the entire system, and this Article attempts to analyze criticisms of the patent system under the assumption that the system is neither perfect nor beyond repair. In general, the criticisms of the quality of issued tax strategy patents fall into three categories of alleged shortcomings: 1) shortcomings of PTO examiner expertise, 2) shortcomings in the patent laws, and 3) shortcomings in the PTO's access to prior art.

1. Supplying Patent Examiners with Tax Expertise

Mirroring the criticism of business method patents generally, critics assert that patent examiners lack training and expertise to analyze tax law-intensive patent applications.¹⁵³ The rebuttal to this criticism, as it was for business method patents generally, is that the PTO has a long history of analyzing cutting-edge technology and should be able to adapt and evaluate this new area of interest.¹⁵⁴ Of course, this argument is premised on adequate PTO funding and industry collaboration.

True to its history, the PTO has taken the initiative to get its arms around tax strategy patents. Since 2004, the PTO has collaborated with the IRS to discuss and study issues relating to

¹⁵² See, e.g., *Hearing on Patenting Tax Advice*, *supra* note 7 (Statement of Dennis I. Belcher, Partner, McGuirewoods, LLP); Brian C. Banner, Note, *Patenting Tax Strategies: The Case for Excluding Legal Methods From the Realm of Patentable Subject Matter*, 15 TEX. INTELL. PROP. L.J. 491, 507 (2007).

¹⁵³ See *Hearing on Patenting Tax Advice*, *supra* note 7 (Statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School).

¹⁵⁴ Banner, *supra* note 152, at 496 (citing *Hearing on Issues Relating to the Patenting of Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. On Ways and Means*, 109th Cong., 2d Sess. (July 13, 2006), available at <http://waysandmeans.house.gov> (hover over "Committee Hearings" hyperlink; then, from dropdown menu that appears, follow "109th Congress" hyperlink; then follow "Hearing on Issues Relating to the Patenting of Tax Advice" hyperlink) (last visited Oct. 8, 2008).

tax strategy patents.¹⁵⁵ The collaboration seeks to improve examiner understanding through task forces and workshops that explore trends in the practice and the latest sources of information.¹⁵⁶ The IRS also taught the PTO how to better recognize tax strategies embedded in patent applications,¹⁵⁷ and trained PTO examiners on “financial products, wealth transfer, and pensions.”¹⁵⁸ Additionally, the PTO is cultivating a relationship with the American Bar Association’s Section of Taxation to provide supplemental input and training for PTO examiners.¹⁵⁹

In one interesting aspect of the PTO and IRS’s collaboration, the PTO and IRS have worked together to develop “a protocol . . . [by which the PTO can] . . . request that patent applicants reveal specific [tax laws] and procedures affected by a patent application.”¹⁶⁰ Of course, because any tax laws particularly relevant to a patent application qualify as prior art, applicants have the affirmative duty to alert the PTO to such laws of which they are aware, even absent any protocol.¹⁶¹ Failure to alert the PTO of such laws known to the applicant at the time of invention would, in most cases, constitute inequitable conduct, and result in an invalidation of the patent.¹⁶²

In any event, the PTO has historically evolved with the changes and growth of science and technology. The PTO has likewise demonstrated its enthusiasm to equip itself to properly evaluate tax strategy applications. Hence, any lack of tax

¹⁵⁵ See *Hearing on Patenting Tax Advice*, *supra* note 7 (Statement of Hon. Mark Everson, Commissioner, Internal Revenue Service).

¹⁵⁶ *Id.*

¹⁵⁷ See *id.* (Statement of J. Toupin, PTO General Counsel).

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* (Statement of Hon. Mark Everson, Commissioner, Internal Revenue Service).

¹⁶¹ See Patents, Trademarks, and Copyrights, 37 C.F.R. § 1.56 (2008) (regarding the patent applicant’s duty to disclose any known information material to patentability).

¹⁶² Inequitable conduct can be difficult to show because a party must demonstrate that the applicant was aware of the prior art, that the art was material, and that the applicant intended to deceive that PTO. *Li Second Family Ltd. P’ship v. Toshiba Corp.*, 231 F.3d 1373, 1378 (Fed. Cir. 2000) (citing *Molins PLC v. Textron, Inc.*, 48 F.3d 1172, 1178 (Fed. Cir. 1995)). Furthermore, “[o]nce the threshold levels of materiality and intent have been established, the trial court must weigh materiality and intent to determine whether the equities warrant a conclusion that inequitable conduct occurred.” *Id.*; 37 C.F.R. § 1.56 (2008).

strategy expertise has already been, or will quickly be, remedied. In the meantime, “[t]he solution is not to banish the subject matter to the commons, but to properly equip the personnel to handle such applications effectively and efficiently.”¹⁶³

2. Solutions in the Patent Laws

Short of prohibiting tax strategy patents or eviscerating them by precluding recovery of damages for infringement, relatively little has been written regarding what changes should be made to the patent laws to better handle tax strategy patents.

a. Mandatory Publication for Tax Strategy Patent Applications 18 Months After Filing

One sensible recommendation is to publish all tax strategy patent applications within 18 months of filing.¹⁶⁴ Mandatory publication has been suggested for all patent applications,¹⁶⁵ but holds particular appeal for tax strategy patents, which are based on U.S. tax laws. In general, only if the applicant desires to file the application in a foreign country must the application be published.¹⁶⁶ While one might expect an inventor of a machine or other “traditional” inventions to file for foreign protection because the patent owner can build or sell the widget in many countries, the same is not true for tax strategy patents that rely on U.S.-specific tax laws. As a consequence, one might expect tax strategy patent applications would not publish after 18 months, given the correlation to the strategy and U.S.-specific tax laws. Thus, the list of published patent applications may not give a complete picture of what is “in the pipeline” as far as tax strategy patent applications.

Mandatory publication at 18 months would have synergistic effects. For example, it would bring the U.S. laws more into

¹⁶³ Matthew A. Melone, *The Patenting of Tax Strategies: A Patently Unnecessary Development*, 5 DEPAUL BUS. & COMM. L.J. 437, 459 (2007).

¹⁶⁴ Ellen P. Aprill, *Responding to Tax Strategy Patents*, Loyola Legal Studies Paper No. 2007-26, <http://www.abanet.org/tax/patents/articles/USCTaxInstitutePatentpiece.pdf> (Apr. 2007) (citing 35 U.S.C. § 122 (2000)).

¹⁶⁵ See *IPL White Paper*, *supra* note 136, at 25.

