
EFFECTING THE IMPOSSIBLE: AN ARGUMENT AGAINST TAX STRATEGY PATENTS

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I. INTRODUCTION

In 1998, in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, the U.S. Court of Appeals for the Federal Circuit rejected the contention that “business methods” are per se unpatentable, and stated that a business process patent can be granted on the same basis as any other patentable invention.¹ The decision fostered a new awareness that business method claims could be patented, and in the wake of *State Street Bank*, the United States Patent and Trademark Office (“USPTO”) saw an almost six-fold increase from 1998 to 2001 in the number of patent applications for business methods.² While some commentators applauded the *State Street Bank* decision,³ others maintained that methods of doing business should

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1. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1375 (Fed. Cir. 1998), *cert. denied*, 525 U.S. 1093 (1999).

2. See *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. 8 (2006) [hereinafter *Hearing on Issues Relating to the Patenting of Tax Advice*] (statement of James Toupin, Gen. Counsel, U.S. Patent and Trademark Office) (explaining that there were approximately 9000 filings for business method patents in 2001, as opposed to only 1500 filings for business method patents in 1998, but also noting that the grant rate for business method applications has declined in the years since the *State Street Bank* decision).

3. See *Business Method Patents: Hearing Before the Subcomm. on Courts, the Internet, and Intellectual Prop. of the H. Comm. on the Judiciary*, 107th Cong. 35 (2001) [hereinafter *Business Methods Hearing*] (testimony of Michael K. Kirk, Exec. Dir., American Intellectual Property Law Association & Ronald E. Myrick, Chief Intellectual Property Counsel, General Electric, General Electric Capital Services, and President, Intellectual Property Owners Association).

be an excluded category of invention, articulating that the traditional filters of patent law are not appropriately sized to sieve overly broad business practices from attaining patent protection.⁴ Despite those concerns, business methods remain patentable inventions.⁵

Perhaps emboldened by patent grants for business methods, some businesses and individuals have begun seeking patent protection for tax strategies that they claim represent new and unique ways to alleviate tax burdens. And while the USPTO has issued patents for tax strategies and created a subclass of business method patents to house those tax strategy patents,⁶ whether tax strategies can and should be patentable processes remains unsettled.

In January of 2006 a Florida company, Wealth Transfer Group, filed suit in the U.S. District Court in Connecticut against the executive chairman of Aetna, John Rowe, alleging that Mr. Rowe infringed its patent for establishing and managing grantor retained annuity trusts that are funded by nonqualified stock options.⁷ The patented product, known as "SOGRAT," was a tax-saving technique that some professional tax planners described as a common estate planning technique.⁸ That a common estate planning technique could be patented seemed strange to many tax professionals;⁹ that the patent might be legally enforceable in court terrified others.¹⁰ While many observers hoped that the court in

4. See, e.g., Peter J. Howe, "Business Methods" Patents Raise the Stakes, THE BOSTON GLOBE, July 5, 2005, at C1 (noting that many "Internet entrepreneurs" became concerned after Sun Microsystems patented the internet "shopping cart" in 1998 and Amazon.com patented one-click online shopping in 1999, since "[a]spects of online shopping as common as writing a check . . . could become subject to demands for royalty payments").

5. For an explanation of what can qualify for a business method patent, see United States Patent and Trademark Office, Class 705 Data Processing: Financial, Business Practice, Management, or Cost/Price Determination, <http://www.uspto.gov/go/classification/uspc705/sched705.pdf> (last visited Apr. 8, 2008).

6. See United States Patent and Trademark Office, U.S. Patent Grant and U.S. PreGrant Publication Documents Classified in U.S. Patent Classification 705/36T, http://www.uspto.gov/patft/class705_sub36t.html (last visited Apr. 8, 2008).

7. Complaint at 1, Wealth Transfer Group, LLC v. Rowe, No. 06CV00024, 2006 WL 434187 (D. Conn. Jan. 6, 2006).

8. *Hearing on Issues Relating to the Patenting of Tax Advice*, supra note 2, at 44 (statement of Dennis I. Belcher, Partner, McGuireWoods LLP) (explaining that grantor retained annuity trusts (GRATs) are a "commonly used estate planning technique[,]," the purpose of which "is to allow taxpayers to minimize their federal estate and gift tax liability").

9. See *id.* ("When word of this patent spread through the estate planning community, most estate planning professionals were shocked to learn that an individual could patent a common estate planning technique . . .").

10. See, e.g., *id.* at 38 (statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles) (explaining that

Wealth Transfer Group, LLC v. Rowe would reach a decision on the merits, and so mark the judiciary's first statement on the validity of patents issued for tax strategies, the case settled on March 9, 2007.¹¹ The parties stipulated that the SOGRAT patent was presumed to be valid, and that there were facts from which a trier of fact could conclude that the patent was not invalid.¹² Accordingly, the court declared the SOGRAT patent "adjudged to be valid and enforceable."¹³ Congress has since begun to weigh in on the appropriateness of tax strategy patents. In early September 2007, the House of Representatives passed a patent reform bill that included a ban on tax strategy patents.¹⁴ Additionally, Senators Carl Levin, Norm Coleman, and Barack Obama introduced a tax bill that would also ban patents for tax strategies.¹⁵ In the absence of confirmed congressional or judicial affirmation that tax strategies are not patentable, the proliferation of applications for tax strategy patents is likely to surge in much the same way that applications for business method patents surged in the wake of *State Street Bank*.