¹⁶⁶ Since November 2000, the PTO publishes most patent applications 18 months after their earliest filing date. 35 U.S.C. § 122(b)(1)(A) (2000). The PTO will not, however, publish patent applications if the applicant files a request for non-publication. 35 U.S.C. § 122(b)(2)(B)(i) (2000). Applicants may only request non-publication if they agree not to file the application in a foreign country. *Id.*

alignment with the world, as many countries, including those in Europe, publish all applications after 18 months.¹⁶⁷ Further, it would increase the available prior art, making future applications less likely to issue as patents. Finally, mandatory publication would allow government and private entities to oppose non-novel or obvious ideas and to monitor for potentially abusive applications.

b. The Supreme Court's *KSR* Decision—"Market Demand" as a Force in Obviousness Determinations

As mentioned, the Supreme Court's recent *KSR* decision may affect the patentability of tax strategy patents based on whether an invention would have been obvious.¹⁶⁸ The *KSR* decision dealt with the issue of obviousness, which involves the combination of two or more pieces of prior art.¹⁶⁹ Because all tax strategies are based on tax laws and related regulations, tax strategy patents will almost always represent the combination of those prior art laws and regulations, thus making *KSR* and the obviousness doctrine important to tax strategy patents. Additionally, the *KSR* court's accentuation that in some fields "market demand, rather than scientific literature, will drive design trends,"¹⁷⁰ may speak particularly strongly to tax strategy patents because the over-arching market demand to lower a person's tax obligations can provide a motivation to combine a variety of prior art references.

Market demand tells an inventor what the invention should be like, but does not tell the inventor how to make it. If the prior art provides the technical know-how to make parts or features of an invention then market demand can act as a bridge to connect the prior art parts or features.

Although market demand may range from the broad to the specific, courts and the PTO have little guidance regarding how specific market demand must be to provide a motivation to combine prior art. Looking to the *KSR* decision, one sees a relatively specific market demand, the "strong incentive to

¹⁶⁷ See European Patent Convention art. 93, Oct. 5, 1973, available at <http://www.epo.org.patents/law/legal-texts/html/epc/1973/e/ar93.html> (providing that European patent applications must be published at least after 18 months).

¹⁶⁸ *KSR Int'l. Co. v. Teleflex Inc.*, 127 S. Ct. 1727, 1740 (2007).

¹⁶⁹ See *supra* Section V.B.

¹⁷⁰ *KSR*, 127 S. Ct. at 1741.

convert mechanical [car] pedals to electronic pedals.”¹⁷¹ While the electronic age has ushered in numerous mechanical-to-electrical conversions, the *KSR* court would appear to require device-specific market pressure to provide motivation to combine references.¹⁷² In the context of a traditional mechanical widget (such as a car pedal), the requirement of device-specific market demand makes sense because numerous scientific and technological factors can affect the design of a single widget.

What does a device-specific market demand look like in the tax strategy area? Much like the mechanical-to-electrical example, the market in the tax strategy area will encourage the use of a specific law or device to lower tax obligations. Unlike the mechanical-to-electrical example, however, where one can come up with reasons why not to convert a mechanical pedal to an electrical one (e.g., reliability, complications from electrical power requirements, technological limits, cost, etc.), in the tax strategy area, the demand to decrease taxes is always the same and always desirable (as long as it is legal).

The ubiquity of the demand for lower taxes results in an environment where *KSR* court’s market demand theory has strong applicability. Whenever a law is issued or changed, the universal quest for combining it with other tax laws and knowledge to reduce taxes begins. That is not to say that a tax strategy is never worthy of a patent, but rather to note that combinations of known technology in the tax strategy area should be viewed skeptically because the combinations might be obvious.

As an example of applying the market demand theory to tax patents, recall the ‘790 patent involving funding a GRAT with nonqualified stock options.¹⁷³ As discussed previously, GRATs had existed long before the ‘790 patent. Recall also that the application for the ‘790 patent stated that a change in Rule 16b-3 of the Security and Exchange Commission regulations allowed nonqualified stock options to be transferred, including to trusts.¹⁷⁴ For this example, consider the laws relating to GRATs

¹⁷¹ *Id.* at 1744.

¹⁷² *See id.* at 1742 (discussing how in situations where “market pressure to solve a problem . . . [with] a finite number of identified, predictable solutions” exists, such pressure provides motivation to persons of ordinary skill to seek out a solution from said identified or predictable solutions).

¹⁷³ *See supra* Section V.B.

¹⁷⁴ U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

as lumped into “Law #1” and the change in Rule 16b-3 as “Law #2.” Also *assume* that Law #1 when combined with Law #2 teaches all the limitations of the ‘790 patent.¹⁷⁵

Before the *KSR* decision, many courts would have required a specific statement in either Law #1 or Law #2, such as a statement in the legislative history of Law #2 that the amendment will permit stock options to be transferred to trusts, to provide a motivation to combine Law #1 and Law #2. Absent such a statement in the prior art itself, many courts would have ruled that there was no motivation to combine the references. Under *KSR*, in contrast, one might demonstrate a motivation to combine the laws through literature or testimony demonstrating a market demand to minimize tax consequences relating to the stock options affected by the change in Law #2.¹⁷⁶

Because tax practitioners have a common goal—legitimately reducing tax obligations—motivating every transaction, analysis, and “invention,” the *KSR* court’s market demand concept can provide a significant bar to patentability of tax strategy patents. Think of it this way: every time a change in the law relating to taxes occurs, the first thing every tax practitioner does is analyze that change in light of how the change can be combined with other laws to reduce tax obligations of individuals and entities. There exists an almost inherent market demand motivating the combination of laws and regulations to produce tax savings. Thus, courts and the PTO can and should aggressively interpret

¹⁷⁵ This may not be the case, given that in the lawsuit involving the ‘790 Patent, the defendant filed its motion for summary judgment based on a theory of non-infringement, not on a theory of obviousness, perhaps indicating that it did not have a strong obviousness argument. *See* Dr. Rowe’s Memorandum in Support of his Motion Pursuant to Rule 56(b), Fed. R. Civ. P., for Summary Judgment of Non-Infringement, *Wealth Transfer Group LLC v. Rowe*, No. 3:06cv00024, (D. Conn. Nov. 3, 2006), 2006 WL 3873114. Further, the ‘790 Patent includes limitations regarding how to calculate the amount of stock options to include in the annuity payment. U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

¹⁷⁶ Arguably, one can demonstrate such market pressure by various articles appearing in the wake of Rule 16b-3’s amendment that discuss the potential advantages of transferring stock options for tax reasons. *See, e.g.*, Edward E. Bintz, *Executive Compensation—Transferable Stock Options: A Complex but Valuable Estate Planning Opportunity*, ARNOLD & PORTER, L.L.P., Aug. 1, 1997, available at <http://www.arnoldporter.com/publications.cfm> (search Type of Publication “Articles” and Author “Bintz”; then follow “Executive Compensation” article hyperlink) (stating that changes to Rule 16b-3 have lead to interest in transferring stock options, including to trusts, “to reduce gift and estate taxes” and that such options can be valued by Black Scholes or other valuation methods).

the *KSR* decision as a mechanism to provide heightened scrutiny of tax strategy patents involving combinations of laws.

c. The Supreme Court's *KSR* Decision—"Predictability" as a Force in Obviousness Determinations

A fundamental difference between tax strategies and traditional widgets is that the workability and success of widgets depends on the interactions of nature-based scientific laws, such as physics and chemistry, whereas the success of tax strategies depends only on a positive law created by statutes and regulations. This fundamental difference is arguably at the heart of most commentators' unease with tax strategy patents, but the implications of the difference are not as far reaching as some may suggest.

One implication of the difference between widgets and tax strategies comes to the forefront in the *KSR* court's focus on predictability in "combination" inventions.¹⁷⁷ The *KSR* court stated that the "combination of familiar elements according to known methods is likely to be obvious when it does no more than yield predictable results."¹⁷⁸ Considered in light of traditional inventions, such as widgets, the issue of predictability can provide a good litmus test for the obviousness of a purported invention. For example, while Chemical A and Chemical B may be known, mixing A and B together may have very unexpected results—either positive or negative. Similarly, changing one part of a complex mechanical or electrical device in light of another piece of prior art may have difficulties because changing one part may affect other parts unintentionally, or the prior art device may need to be modified to work with different devices. Simply stated, in traditional inventions, combinations of prior art may not work for a variety of real-world reasons.

However, in the tax strategy area, combinations based on changes in tax laws will, in theory, always "work" as expected (although they may be illegal). Following the '790 patent example, transferring stock options into GRATs has no chance of failing due to an unaccounted for force of nature. Instead, in the '790 patent, the stock option acts just like any other stock option, and the GRAT acts just like any other GRAT. Of course, a

¹⁷⁷ *KSR Int'l Co.*, 127 S. Ct. at 1739–41.

¹⁷⁸ *Id.* at 1739.

practitioner must be careful to ensure that the new structure does not violate any interrelated law, but whether a strategy is legal does not seem to determine whether it is patentable.¹⁷⁹ Hence, the routine combination of a new or changed law with existing law faces a difficult obviousness hurdle. As the *KSR* court stated, “[w]hen there is a design need or market pressure to solve a problem and there are a finite number of identified, predictable solutions . . . [and] this leads to the anticipated success, it is likely the product not of innovation but of ordinary skill and common sense.”¹⁸⁰

While more traditional inventions must deal with numerous variables that affect their success, including gravity, rust, molecular interactions, material safety, material strength, and so on, tax strategy patents need only weave through the web of tax laws and related regulations. Thus, the court’s emphasis on predictability can and should have a pointed effect on tax strategy patents because when combining the teaching of the laws relating to nonqualified stock options and GRATs, the results are not merely predictable, but 100% guaranteed! The invalidating power of published law and regulations should be particularly strong in the area of tax strategy patents.

d. A “State of the Law” Affidavit for Patent Applicants Will Guide Examiners, Prevent Rent Seeking, and Preclude Pure Capture of Tax Laws

Because tax laws will often serve as the most important pieces of prior art to tax strategy patents, the PTO should create an affirmative duty for the applicant to identify and summarize the primary tax laws relevant to an alleged invention. This duty can be fulfilled in a *state of the law* affidavit in which the applicant discloses and describes how the current tax laws relate to the alleged invention.¹⁸¹ Of course, applicants already have a “duty to disclose to the [PTO] all information known [to that

¹⁷⁹ See *supra* Section I-II (hypothesizing about the tax community patenting illegal tax strategies and describing the four requirements for patenting, none of which involve checking for legality of the invention).

¹⁸⁰ *KSR*, 127 S. Ct. at 1742.

¹⁸¹ A good example of the type of tax law discussion envisioned can be found in the ‘790 patent’s specification, which describes the most relevant laws relating to transferable stock options and GRATs. See U.S. Patent No. 6,567,790 (filed Dec. 1, 1999). Perhaps an examiner with a stronger background in the tax area would have considered the alleged invention obvious in light of the change in the law.

individual] to be material to patentability,”¹⁸² but they are not required to affirmatively search for the relevant information. The *state of the law* affidavit, however, would also require the applicant to affirmatively search for and explain the relevance of tax laws implicated under the inventions.¹⁸³ Moreover, to prevent “prophetic” patents, applicants must base their affidavits on the actual current tax laws, rather than anticipated (or lobbied-for) changes.

A *state of the law* affidavit fits nicely into existing patent principles. For example, the requirement to search for and explain the relevant tax laws would not burden applicants greatly because they arguably must know the primary laws relating to the invention, or else they would not realize they had an invention in the first place. Further, the patent laws already require an applicant to disclose the best mode for practicing the invention and to enable one skilled in the art to practice the invention, so the affidavit would only incrementally increase this burden.¹⁸⁴

In addition, the affidavit would aid the examiner in understanding whether the alleged invention conforms to the current tax laws. As mentioned in Section IV of this Article, courts and the PTO already have in place a framework to require traditional “widget-type” inventions to conform to the known laws of science through the *Chilowsky* test for specific utility. The affidavit requirement would allow a test that mirrors the *Chilowsky* test, but would be based not on science laws, but on tax laws. Because tax laws, unlike the laws of science, change regularly, the law should require applicants to present the current laws to the patent examiner. If a patent is issued and the affidavit is later shown to be incorrect, then the patent should be invalid. Thus, much like patent applicants must correctly apply the laws of physics and chemistry,¹⁸⁵ tax strategy

¹⁸² 37 C.F.R. § 1.56.

¹⁸³ See, e.g., 37 C.F.R. § 1.56(a)–(b) (noting that the individual must disclose and explain all information that is relevant or material). Care must be taken to identify what laws constitute “tax laws.” For instance, the ‘790 Patent dealt with a change in an SEC regulation. Those within the tax community would be best suited to draft sufficiently inclusive language to capture the appropriate laws and regulations.

¹⁸⁴ See Utility Examination Guidelines, 66 Fed. Reg. 1092 (Jan. 5, 2001).

¹⁸⁵ See e.g., *In re Chilowsky*, 229 F.2d 457, 462 (1956) (“[W]here the mode of operation alleged can be readily understood and conforms to the known laws of physics and chemistry, operativeness is not questioned, and no further evidence is required.”).

applicants would be required to correctly state the tax laws and apply them to the asserted invention.