Whether tax strategies are and should be patentable requires an analysis of both U.S. patent law and federal tax policy. This Note will evaluate both whether our patent system is capable of accommodating tax strategies and whether granting tax strategy patents is consistent with the goals of tax and patent law. Part II explores the relevant current legal landscape concerning the validity of business method patents, and also explores how many of the traditional filters of patent law can serve to sift out abusive and overly broad tax strategy patents. Part III evaluates whether our patent system is capable of accommodating tax strategies; in

tax advisors whose clients face patent infringement suits may themselves face malpractice claims); Alan S. Lederman, *Tax-Related Patents: A Novel Incentive or an Obvious Mistake?*, 105 J. TAX'N 325, 330-31 (2006) (pointing out that some commentators have cautioned that tax practitioners who negligently fail to "search for, detect, and advise a client about the existence of a patent covering a recommended tax strategy could be liable for state law malpractice").

11. Consent Final Judgment Regarding Settlement Agreement, *Wealth Transfer Group, LLC v. Rowe*, No. 06CV00024, 2006 WL 434187 (D. Conn. Mar. 9, 2007), available at http://tax.aicpa.org/NR/rdonlyres/D62E55BF-474B-4E5C-94A9-AF140F9D5604/0/WTG_ROW_FINALCONSENT_JUDGMENT.pdf.

12. *Id.* at 1.

13. *Id.* at 2. See also Charles F. Wieland III & Richard S. Marshall, *Tax Strategy Patents—Policy and Practical Considerations*, 35 TAX MGMT. COMPENSATION PLAN. J. 123, 125 (2007).

14. Patent Reform Act of 2007, H.R. 1908, 110th Cong. See also Alison Bennett, *Baucus, Grassley, Others Crafting Legislation Solely to Ban Tax Strategy Patents*, *Aides Say*, DAILY TAX REP., Sept. 13, 2007, at GG-1.

15. Stop Tax Haven Abuse Act, S. 681, 110th Cong. § 303 (1st Sess. 2007). See also Press Release, Senator Carl Levin, Levin Cosponsors Bill to Ban Patents on Strategies to Reduce Taxes (Nov. 15, 2007), available at <http://levin.senate.gov/newsroom/release.cfm?id=287634>.

particular, it evaluates whether the utility filter that currently exists in patent law is able to effectively prevent potentially credibly useless tax strategies from being patented. Part III concludes that the utility filter cannot ensure the continuing credible utility of tax strategies that sift through its sieve because changes in the tax law after the patent has been granted can yield once credibly useful tax strategies credibly useless. Part IV evaluates whether granting tax strategy patents is consistent with the goals of patent law, and concludes that it is not given that the government may not need to artificially induce tax practitioners to develop new tax reduction strategies, and even if it does, increased innovation will not provide a net benefit to society. Part V discusses two possible solutions to the problems that stem from the issuance of tax strategy patents: (1) legislation protecting certain individuals against tax strategy patent infringement actions, and (2) legislative action excluding tax strategies from patentability. Part V concludes that because patenting tax strategies will yield a net detriment to society, in part by reducing federal tax revenues, the second solution may be the best remedy to cauterize the problems associated with the issuance of tax strategy patents before they proliferate. This Note concludes that if a remedy is not implemented, the problems that stem from issuing tax strategy patents will become more manifest as the number of patents for tax strategies will likely proliferate.

II. LEGAL LANDSCAPE

A. GETTING TO TAX STRATEGY PATENTS

The foundation of the U.S. patent system rests on Article I of the U.S. Constitution, which gives Congress the power to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”¹⁶ From the beginning, the driving purpose behind patent law has been to liberally encourage innovation.¹⁷ To serve that end, patent law grants patentees the legal right to exclude others from making, using,

16. U.S. CONST. art. I, § 8, cl. 8.

17. *See, e.g.*, *Diamond v. Chakrabarty*, 447 U.S. 303, 308–09 (1980) (explaining that the language of the Patent Act of 1793, which was authored by Thomas Jefferson and defined patentable subject matter as “any new and useful art, machine, manufacture, or composition of matter, or any new or useful improvement [thereof]” was motivated by Jefferson’s philosophy that “ingenuity should receive a liberal encouragement” and that “[s]ubsequent patent statutes in 1836, 1870, and 1874 employed this same broad language”); STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., BACKGROUND AND ISSUES RELATING TO THE PATENTING OF TAX ADVICE (JCX-31-06) 2 (2006) [hereinafter JOINT COMM. REPORT].

offering for sale, or selling the patented invention, and to seek money damages from infringers of the patent.¹⁸ With that in mind, Congress and the courts have tried to define the scope of what constitutes patentable material through a variety of legislative enactments and court decisions. Specifically, the Patent Act of 1952¹⁹ prescribes that inventors can obtain patents on processes, machines, manufactures, and compositions of matter, provided that the inventions are useful,²⁰ novel,²¹ nonobvious,²² and the inventions are properly disclosed.²³ Various courts have further defined the limits of the Patent Act. Notably, in 1980 the U.S. Supreme Court, in *Diamond v. Chakrabarty*, rejected the contention of the Patent Office Board of Appeals that 35 U.S.C. § 101 was not intended to cover living things such as laboratory-created microorganisms.²⁴ Writing for the majority, Chief Justice Burger explained that Congress intended for § 101 to be construed broadly to “include anything under the sun that is made by man.”²⁵ Other Federal Circuit Court decisions have helped further define the scope of the Patent Act,²⁶ and in 1998, the U.S. Court of Appeals for the Federal Circuit held in *State Street Bank* that business methods are not per se unpatentable subject matter. The court held that a computer program that performed tax-related calculations was the proper subject of patentability.²⁷ Cases after *State Street Bank* have further concluded that pure process claims that do not require computer implementation are also patentable.²⁸ *State Street Bank* alerted many people to a relatively unprotected class of patentable inventions, and before long, a stream of tax-

18. See JOINT COMM. REPORT *supra* note 17, at 2.

19. 35 U.S.C. §§ 101–12 (2000).