Moreover, to prevent rent seeking and wildcatting,¹⁸⁶ the affidavit requirement should be based on the tax laws as they exist at the time of the application. As discussed in Section IV, the utility requirement arguably should prevent prophetic patents based on guesses about future changes in the tax laws. To the extent that the utility requirement does not prevent prophetic applications, the affidavit would clearly do so. Moreover, because tax strategy patents stand or fall based on changes in the tax laws, the affidavit will act as a wall to separate patent holders/applicants from the lawmakers who can make or break a patent's worth. According to Professor Melone, "[t]ax law is notoriously fertile ground for rent seeking and rent extraction in the political arena."¹⁸⁷ Supplemental evidence for the legitimate fear of rent seeking stems from analogous occurrences in industries with "standards-setting bod[ies]," such as the cell phone industry.¹⁸⁸ While some have called for mandatory licensing in similar situations,¹⁸⁹ given the government's direct involvement in enacting tax laws, prophetic tax strategy patents should be precluded to eliminate the possibility or appearance of government corruption.¹⁹⁰

Further, the affidavit would assist in the PTO examiner's analysis of the claimed invention's novelty and non-obviousness in light of tax laws. Unlike the best mode requirement, which does not limit the patent from including later-discovered modes of operation,¹⁹¹ the affidavit could provide a limiting effect on the patent's scope by limiting the patent's reach to those areas of the law disclosed in the specification. If an alleged infringer can

¹⁸⁶ See *supra* Section IV.A (discussing the terms rent seeking and wildcatting).

¹⁸⁷ Melone, *supra* note 163, at 473.

¹⁸⁸ See generally Janice M. Mueller, *Patent Misuse through the Capture of Industry Standards*, 17 BERKELEY TECH. L.J. 623, 632-3, 684 (2002).

¹⁸⁹ See, e.g., Banner, *supra* note 152, at 504-05 (citing Janice M. Mueller, *Patent Misuse Through the Capture of Industry Standards*, 17 BERKELEY TECH L.J. 623, 684 (2002)).

¹⁹⁰ See Melone, *supra* note 163, at 474 (discussing the disadvantages of rent seeking with the tax strategy patents and noting that the perception of unfairness in the tax arena can affect compliance).

¹⁹¹ U.S. PATENT AND TRADEMARK OFFICE, U.S. DEP'T OF COMMERCE, MANUAL OF PATENT EXAMINING PROCEDURE § 2165, 2165.04 (2007), available at http://www.uspto.gov/web/offices/pac/mpep/mpep_e8r6_2100.pdf (providing an example of when the best mode requirement was satisfied even though applicant did not disclose information relevant to the invention).

demonstrate that the applicant's "status of the law" affidavit did not cover the alleged infringing use, the alleged use will not infringe. In this way, the applicant's burden of clarity is heightened.

Finally, a "*state of the law*" affidavit requirement would help police patent applications for abusive tax shelters. Interested third parties could review the affidavit and challenge any inconsistencies. While of course, accused infringers would be slow to declare a tax strategy "abusive" if they might in fact be performing the strategy, non-accused third parties should be permitted to request reexamination based on an incorrect statement of the tax laws.

3. The Need for Quality Searchable Prior Art

The third category of criticisms against tax strategy patents concerns the lack of adequate sources of searchable prior art.¹⁹² Commentators within the tax community differ on whether adequate sources of searchable prior art exist,¹⁹³ and some sources on the subject appear to be internally conflicted.¹⁹⁴ As

¹⁹² See Letter from Tax Section, New York State Bar Ass'n Tax Section to Congress (Aug. 17, 2006), available at http://tax.aicpa.org/NR/rdonlyres/A8E1569D-7BD0-40FC-8172-0F915AFA9F9E/0/2nd_attachmentNYSTBA_Report_Patents.pdf [hereinafter *NYSBA letter*].

¹⁹³ Compare Melone, *supra* note 163, at 459 ("[T]here exists an extensive and rich body of tax literature."), with *NYSBA letter*, *supra* note 192, at 7 ("In many cases, strategies adopted by taxpayers are not publicly disclosed. . . Tax returns are confidential, and tax advice is typically protected under the attorney-client privilege or the practitioner privilege.").

¹⁹⁴ Compare *NYSBA letter*, *supra* note 192, at 4 ("Our experience also suggests that creative, sound tax planning ideas are generally available and widely discussed among practitioners and in the tax literature."), with *id.* at 7

We believe that the practical difficulties of establishing or disputing the originality of tax strategies strongly militates against giving them patent protection. . . . In many cases, strategies adopted by taxpayers are not publicly disclosed. . . . Tax returns are confidential, and tax advice is typically protected under the attorney-client privilege or the practitioner privilege . . .

Compare Wieland III & Marshall, *supra* note 68, at 127 (stating that "many tax strategies are publicly discussed and disseminated among tax practitioners," including through practitioner seminars, publications, and published excerpts of private letter rulings and technical advice memoranda), with *id.* at 140 (stating that "the attorney-client privilege may very well limit the scope of such efforts" to develop prior art databases); compare *AICPA*, *supra* note 68, at 9 (stating that the tax profession is home to vast discussion that "support the constant development, broad public exposure, analysis and refinement of tax strategies"), with *id.* at 11 (stating that the PTO has limited access to tax

with business methods in general, however, any temporary lack of adequate searchable prior art should not bar tax strategy patents, because increasing the searchable prior art is easily attainable and socially desirable.¹⁹⁵

Tax professionals can increase the sources of searchable prior art by increasing both the amount and quality of their publications relating to tax strategies. Tax professionals consistently describe their community's atmosphere as one of free and open discussion of tax savings techniques,¹⁹⁶ so publishing those discussions in a searchable database would require little effort. The PTO has also collaborated with the IRS and industry professionals to improve and maintain quality tax strategy prior art databases.¹⁹⁷ Finally, third party competitors can increase prior art awareness by submitting prior art for PTO review under Rule 99 submissions and reexaminations.¹⁹⁸ Increasing available prior art benefits society because it helps prevent low quality patents, and because the public can use, improve upon, and build upon known art.¹⁹⁹ Additionally, the desire to design around an existing patent can lead to ancillary innovation. For these reasons, many commentators agree that the temporary lack of searchable prior art should not preclude patentability of tax strategy patents.²⁰⁰

strategy prior art because much of it "consists of confidential or privileged communications" or "are not described in printed publications.").

¹⁹⁵ See Melone, *supra* note 163, at 458–59.

¹⁹⁶ *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Dennis Belcher) ("Many lawyers, accountants, and financial planners give estate planning advice and do not publish their techniques but discuss these techniques in numerous meetings of professionals.").

¹⁹⁷ See, e.g., *id.*, *supra* note 7 (statement of Ellen Aprill) (recognizing ongoing beneficial collaboration and encouraging further collaboration between the PTO and tax professionals).

¹⁹⁸ See *supra* Part VI.A.3 (discussing Rule 99 submissions and reexaminations).

¹⁹⁹ See, e.g., *Yarway Corp. v. Eur-Control USA, Inc.*, 775 F.2d 268, 277 (1985) (quoting *State Indus., Inc. v. A.O. Smith Corp.*, 751 F.2d 1226, 1236 (1985)) (discussing that a positive result of the patent system is an individual's ability to build upon a patent in order to bring new innovations to the marketplace); Michael Risch, *The Failure of Public Notice in Patent Prosecution*, 21 HARV. J.L. & TECH. 179, 217 (2007) (discussing that increasing prior art will help in invalidating bad patents); *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Ellen Aprill) (discussing methods of increasing available prior arts and its benefits, including an improved PTO review process, better understanding by policymakers, and IRS access to undertake policy considerations).

²⁰⁰ Richard S. Gruner, *In Search of the Undiscovered Country: The Challenge of Describing Patentable Subject Matter*, 23 SANTA CLARA COMPUTER & HIGH

B. Should Tax Strategies Be Eligible Subject Matter for Patenting?

Many commentators assert that tax strategies should not be eligible for patenting on various public policy grounds. This Subsection explores some of those concerns and offers responses to the same.

1. Does the Tax Profession Need or Want the Patent System's Incentives to Innovate?

Interestingly, the tax community disagrees on the optimal level of incentive to innovate in the tax strategy area. Much like Goldilocks' subjective assessment of the three bears' porridge, some argue that the current level of incentive for tax strategies is just right, while others argue that there is too much incentive. One may also question whether there is too little incentive.

a. The Argument That the Tax Profession Has Adequate Incentives to Create Is Oversimplified

Some critics of tax strategy patents assert that the tax profession does not "need" the patent system's incentive to create beneficial tax strategies.²⁰¹ In its over-simplified form, this argument assumes that because tax strategies existed before patent protection became popular; the patent system is not needed.²⁰² But commercial incentives to innovate exist in almost any industry, even without patent protection.²⁰³ In other words,

TECH. L.J. 395, 434 (2007) (stating that a temporary shortage of strong prior art "should probably not influence decisions about the proper scope of patentable subject matter.").

²⁰¹ See, e.g., Banner, *supra* note 152, at 497 ("People simply do not need the promise of a limited monopoly to spur ingenuity in reducing their tax burden"); NYSBA letter, *supra* note 192, at 4; *Hearing on Patenting Tax Advice*, *supra* note 7 (Statement of Ellen Aprill).

²⁰² U.S. Treasury, Fact Sheet on the History of the U.S. Tax System, <http://www.treas.gov/education/fact-sheets/taxes/ustax.shtml> (last visited Oct. 8, 2008) (describing the U.S. tax system before the adoption of the U.S. Constitution).

²⁰³ See, e.g., Jared Earl Grusd, *Internet Business Methods: What Role Does and Should Patent Law Play?*, 4 VA. J.L. & TECH. 9 (1999) (providing an example of one industry, Internet business methods, that does not need patents to create an incentive to innovate). Of course, some industries have a higher need for patents than others. For example, the pharmaceutical industry has huge R&D costs and low copying costs, so it benefits highly from the patent system. Judith Kaufmann, *Intellectual Property Rights and the Pharmaceutical Industry* (Jan. 2006), available at

the fact that tax professionals were developing tax strategies before patenting them became prevalent does not by itself prove that the patent system will not provide additional incentive to innovate, thus bringing the level of innovation to a more optimal point.²⁰⁴ Even without empirical evidence of the patent system's benefits in the tax area, most observers probably acknowledge that the patent system will add some fuel to the creative fire, thus expanding the universe of beneficial tax strategies.

Arguments that tax professionals do not need the incentives of the patent system are weakened by concerns that the profession lacks adequate searchable prior art.²⁰⁵ If the profession lacks searchable and organized databases for prior art, then beneficial information is not accessible to many professionals.²⁰⁶ As discussed with respect to business method patents, the public disclosure mandated by the patent system fosters innovation because others may analyze, build upon, or design around another's patent. In addition to patents and published applications, the patent system can foster other publications, such as industry writings and commentary. Given concerns over the lack of adequate searchable prior art for tax strategies, a strong argument can be made that the public disclosure fostered by the patent system will spur tax strategy innovation because patents and any attendant increased published art would advance the corporate understanding of the state of the art.

b. The Argument That the Tax Profession Needs Less Incentives to Create Only Applies to Abusive Tax Strategies

Others within the tax community feel that tax professionals have too much incentive to create, thus leading to abusive tax

<http://usinfo.state.gov/products/pubs/intelprp/industry.htm>. Other industries more analogous to the tax strategy area, however, receive patent protection, including most business methods.

²⁰⁴ The trouble with the "optimal level of innovation" argument is that it cannot be adequately supported or refuted without empirical evidence, and the author has not found any such data relating specifically to tax strategies.

²⁰⁵ See *supra* Part VII.A.3 (discussing the existence of tax strategy prior art that can be readily searched).

²⁰⁶ Cf. Paul Devinsky et al., *Whose Tax Law Is It? Alarm Bells Should Ring Over Rising Efforts to Patent Tax Strategies*, LEGAL TIMES, Oct. 16, 2006 (discussing the confidential and protected nature of information that would be prior art for tax strategies and advocating creation of a record and archive of prior art. Because a tax advisor's work is typically confidential, there is little prior art and, subsequently, little beneficial information available to tax professionals).

strategies.²⁰⁷ One author goes as far as saying that “all tax planning, not just planning associated with . . . [tax] shelters, produces nothing of value.”²⁰⁸ Arguments against incentives for tax strategy patents presuppose that the strategies embodied in the patents are or will be abusive. The IRS, however, has conducted reviews of numerous tax strategy patents and patent applications, and has yet to discover a patent that embodies an abusive tax strategy.²⁰⁹

Aside from the absence of evidence of patents embodying abusive structures, the public nature of patents militates against fears of widespread abusive patents. Because the public has access to all patents and those patent applications that publish 18 months after filing,²¹⁰ applicants run serious risk of being discredited if they try to patent an abusive strategy.²¹¹ The high costs of applying for a patent²¹² and the exponentially greater costs of legal exposure if a patent turns out to be improper provide weighty disincentives to patenting improper strategies.²¹³

The patent system will also allow the government to have greater access to state of the art tax strategies,²¹⁴ allowing it to make timely public announcements about the propriety of certain strategies.²¹⁵ To the extent that the government needs greater access to monitor potentially abusive patented strategies, the law can be changed to make patented tax strategy transactions reportable.²¹⁶ Making patented transactions reportable may be

²⁰⁷ See Melone, *supra* note 163, at 479–80.