20. § 101. The section reads in full: “Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.”

21. § 102. The code section details a number of factors that would point to non-novelty. For an in-depth discussion of the “novelty” requirement set forth in 35 U.S.C. § 102, see discussion *infra* Part II.C.2.

22. § 103.

23. § 112. For an in-depth discussion of the disclosure requirement, see discussion *infra* Part II.C.1.

24. *Diamond v. Chakrabarty*, 447 U.S. 303, 306, 309 (1980).

25. *Id.* at 309 (quoting S. REP. NO. 1979-82, at 5 (1952); H.R. REP. NO. 1923-82, at 6 (1952)).

26. See, e.g., *In re Alappat*, 33 F.3d 1526, 1543–45 (Fed. Cir. 1994) (holding that the claimed invention—a rasterizer for creating a waveform—did not constitute 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,” and so could be patented).

27. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1375 (Fed. Cir. 1998), *cert denied*, 525 U.S. 1093 (1999).

28. See, e.g., *AT&T Corp. v. Excel Commc’ns, Inc.*, 172 F.3d 1352, 1353–55 (Fed. Cir. 1999) (explaining that a process to be implemented in a telecommunications system with multiple long-distance service providers constituted patentable subject matter).

strategy-related business method applications began to flow into the USPTO.²⁹ Subsequently, the USPTO created a subcategory of business method patents to house tax strategy patents.³⁰

B. PATENT LAW LANDSCAPE

Since its promulgation in the eighteenth century, U.S. patent law has consistently adapted to accommodate and cover emerging technologies and trends. That patent law has proven so adaptable is a testament to its ability to filter widely varying inventions through four safeguards in order to identify bad inventions. Those four safeguards are the requirement that an invention be useful, that it be novel, that it be nonobvious, and that it follow the disclosure requirements embodied in § 112.

In general, an invention will be considered “useful” as long as it is not “incapable of serving any beneficial end.”³¹ Many commentators have suggested that the “utility” requirement has become almost meaningless in contemporary society.³² An invention is “novel” pursuant to § 102 if it was not “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.”³³ Patent examiners determine if there is prior knowledge of a proposed invention by referencing a library of “prior art.”³⁴ An invention is nonobvious if the subject matter would not 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 Finally, § 112 requires a patent applicant to fully disclose the details of the claimed invention and the “proprietary interest asserted by the inventor.”³⁶

29. See *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 8 (statement of James Toupin, Gen. Counsel, U.S. Patent and Trademark Office); Wieland & Marshall, *supra* note 13, at 124.

30. In 2006, the USPTO added subclass 36T to class 705 in its patent classification system. See United States Patent and Trademark Office, U.S. Patent Grant and U.S. PreGrant Publication Documents Classified in U.S. Patent Classification 705/36T, http://www.uspto.gov/patft/class705_sub36t.html (last visited Apr. 8, 2008).

31. *Juicy Whip, Inc. v. Orange Bang, Inc.*, 185 F.3d 1364, 1366 (Fed. Cir. 1999) (quoting in parenthetical *Fuller v. Berger*, 120 F. 274, 275 (7th Cir. 1903)).

32. See Andrew A. Schwartz, *The Patent Office Meets the Poison Pill: Why Legal Methods Cannot Be Patented*, 20 HARV. J.L. & TECH. 333, 358–59 (2007).

33. 35 U.S.C. § 102(a) (2000).

34. See ROGER E. SCHECHTER & JOHN R. THOMAS, *PRINCIPLES OF PATENT LAW*, § 4.1, at 74 (2004). For an in-depth discussion of prior art, see discussion *infra* Part II.C.2.

35. 35 U.S.C. § 103(a).

36. JOINT COMM. REPORT, *supra* note 17, at 13.

Those four safeguards have enabled patent law to adapt to emerging technologies and trends as inventors have sought patent protection in new subject areas over the years. As patent law has adapted, though, it has generated intense debate with each evolution.³⁷ Debate raged, for example, when the USPTO issued a patent for a man-made life form, and when it began issuing patents for software in the 1990s.³⁸ Through it all, however, patent law has proven adaptable and equipped to deal with inventions in those new subject areas. Indeed, few today would question whether man-made life forms should be patentable. That patent law has proven so repeatedly adaptable, many contend, suggests that it is equipped to deal with tax strategies, just as it has dealt with other new classes of inventions.³⁹

C. APPLYING PATENT FILTERS TO TAX STRATEGIES

The goals of patent law and the goals of tax law are not always symbiotic. After all, the foundational force driving the U.S. patent system is the desire to promote innovation,⁴⁰ and the primary mission of the U.S. tax regime is to efficiently foster compliance with the tax law while raising revenue for the U.S. government.⁴¹ Where patent law and tax law intersect, it may not always be possible to harmonize those goals; promoting the quest for innovative ways to reduce federal tax burdens, for example, may not effectuate increased compliance with the tax law, and may decrease federal income tax revenues. Yet many of the concerns articulated by tax specialists regarding the patentability of tax strategies can be effectively addressed by the traditional filters of the patent system in ways that still promote the goals of our federal tax regime.

In particular, filtering tax strategies through three of the four statutory requirements contained in the 1952 Patent Act should serve to ameliorate many of the concerns expressed by those opposed to patenting tax strategies. Assuming that the patent system works the way that it is intended to work, the issuance of tax strategy patents may not always come into conflict with federal tax policy.

37. See, e.g., *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 60 (statement of Stephen T. Schreiner, Hunton & Williams).

38. See *id.* at 60 (alluding to the patent at issue in *Diamond v. Chakrabarty*, and the various software patents issued by the USPTO during the dotcom boom in the 1990s).