²⁰⁸ David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 222 (2002).

²⁰⁹ *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Mark Everson).

²¹⁰ See *supra* Section VII.A.2.a (arguing for mandatory publication of all tax strategy patents at 18 months).

²¹¹ See Drennan, *supra* note 96, at 314–15.

²¹² As discussed *supra*, filing a patent application and prosecuting it to issuance can cost between \$10,000 and \$25,000 or more. See Lemley, *supra* note 17, at 1498.

²¹³ See Drennan, *supra* note 96, at 317–19 (detailing the downfall of a reverse split-dollar strategy that was the subject of three patent applications).

²¹⁴ See *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Ellen Aprill).

²¹⁵ *Id.* But see Melone, *supra* note 163, at 470 (“At best, one should retain a healthy skepticism toward claims that advance notice to the government will have a significant impact in reducing abusive transactions.”).

²¹⁶ Letter from ABA Section of Taxation to The Honorable Mark W. Everson (Feb. 21, 2007), *available at* <http://meetings.abanet.org/webupload/commupload/TX800000/relatedresources/CommentsonaNewCategoryof>

desirable for a number of reasons, including that some patent drafters have mastered the art of saying very little of substance in the pages of patent applications.²¹⁷

Thus, one can argue that the incentives of the patent system benefit, or at least do not harm, the tax profession or tax consumers. The public nature of patents decreases the chances of abusive patents. Changing the law to make patented transactions reportable seems desirable from a patent policy standpoint to enable an additional check against abusive tax strategy patents.

2. Assuming a Robust Database of Prior Art, Tax Strategy Patents Will Not Unfairly “Capture” the Law

Some have argued that the government should ban tax strategy patents because, in theory, someone could “capture”²¹⁸ a primary benefit of (or the only means of) compliance with a certain tax law.²¹⁹ Although this Article supports precluding prophetic patents,²²⁰ it does not support precluding even broad patents based on current tax law, provided they comply with the requirements of novelty and nonobviousness. The argument that tax patents can “capture” a law stems from either a misunderstanding of or lack of faith in the current patent laws and the PTO. While the latter is understandable given the human fallibility of PTO examiners,²²¹ we should not throw out

ReportableTransactionsCoveringPatentedTaxStrategies.pdf; *JCT*, *supra* note 7, at 23 (“[T]he IRS and Treasury could amend the reportable transaction regulations to include the application, grant, or use of a tax strategy patent.”); Drennan, *supra* note 96, at 313–14.

²¹⁷ See *Brenner*, 383 U.S. 519, 534 (1966) (noting “the highly developed art of drafting patent claims so that they disclose as little useful information as possible”); see also *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Mark Everson) (“Ultimately, we often need to see a real world example of how the transaction is carried out before we can be confident that the transaction is not abusive.”); *supra* Part VII.A.2.d (suggesting that a “state of the law” affidavit can place a higher burden of clarity on applicants for tax strategy patents).

²¹⁸ See *supra* note 87 (regarding this author’s understanding of the definition of “capturing” a tax law).

²¹⁹ See, e.g., Wieland III & Marshall, *supra* note 68, at 129; *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Dennis Belcher); *AICPA*, *supra* note 68, at 5, 9.

²²⁰ See *supra* Part VII.A.2.d.

²²¹ A widely publicized case like the SOGRAT patent should not cause the public to lose all hope. Even assuming the ‘790 patent was truly obvious at the time of its application, the decision whether tax strategies should be eligible for patenting should not be made based on this patent alone.

the baby with the bath water. Instead, the modifications to the patent system described in this Article provide sufficient assurance that, for the most part, only deserving tax strategy patents will issue.

At its core, the assertion that patents would *unfairly* preempt other people's use of a tax strategy ignores one of the basic premises of the patent system: If the inventor of the tax strategy had not invented the strategy and disclosed it to the public, people would have never known the strategy existed, and thus would not have been deprived of something to which they are entitled. Even assuming independent invention of a tax strategy (after the patentee's invention date and without the benefit of the patentee's disclosure), the patent system purposefully precludes the later inventor's use to provide an incentive to create. Arguments that multiple people would have independently invented a given tax strategy is an indicia that an invention is obvious, not a reason to bar tax strategy patents altogether.

This Article's discussion of the topics of novelty and obviousness²²² should bring comfort to those who fear that an entire area of the tax law could be preempted by a patent. Almost by definition, absent a prophetic patent, one could not patent the only means of compliance with a new law, because the prior art embodied in the law itself (including draft legislation) would either anticipate or render obvious all or most of the explicitly intended applications of the law. Similarly, fears that non-novel or obvious tax strategies will issue should be met with strengthening examiner training and access to prior art, not with pulling the plug on a segment of the patent world.

That being said, this Article contends that ideas worthy of a patent may utilize various laws and regulations in such a way as to lower one's tax obligations, but this is a far cry from preempting an entire area of the law. Instead, patenting one method does not preclude other tax strategies involving the same assets or vehicles. Consider again the '790 patent: If valid, the '790 patent does not preclude all tax reducing strategies involving nonqualified stock options, but only those using a GRAT per the claims. One can still reduce the tax consequences of nonqualified stock options by transferring the options to vehicles other than a GRAT.

Thus, the fears of capturing tax laws appear to be exaggerated.

²²² See *supra* Section V.

By preventing prophetic patents and strengthening the review of tax strategy patent applications, only those tax strategies that would otherwise lie dormant until a later time will receive patent protection. While a “bad” (i.e., obvious) patent will undoubtedly issue from time to time, the exception should not bring down the rule.

3. Tax Strategy Patents Do Not Act as Undesirable Roadblocks or Tollbooths to Compliance With the Law

Some have argued that the government should ban tax strategy patents because an accumulation of tax strategy patents will impede taxpayers’ access to tax-savings strategies by blocking them or forcing them to license one or more strategies.²²³ It is quite correct that patents can impede others’ access to performing patented tax-savings strategies, for that is the nature of the patent system. Deadweight loss due to monopoly is the *quid pro quo* for disclosure of the idea via a patent application.²²⁴ But again, if the invention is novel and non-obvious, the public would not have known of the strategy absent the inventor’s ingenuity.

a. Tax Strategy Patents Do Not Block “Compliance” With the Law

Some argue a step further that tax strategy patents will act as a roadblock to prevent “compliance” with the law,²²⁵ but the doctrines of novelty and non-obviousness demonstrate this characterization to be a straw man²²⁶ in that an entire law cannot be captured by a patent.²²⁷ In addition, tax strategies receiving patents thus far only involve ways to *reduce* the amount of taxes owed, not ways to physically pay one’s taxes.