39. See, e.g., *id.*

40. See United States Patent and Trademark Office, *Our Business: An Introduction to the USPTO*, <http://www.uspto.gov/web/menu/intro.html> (last visited Apr. 8, 2008).

41. See Internal Revenue Service, United States Dep't of the Treasury, *The Agency, its Mission and Statutory Authority*, <http://www.irs.gov/irs/article/0,,id=98141,00.html> (last visited Apr. 8, 2008).

1. Concern One: Proliferation of Abusive Tax Avoidance Schemes

One of the primary goals of the U.S. tax regime is to promote widespread (in a perfect system, universal) compliance with the federal tax laws.⁴² If granting tax strategy patents somehow fosters noncompliance with federal tax laws, then granting those patents would be antithetical to the stated goals of U.S. tax policy. Indeed, that has been one of the primary concerns articulated by the IRS in response to recent grants of tax strategy patents. As IRS Commissioner Mark Everson explained in a written statement prepared for a hearing before the Subcommittee of Select Revenue Measures of the U.S. House of Representatives Committee on Ways and Means, “[the] IRS’s principal interest in patented tax strategies is in determining whether promoters are patenting abusive tax avoidance transactions (ATATs).”⁴³ And while many commentators have echoed that concern, an examination of the patents granted for tax strategies since *State Street Bank* suggests that allowing people to patent tax strategies will not encourage noncompliance with federal tax laws, in part because the disclosure requirements set forth in § 112 will serve to discourage abusive strategies.

Indeed, the patents issued for tax strategies in the last few years suggest as much. For example, in 2004, the IRS conducted a search of more than 6.5 million patents housed in the USPTO database in an effort to identify any patents or patent applications related to tax shelter strategies that the IRS had previously identified as “listed transactions.”⁴⁴ A listed transaction, as set forth in IRS Treasury Regulation 1.6011-4(b)(2), is a transaction that is the same as, or substantially similar to, a transaction that the IRS has determined is a tax avoidance transaction.⁴⁵ The search, which Commissioner Everson explained was updated in 2005 and 2006, did not reveal a single patent or patent application that related to any of the listed

42. *Id.* (explaining that Congress passes tax laws and requires taxpayers to comply, and that the IRS’s role is to “help the large majority of compliant taxpayers with the tax law, while ensuring that the minority who are unwilling to comply pay their fair share”).

43. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 13 (statement of Mark Everson, Comm’r, Internal Revenue Service).

44. *Id.*

45. Treas. Reg. § 1.6011-4(b)(2) (as amended in 2006). *See also* Internal Revenue Service, Disclosure Reminder for Participants in Listed Transactions (explaining, before the IRS recently redesigned its website and removed the link, that “[l]isted transactions are those that the IRS has determined to be structured for the significant purpose of tax avoidance or evasion”) (on file with author). For a complete list of IRS listed transactions, see Internal Revenue Service, Listed Abusive Tax Shelters and Transactions, <http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html> (last visited Apr. 8, 2008).

transactions.⁴⁶ In addition, the IRS conducted another search in 2005, which it has updated periodically, to ascertain how many business method patents might involve tax strategies.⁴⁷ Most of the patents that related to tax strategies were patents for software models of computing taxes or potential tax effect, and only fourteen patents and applications specifically involved particular strategies for complying with the Internal Revenue Code.⁴⁸ Of those fourteen patents, none were considered to be ATATs by the IRS.⁴⁹

At the threshold, these statistics suggest that granting patents for tax strategies will not encourage increased noncompliance with the Internal Revenue Code. The disclosure requirements set forth in § 112 apparently provide a safeguard that ensures that only non-ATATs will receive patent protection. In fact, the disclosure requirements seem particularly useful in the tax strategy setting, when viewed in conjunction with the penalty provisions associated with noncompliance with the federal tax laws. First, individuals can only seek patent protection for their invention if they properly disclose the substance of the invention in specific detail such that “any person skilled in the art to which it pertains, or with which it is most nearly connected” could make or use the invention on his or her own.⁵⁰ Second, those who do not comply with the Internal Revenue Code are only punished for their noncompliance if it is discovered by the IRS. Finally, a taxpayer who *willfully* does not comply with the Internal Revenue Code can be subject to criminal prosecution and potential incarceration.⁵¹ Presumably, then, a taxpayer who wants to avoid federal taxes by utilizing a new, novel, and nonobvious—but illegal—tax strategy will not seek patent protection for that strategy because that person will have to disclose that strategy pursuant to § 112. As one attorney pointed out, “[s]omebody who is trying to do something that is not quite kosher might not want that strategy being published for the whole world, including the Internal Revenue Service, to see.”⁵² Moreover, even if individuals are not deterred from patenting an abusive tax avoidance strategy by the threat of civil liability, the threat of criminal liability for willful tax evasion will likely

46. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 13 (statement of Mark Everson, Comm’r, Internal Revenue Service).

47. *Id.*

48. *Id.*

49. *Id.*

50. 35 U.S.C. § 112 (2000).

51. 26 U.S.C. §§ 7201, 7203 (2000) (criminalizing willful evasion of taxes and willful failure to file a return). *See generally* Joshua Stein, *Criminal Liability for Willful Evasion of an Uncertain Tax*, 81 COLUM. L. REV. 1348 (1981).

52. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 22 (testimony of James Toupin, Gen. Counsel, U.S. Patent and Trademark Office).

deter most people from patenting strategies that they know to be illegal.⁵³

A more salient concern, however, manifests itself at the margins, where once nonabusive tax-reduction transactions can morph into ATATs with just a slight modification of the implementation strategy. As IRS Commissioner Mark Everson explained in his testimony to the Subcommittee on Select Revenue Measures of the House Ways and Means Committee, the evolution of abusive tax transactions often follows a similar pattern: first, somebody structures a compliant transaction; next, somebody slightly modifies the transaction to obtain even more tax-reduction benefits; and eventually, somebody modifies the initial strategy a little more and implements a transaction that crosses the line into illegality.⁵⁴ In the tax strategy setting, however, disclosing legal tax strategies in order to receive patent protection may alert the IRS in advance to potential future—and possibly abusive—adaptations of those legal strategies. Indeed, new procedures agreed upon by the IRS and the USPTO should serve to further that end. Recently, for example, the IRS consulted with the USPTO to develop a protocol by which, after a patent examiner determines that a patent application involves a tax strategy, the examiner can require the applicant to reveal the specific Internal Revenue Code regulations and procedures implicated by the applicant's strategy.⁵⁵ In addition, the Treasury Department and the IRS recently promulgated proposed regulations that would amend 26 C.F.R. sections 1 and 301 to create a new category of reportable transactions whereby all taxpayers would be required to disclose any "patented transactions."⁵⁶ A "patented transaction" would include any "transaction for which a taxpayer pays (directly or indirectly) a fee in any amount . . . to use a tax planning method that the taxpayer knows or has reason to know is the subject of the patent," as well as "a transaction for which a taxpayer (the patent holder or the patent holder's agent) has the right to payment for another person's use of a tax planning method that is the subject of the patent."⁵⁷ These steps should not

53. In the absence of criminal liability, for example, individuals who can expect to receive more money from licensing fees for use of their tax strategy than they can expect to pay in civil fines may go ahead and patent the abusive tax strategy and incur the civil fines for noncompliance with the federal tax laws. With the threat of criminal liability looming for implementation of an illegal tax avoidance strategy that individuals know are illegal, however, that those same individuals are less likely to patent the abusive tax avoidance strategy for fear of incarceration.

54. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 18 (testimony of Mark Everson, Comm'r, Internal Revenue Service).

55. *Id.* at 14 (statement of Mark Everson, Comm'r, Internal Revenue Service).

56. REG-129916-07, 2007-43 I.R.B. 891, available at <http://www.irs.gov/pub/irs-irbs/irb07-43.pdf>.

57. *Id.* at 892.

only make it easier for the IRS to track patents of tax strategies, as Commissioner Everson pointed out,⁵⁸ but they should also help the IRS to anticipate potentially abusive deviations from legally implemented tax-saving strategies.

2. Concern Two: Patenting Common Tax Strategies and Impacting Individuals' Abilities to Comply with the Tax Law

Some opponents of tax strategy patents are also worried that people will receive patents for common tax-reduction techniques, and will therefore create a Hobson's choice for other taxpayers: pay a licensing fee and use the tax-saving technique, or do not pay the licensing fee and pay higher taxes.⁵⁹ For example, when word of the SOGRAT patent at issue in the *Wealth Transfer Group* case got out, one attorney noted that "most estate planning professionals were shocked to learn that an individual could patent a common estate planning technique used in connection with a specific asset."⁶⁰ That statement, however, highlights how the novelty filter embodied in 35 U.S.C. § 102 can function in the tax strategy setting, and how it might alleviate the "shock" suffered by some tax practitioners in the wake of a grant of a tax strategy patent like the SOGRAT patent.

First, in order to receive patent protection for a particular invention, the invention must be "novel" pursuant to 35 U.S.C. § 102. Hence, the USPTO references every patent application with an established library of prior art to determine whether or not the invention is novel. While traditional sources of prior art, namely, preexisting U.S. and foreign patents, are largely nonexistent in the tax strategy setting, the novelty filter should still function in the tax strategy setting because the development of alternative means of establishing a sufficiently complete collection of prior art for USPTO examiners to reference is possible.

As the evolution of prior art in the business method patent setting evidences, for example, patent examiners can rely on a variety of new mechanisms to bolster the collection of applicable prior art so that they can effectively prevent overbroad and non-novel business methods from being

58. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 14 (statement of Mark Everson, Comm'r, Internal Revenue Service).

59. *Id.* at 46 (statement of Dennis I. Belcher, Partner, McGuireWoods LLP). *See also* Paul Devinsky, John R. Fuisz & Thomas D. Sykes, *To Practice Tax Law, You Need a Patent License*, IP LAW 360, Sept. 11, 2006, available at <http://www.iplaw360.com/Members/ViewArticlePortion.aspx?Id=9940&ReturnUrl=%2fsecure%2fViewArticle.aspx%3fId%3d9940>.

60. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 44 (statement of Dennis I. Belcher, Partner, McGuireWoods LLP).

patented.⁶¹ In response to concerns about an underdeveloped collection of prior art in the business method setting, the USPTO implemented Rule 105 in 2000, which gives patent examiners the explicit authority to ask patent applicants for information that may be “reasonably necessary to properly examine” whether the invention conforms to the requirements set forth by the Patent Act.⁶² Importantly, pursuant to Rule 105, examiners can ask applicants to provide a submission detailing the existence of any commercial databases known to the applicants that could be searched for a particular aspect of the invention.⁶³ In addition, 37 C.F.R. section 1.99(a) permits third-party members of the public to submit patents or publications that may be relevant to a pending or published patent application.⁶⁴ The USPTO also recently established “Electronic Information Centers,” which provide examiners with access to over 900 commercial databases housing nonpatent literature to aid in the examination process.⁶⁵ Finally, the American Inventors Protection Act, enacted in 1999, provides a bulletproof defense for people who had been practicing a newly patented business method prior to the grant of the patent: people who can show that they were using the same business method more than a year before the person holding the patent filed a patent application will be deemed not to have infringed the patent.⁶⁶ Because the USPTO currently classifies tax strategy patents as a subset of business method patents, the same protections should serve to bolster the amount of prior art available to examiners investigating tax strategy patent applications. Moreover, that a fully formed library of prior art is not currently available to examiners investigating tax strategy patents is not a reason to entirely condemn the issuance of tax strategy patents. As illustrated above, many of the mechanisms implemented to bolster the library of prior art in the business method setting were enacted to ameliorate the deficient then-existing collection of prior art available to examiners. In the wake of those new implementations, the USPTO review

61. See Wynn W. Coggins, United States Patent and Trademark Office, *When is an Electronic Document a Printed Publication for Prior Art Purposes?* (Fall 2002), <http://www.uspto.gov/web/menu/pbmethod/aiplafall02paper.htm>.