²²³ See, e.g., *Hearing on Patenting Tax Advice*, *supra* note 7 (statement of Dennis L. Belcher); *NYSBA letter*, *supra* note 192, at 5.

²²⁴ *But see* Melone, *supra* note 163, at 471–72 (arguing that the deadweight loss due to monopoly may be small for tax strategy patents).

²²⁵ *AICPA*, *supra* note 68, at 9. The AICPA’s article argues that if a taxpayer enters into certain transactions, filing of certain tax returns are required by law. It goes on to argue that if the taxpayer must implement a patented tax strategy to file the return, then the patent prevents compliance with the law. The obvious response is that taxpayers should not enter into transactions in the first place if they cannot report the transaction without infringing a patent.

²²⁶ See BLACK’S LAW DICTIONARY 1461 (8th ed. 2004) (defining “straw man” as “[a] fictitious person, esp. one that is weak or flawed.”).

²²⁷ See *supra* Section VII.B.2 (regarding “capturing” the law).

For example, an individual wage earner complies with the law by paying taxes based on his adjusted gross income (“AGI”).²²⁸ Assuming he qualifies to reduce his AGI based on charitable giving, he can *comply* with the law whether he accounts for his charitable giving or not, he just pays more taxes if he fails to account for his charitable giving. Similarly, a certain patented strategy may exist that can lower the taxpayer’s adjusted gross income, but he can comply with the requirement to pay income taxes without using the patented strategy. Of course, he must pay more than one who uses the strategy, but he can comply with the law.

The argument that tax strategies are somehow different from other inventions because paying taxes is mandatory²²⁹ suffers from an additional weakness. While *paying* taxes is mandatory, *paying the minimum amount* of taxes is not mandatory.²³⁰ It is like trying to argue that because drinking water is necessary for humans to live, patents relating to purifying drinking water should be prohibited. On the contrary, one is free to drink water that is less purified, but one may prefer to pay more for water purified by a patented method. Paying more taxes or drinking slightly less pure water may seem unpleasant, but neither will kill you.

One commentator recognizes the possibility of the patent system providing added incentive to innovate for tax professionals, but frames “the mandatory nature of tax[ation]” argument as follows: in a normal industry, a company incurs a net cost to embark on research and development, but in the tax area, because taxpayers are *required* to pay taxes, they begin with a net loss and any tax strategy results in a net gain.²³¹ This argument improperly compares apples to oranges because the

²²⁸ See generally Internal Revenue Code, 26 U.S.C. § 1 (2007); Internal Revenue Service, 2007 Adjusted Gross Income (AGI), http://www.irs.gov/app/freeFile/html/moreInfo/more_info_agi.html (last visited Oct. 8, 2008).

²²⁹ Banner, *supra* note 152, at 500 (arguing that “the mandatory nature of paying taxes provides an important distinction that will not apply to other areas encompassed by our patent system” because in other industries, the company can cease production of a good); see also *NYSBA letter*, *supra* note 192, at 4 (“The tax laws, however, are perhaps unique in that they impose universal affirmative obligations of compliance on U.S. citizens and residents.”).

²³⁰ See Melone, *supra* note 163, at 482 (“To date no one has asserted that all taxpayers must have equal access to tax minimization techniques. Such an assertion would be tantamount to a call for equal access to good tax advice.”).

²³¹ Banner, *supra* note 152, at 498.

party most analogous to the researching company is the researching tax professional, not the taxpayer.

That is, a tax professional incurs a cost for studying the tax law and developing a strategy in much the same way that an individual incurs a cost for tinkering with an idea or developing a business strategy. The taxpayer is more analogous to the consumer of goods, both of whom benefit from the inventor's development and who, absent the inventor, would have no way of receiving the benefit of the invention absent independent invention. In sum, it seems no tax strategy patent yet issued prevents compliance with the law, and no such patent can issue assuming a properly running patent system and the unavailability of prophetic patents. To the extent that the law requires filing tax returns for certain business transactions, entities should avoid the transaction if the tax returns will run afoul of a patented strategy.

b. Tax Strategy Patents are Not Unfair Tollbooths

Another argument states, in effect, that tax strategies operate as burdensome tollbooths preventing access to the entitlement of tax strategies. This tollbooth argument is a less-compelling version of similar arguments made in the field of steroid patents in the 1960s and research tool²³² patents in the 1990s.²³³ In the cases of steroids and research tools, researchers wanted to use the patented items for basic fundamental research.²³⁴ In those scenarios, the patented items were arguably keys to future scientific development.²³⁵ Some suggested that patents on these basic building blocks of research were detrimental to science because the royalties researchers would pay would become

²³² The National Institutes of Health broadly defines research tools as “the full range of resources that scientists use in the laboratory . . . [which include, but are not limited to,] cell lines, monoclonal antibodies, reagents, animal models, growth factors, combinatorial chemistry libraries, drugs and drug targets, clones and cloning tools (such as PCR), methods, laboratory equipment and machines, databases and computer software.” Report of the National Institutes of Health, *Working Group on Research Tools*, June 4, 1998, available at <http://www.nih.gov/news/researchtools/#backgrnd>.

²³³ See Michael A. Heller & Rebecca Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, *SCIENCE*, May 1, 1998, at 699 (arguing that patenting of upstream biotechnology research tools can deter innovation in the field of basic biological research by acting as “tollbooth[s] on the road to product development.”).

²³⁴ *Id.* at 698–99.

²³⁵ *Id.* at 698.

prohibitive, thus halting research.²³⁶ No strong parallel exists with tax strategy patents. Patented tax strategies do not preclude other professionals from inventing or exploring additional tax strategies. On the contrary, they arguably spur more ideas.

Instead, some critics of tax strategy patents seem simply indignant at the thought of paying license fees for access to strategies, probably because they believe the strategies would be discovered absent the patent system. Thus, the question of whether tax strategy patents are unfair tollbooths is subsumed in the question of whether society benefits on the whole from tax strategy patents. While patents will raise the costs to tax strategy consumers via royalty, it will also lower costs by providing access to strategies that otherwise would not exist.

One must at least pause to consider the irony of tax professionals complaining about patent holders and other individuals profiting from tax strategies. Tax professionals have been making money—and lots of it—from tax strategies for years, so why should they have a monopoly on the area? Paying a patent holder fees for the right to use a strategy is not unlike paying tax professionals to get access to their knowledge and expertise. In both cases, the taxpayer only gets access to certain strategies by paying.²³⁷ It is true that with the patent system, the restriction to the patented tax strategy is backed by the very government that enacted the tax laws on which the strategy is based, but this does not seem a convincing reason to exclude tax strategy patents altogether. The patent system coexists with other government laws and regulations, including pollution laws, under which a patented invention may be the only or best means of compliance with the law.²³⁸

Critics also seem annoyed at the increased effort required for tax professionals to analyze and confront tax strategy patents

²³⁶ *Id.* at 699. *But see* John J. Doll, *The Patenting of DNA*, SCIENCE, May 1, 1998, at 689 (responding to Heller and Eisenberg and arguing that similar arguments against patenting polymer building blocks made in the 1960s failed to come to realization).

²³⁷ To be fair, patent lawyers are not without financial reasons to desire tax strategy patents: they stand to profit from tax strategy patents because they will need to advise tax practitioners about the existence, strength and relevance of patented tax strategies. In addition, patent lawyers may profit from litigation and transactions relating to tax strategy patents.

²³⁸ *See* Warren F. Schwartz, *Mandatory Patent Licensing of Air Pollution Control Technology*, 57 VA. L. REV. 719, 720–23, 726 (1971).

posing legal barriers, calling the burden unacceptable given the already burdensome task of contending with the labyrinth of tax laws.²³⁹ While patents will add additional dimensions to the tax strategy area, other complex industries have dealt with patents for years, and the tax profession does not appear to have any inherent quality that should insulate it from any inconveniences accompanying the patent system. The unfortunate complexity of the tax laws may justify changes to the tax laws, but should not be grounds for limiting the patent system.

Indeed, tax strategy patents may engender some clarity to the tax laws by highlighting the state of the art for both the public and the government.²⁴⁰ Further, the public nature of patents, coupled with patent owners' commercial incentives to distribute widely their patented tax strategies, should result in patented strategies being streamlined to consumers. Although some see "commodifying" tax laws as undesirable,²⁴¹ it can be argued that such commodification increases access to good strategies and helps others make sense of complex laws. Given the potential benefits of the patent system, the predilection for equilibrium in the tax profession should not hinder the otherwise unobjectionable development.

4. Tax Strategy Patents Will Not Affect Taxpayer Morale

There are several reasons to doubt contentions that tax strategy patents will increase disillusionment with the tax system by violating horizontal taxpayer equity (the idea that similarly situated taxpayers should pay similar taxes)²⁴² and/or horizontal infringer equity (the idea that all infringers should be treated alike).²⁴³ First, even the critics suggesting the problem

²³⁹ See Melone, *supra* note 163, at 465 (arguing that tax strategy patents "inexorably lead[] to further complications in tax planning and compliance").

²⁴⁰ See *supra* Section VII.B.1.

²⁴¹ See Melone, *supra* note 163, at 483–84.

²⁴² Drennan, *supra* note 96, at 280–81 (describing horizontal taxpayer equity as "the notion that similarly situated taxpayers should pay similar taxes," and arguing that excluding non-patent holders from access to strategies will cause taxpayers to "view the tax system as unfair and arbitrary").

²⁴³ The term "horizontal infringer equity" is used in this article to describe the situation discussed in Professor Melone's article in which some tax strategy patents may be more easily enforced than others, thus causing similarly situated taxpayers (those who infringe tax strategy patents) to experience different consequences. See Melone, *supra* note 163, at 476–78. Professor Melone suggests that disparate patent enforcement will lead to taxpayer's "perceptions that the tax system is gamed and subject to manipulation,"

concede that tax strategy patents will predominantly impact only the most sophisticated and affluent consumers.²⁴⁴ To the extent that wealth approximates sophistication (or at least access to sophisticated advisors), disillusionment from misperception should be underwhelming. These sophisticated consumers will comprehend why tax strategy patents do not greatly affect horizontal taxpayer equity, as discussed in this Article and elsewhere.²⁴⁵ Regarding any perceived lack of horizontal “infringement” equity, the sophisticated consumer will understand that disparate patent enforcement relates not to an unfair tax system, but to the constraints—and even the whims—of the patent owner. Thus, tax strategy patents should not affect the taxpayer morale.

VIII. CONCLUSION

Generally speaking, lawyers do not like change. Many objections to tax strategy patents echo those made by other professionals when patents first entered their fields. The patent system brings with it costs as well as benefits, and the growth of tax strategy patents counsels for harnessing the benefits of the patent system while minimizing the costs. In this regard, this Article suggests the following changes in the law:

- instituting a “state of the law” affidavit requiring patent applicants to base tax strategy patent applications on current tax laws and to identify and explain the primary tax laws relevant to an alleged invention;²⁴⁶
- reviewing all tax strategy patents under a strict obviousness standard based on the recent *KSR v. Teleflex* Supreme Court case;²⁴⁷
- requiring notifications to clients and prospective clients that patented tax strategies are not necessarily legal;²⁴⁸

resulting in “corrosive effects on the voluntary compliance system.” *Id.* at 478.

²⁴⁴ *Id.* at 460 (stating that “tax strategy patents will likely have their greatest impact on large, complex businesses”); *see also, supra* Section V. n.71 (arguing that tax strategies for routine tax strategies likely to apply to the less wealthy would be obvious).

²⁴⁵ *See supra* Section VII.B.3; *see also* Melone, *supra* note 163, at 482. In addition, to the extent that certain patents cannot practically be enforced (because of difficulty finding infringers), one would expect entities will not pay the costs to obtain a patent they cannot enforce.

²⁴⁶ *See supra* Section VII.A.2.d.

²⁴⁷ *See supra* Section VII.A.2.b and c.

²⁴⁸ *See supra* Section IV.B.

- mandating publication for all tax strategy patent applications within 18 months from the application date;²⁴⁹ and
- amending the tax laws to make the use of patented tax strategies reportable transactions.²⁵⁰

While the PTO may have been somewhat unprepared to deal with the earliest tax strategy patents, it has taken measures to properly analyze and understand such applications in the future. In addition to the PTO's initiatives, the suggestions in this Article should strengthen the quality of issued tax strategy patents. Minimizing the issuance or viability of "bad" tax strategy patents will result in a patent system whose value to the public correlates to the value of the tax planning profession as a whole. Thus, interested parties should focus their efforts not on eliminating tax strategy patents, but on increasing the quality of issued patents and improving the tax laws under which any such patents would operate.

²⁴⁹ See *supra* Section VII.A.2.a.

²⁵⁰ See *supra* Section VII.B.1.b.