62. 37 C.F.R. § 1.105 (2007). See also *Business Methods Hearing*, *supra* note 3, at 12–13 (statement of Nicholas P. Godici, Acting Under Sec’y of Commerce for Intellectual Property and Acting Dir. of the U.S. Patent and Trademark Office).

63. 37 C.F.R. § 1.105(a)(1)(i) (2007).

64. § 1.99(a).

65. See *Business Methods Hearing*, *supra* note 3, at 12 (statement of Nicholas P. Godici, Acting Under Sec’y of Commerce for Intellectual Property and Acting Dir. of the U.S. Patent and Trademark Office); Coggins, *supra* note 61.

66. 35 U.S.C. § 273 (2000). See also Deborah L. Jacobs, *Patent Pending: As Estate Planning Heats Up, It May Not Be Enough to Invent a Brilliant Tax-Saving Technique for Your Clients. You May Need to Patent It, Too*, BLOOMBERG WEALTH MANAGER, May 2005, at 48.

process for business method patents has greatly improved.⁶⁷ Moreover, the goals of those implementations are transferable to the tax strategy setting, and already, the tax community has evidenced its willingness to reach out to the USPTO in order to expand the collection of prior art available to tax strategy patent examiners.⁶⁸

Some of the concerns expressed by tax practitioners over the SOGRAT patent, thus, seem largely misplaced. Indeed, the SOGRAT patent will not “restrict the availability of commonly used estate planning techniques, such as [grantor-retained annuity trusts (“GRATs”)],”⁶⁹ provided that the use of nonqualified stock options to fund a GRAT was innovative and the novelty filter worked as intended.⁷⁰ Rather, it will only restrict the use of nonqualified stock options to fund a GRAT. Attorneys in the estate planning community are still free to fund a GRAT with all of the methods that they used in the past without fear of infringing on the SOGRAT patent. Moreover, if any of those practitioners had used a nonqualified stock option to fund a grantor-retained annuity trust at least one year prior to Wealth Transfer’s filing of its SOGRAT patent, those

67. See, e.g., *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 39 (statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles).

68. See *id.* at 13 (statement of Mark Everson, Comm’r, Internal Revenue Service); Lederman, *supra* note 10, at 333 (Mr. Lederman notes, however, that because “many tax-related techniques are presented to clients through privileged . . . communications, comprehensive prior art searches of tax-related techniques often will be incomplete”); Dustin Stamper, *USPTO Official Critical of Bill to Prevent Patents on Tax Strategies*, Tax Notes Today, May 14, 2007, Lexis, 2007 TNT 94-1 (pointing out that the USPTO has partnered with the IRS to “learn about financial products, wealth transfer, and pension funds”); Stephen Joyce, *Patent Office Petitioning to Hire Examiners With Expertise in Tax to Review Applications*, 93 BNA Daily Tax Report G-9 (May 15, 2007), available at http://www.abanet.org/tax/patents/articles/070515_patentoffice.pdf (pointing out that the USPTO, in May, requested that the Office of Personnel Management change hiring requirements for patent examiners and hire an additional forty examiners specializing in tax, finance, and insurance). *But see* Ellen P. Aprill, *Responding to Tax Strategy Patents*, Proceedings of the Fifty-Ninth Tax Institute, Gould School of Law, USC, 2007, at 13–14, available at <http://ssrn.com/abstract=980347> (asserting that there are some unique barriers to establishing a comprehensive library of prior art in the tax-strategy arena, including constraints stemming from the fact that tax return information is confidential).

Some commentators have also suggested that the USPTO could improve the quality of tax strategy patents by seeking IRS assistance in understanding the patented strategies. This would require statutory authorization; authorization similar to 35 U.S.C. § 164, which permits the Secretary of Agriculture, under certain circumstances, to furnish information to USPTO employees to help them evaluate plant patents. See *id.* at 40.

69. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 44 (statement of Dennis I. Belcher, Partner, McGuireWoods LLP).

70. Wieland & Marshall, *supra* note 13, at 127 (noting that “valid patents issue only when the claimed invention is both novel and nonobvious . . . at the time of the invention,” and therefore, “[v]alid patents . . . should . . . only have the potential to restrict access to . . . those tax strategies that would not have been obvious to the ordinary tax practitioner”) (emphasis in original).

practitioners will have a bulletproof defense against infringement under the American Inventors Protection Act.⁷¹

III. PATENT LAW IS NOT ALWAYS ADAPTABLE TO THE TAX STRATEGY SETTING

As explained above, most of the traditional filters of patent law should serve to filter out abusive tax strategies in the same fashion that they serve to filter out overbroad business methods or other inventions that should not receive patent protection. Moreover, the traditional filters of patent law should also provide that no individual is precluded from utilizing a common and previously utilized tax reduction technique if a particular tax strategy is granted a patent. But not all of the protections in place in the patent system are transferable to the tax strategy setting.

In particular, 35 U.S.C. § 101 requires that the applicant's invention be "useful."⁷² Over the years, the bar denoting what minimally constitutes utility has been consistently lowered. Indeed, some legal commentators have proclaimed that the requirement that an invention be "useful" has become essentially meaningless in today's world.⁷³ Courts, moreover, have repeatedly affirmed the appropriateness of that continually sinking bar. In 1999, for example, the U.S. Court of Appeals for the Federal Circuit bluntly proclaimed in its decision in *Juicy Whip, Inc. v. Orange Bang, Inc.* that "[t]he threshold of utility is not high: An invention is 'useful' under section 101 if it is capable of providing some identifiable benefit."⁷⁴

At the outset, it is important to note that the utility requirement embodied in § 101 is fractured, and the USPTO has rejected—and courts have affirmed the rejections of—various patent applications on the ground that the proposed inventions failed to meet a particular strain of utility. For example, the USPTO and some courts have keyed in on the notion of "specific utility." A determination that an invention lacks specific utility is tantamount to a determination that the claimed invention essentially does not do what it purports to do, or the inventor has not sufficiently articulated

71. *But see id.* at 137 (pointing out that the defense is relatively restricted in the tax strategy context because, among other things, "[t]he person asserting the defense has the burden of establishing it by 'clear and convincing evidence,'" and that "[m]eeting such a burden can be difficult in the tax strategy area insofar as much of the evidence likely would be covered by attorney-client privilege or other confidences"); Aprill, *supra* note 68, at 18–19 (noting that the applicability of the defense is as of yet unproven in the tax strategy setting).

72. 35 U.S.C. § 101 (2000).

73. See Schwartz, *supra* note 32, at 358–59; John R. Thomas, *The Post-Industrial Patent System*, 10 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 3, 4 (1999).

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

a specific use for the proposed invention pursuant to § 112.⁷⁵ Because the bar of what constitutes specific utility is so low, very few inventions will fail to satisfy the § 101 utility requirement on the ground that they are not specifically useful.⁷⁶

Similarly, prior to the *Juicy Whip* decision, patent examiners had historically rejected some patent applications on the ground that they offended societal norms, and so failed the “moral utility” requirement.⁷⁷ Pursuant to the moral utility doctrine, a patent examiner could reject an invention on the grounds that it promoted an immoral end or was against public policy.⁷⁸ In 1999, however, the court in *Juicy Whip* essentially eviscerated the moral utility doctrine, holding that the requirement of utility under § 101 is not a directive to the USPTO to “serve as [the] arbiters of deceptive trade practices.”⁷⁹ The court pointed out that it was the province of the states to promote the health and general welfare of the community, and that the patent laws were not meant to displace those police powers.⁸⁰ Contemporarily, the Manual of Patent Examining Procedures (“MPEP”) echoes this understanding,⁸¹ and an invention that is capable of affecting some identifiable benefit, but is morally offensive and subjectively useless should survive the § 101 filter during the patent examination process.⁸² As

75. See *In re Fisher*, 421 F.3d 1365, 1371–75 (Fed. Cir. 2005) (affirming a USPTO determination that an invention related to five purified nucleic acid sequences was not useful because the inventor disclosed only general uses for its claimed ESTs, and not specific ones sufficient to satisfy the § 101 requirement of utility).

76. *But see id.* at 1374 (holding that the applicant’s proposed uses were not sufficiently specific). Note, however, that in *Fisher*, the court also found that the invention at issue failed to meet the “substantial” or general utility bar, noting that the inventor only proposed that his invention would effectuate hypothetical results. *Id.* at 1373.

77. See, e.g., *Brewer v. Lichtenstein*, 278 F. 512, 513 (7th Cir. 1922) (invalidating a patent for a gambling device on the grounds that it was contrary to public policy).

78. See SCHECHTER & THOMAS, *supra* note 34, § 3.4. For examples of other instances when the USPTO rejected inventions as not useful because they promoted an immoral end, see Schwartz, *supra* note 32, at 360 (pointing out that “deadly weapons, gambling machines, and inventions useful for committing fraud were found not ‘useful’ in the past because they facilitated illegal activities and failed to provide a morally acceptable benefit to society”).

79. *Juicy Whip*, 185 F.3d at 1368.

80. *Id.* (citing *Webber v. Virginia*, 103 U.S. 344, 347–48 (1880)).

81. United States Patent and Trademark Office, Manual of Patent Examining Procedures § 706.03(a)(II) (2006) [hereinafter MPEP] (“A rejection under 35 U.S.C. § 101 for lack of utility should not be based on grounds that the invention is frivolous, fraudulent or against public policy.”) (emphasis in original).

82. Note, however, that the USPTO has still expressed an unwillingness to grant patents for inventions relating to “human/non-human chimera” on the grounds that such an invention fails to meet the morality aspects of the utility requirement. See Media Advisory, U.S. Patent and Trademark Office, Facts on Patenting Life Forms Having a Relationship to Humans (Apr. 1, 1998), <http://www.uspto.gov/web/offices/com/speeches/98-06.htm>.

Andrew Schwartz explains, the “courts, commentators, and the Patent Office itself have come to recognize the limited role that patent law plays in the overall legal and regulatory apparatus.”⁸³ Patent examiners do not inquire into an invention’s legality when determining its utility; that task is left to other federal regulatory bodies.⁸⁴

Finally, patent examiners can reject a patent application on the ground that the proposed invention lacks “credible utility”; that is, it is entirely incapable of effecting its stated purpose.⁸⁵ Thus, even though USPTO guidelines suggest that a patent examiner should almost unquestioningly accept an applicant’s assertion of utility,⁸⁶ an invention that proposes the impossible cannot achieve patent protection because it is not credibly useful. In *Newman v. Quigg*, for example, a patent examiner rejected a patent application proposing to patent a “perpetual motion machine,” because the claimed invention could not affect its stated purpose given that to do so would violate the second law of thermodynamics.⁸⁷ The U.S. Court of Appeals for the Federal Circuit upheld the decision of the USPTO examiner to reject the invention as unpatentable under § 101 on the ground that the proposed invention lacked utility.⁸⁸

Even though the specific utility bar is set extraordinarily low, the moral utility doctrine has essentially been eviscerated, and an invention will only lack credible utility if its proposed effect is impossible to effectuate, the requirement that an invention be useful pursuant to § 101 still stands as a formal gatekeeper in the patent examination process. Indeed, Congress has not repealed § 101 as a requirement for patentability, and it still requires that an invention, at a minimum, be credibly useful. Patent examiners, thus, must still make some assessment of an invention’s utility before approving the invention for patent protection.

83. Schwartz, *supra* note 32, at 362.

84. See SCHECHTER & THOMAS, *supra* note 34, § 3.4.

85. See Zachary Lerner, *Rethinking What Agriculture Could Use: A Proposed Heightened Utility Standard for Genetically Modified Food Patents*, 55 U. KAN. L. REV. 991, 1012 (2007) (citing ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 152 (4th ed. 2006)).

86. See MPEP, *supra* note 81, at § 2107.01 (2006).

87. *Newman v. Quigg*, 877 F.2d 1575, 1577–78 (Fed. Cir. 1989). See also *Ex Parte Heicklen*, 16 U.S.P.Q.2d (BNA) 1463, 1464 (B.P.A.I. 1990) (disallowing a patent for a method that allegedly slowed the human aging process).

88. *Newman*, 877 F.2d at 1581.

A. REFUSING TO PATENT TAX STRATEGIES ON THE GROUND THAT THEY ARE ILLEGAL IS IMPROBABLE

Many commentators have suggested that it should be against public policy for a private individual to patent a tax strategy because to do so is an affront to fundamental notions of fairness in a society where “[a]ny one may so arrange his affairs that his taxes shall be as low as possible.”⁸⁹ Note, however, that this contention cannot be translated into an objection that tax strategy patents categorically fail the utility requirement on the ground that they contravene a moral sense of fairness. After all, the rejection of the moral utility doctrine by the court in *Juicy Whip* was tantamount to a determination that an assessment of utility cannot depend solely on positive law principles, which are definitionally value laden. As a society, we outlaw gambling, speeding, and cock fights, in large part because we have determined that their value is outweighed by their detriment. And yet, after *Juicy Whip*, we still grant patents for devices that facilitate those illegal activities⁹⁰ because, as Schwartz points out, the courts have determined that “positive law is to be ignored when determining whether something is ‘useful’ within the meaning of § 101.”⁹¹ Even under the most scrutinizing interpretation of what contemporarily constitutes utility, the inquiry is result driven; if a *result* is effectuated, the invention is useful, regardless of how morally offensive or illegal the result may be.⁹²

Given that understanding, it seems unlikely that any proposed tax strategy could—or should—be denied patent protection on the ground that it is morally offensive or illegal. After *Juicy Whip*, a given tax strategy that effectuates a tangible way to lower an individual’s or an entity’s tax burden, albeit illegal and perhaps morally offensive, should not be rejected by a patent examiner on the ground that it is useless. For purposes of a utility analysis, it is irrelevant whether the strategy effectuates a good and

89. *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934).

90. *See, e.g.*, U.S. Patent No. 7,023,374 (filed Oct. 6, 2002) (issued Apr. 4, 2006) (a type of radar detector); U.S. Patent No. 6,928,960 (filed Mar. 5, 2003) (issued Aug. 16, 2005) (a device for use in cock fights); U.S. Patent No. 6,540,609 (filed Feb. 22, 1999) (issued Apr. 1, 2003) (a device to be utilized in slot machines).

91. Schwartz, *supra* note 32, at 367.

92. *See* discussion *supra* note 82 (the USPTO has stated that an invention relating to a “human/non-human chimera” may fail to satisfy the utility requirement because it is immoral). Some commentators, however, have suggested that the courts will disagree. *See* Margo A. Bagley, *Patent First, Ask Questions Later: Morality and Biotechnology in Patent Law*, 45 WM. & MARY L. REV. 469, 492 (2003).

legal—as opposed to a bad and illegal, or even a good and illegal—result. The important point is that *if* the particular tax strategy will manifest *any* result—good, bad, legal, or illegal—when it is implemented, it should survive the § 101 moral utility filter, just like other devices that facilitate illegal activities, but still effectuate a tangible result.

Whether tax strategies satisfy the credible utility requirement, however, is less clear.

B. UNLIKE OTHER PATENTABLE INVENTIONS, TAX STRATEGIES CAN BECOME CREDIBLY USELESS

Although patent examiners cannot reject a patent application on the ground that the proposed invention lacks moral utility, they can reject a patent application on the ground that the proposed invention lacks credible utility. An invention will lack credible utility if it is entirely incapable of affecting its stated purpose. Again, in *Newman v. Quigg*, a patent examiner rejected a patent application proposing to patent a “perpetual motion machine,” because the claimed invention could not affect its stated purpose given that to do so would violate the second law of thermodynamics.⁹³ The U.S. Court of Appeals for the Federal Circuit upheld the decision of the USPTO examiner to reject the invention as unpatentable on the ground that the proposed invention lacked utility.⁹⁴

Notice, however, that a determination of whether a particular invention can achieve the result it claims is subject to reconsideration as new understandings about natural laws emerge and scientific capabilities expand. Thus, for example, treating baldness was once considered an impossible undertaking, and multiple courts affirmed the USPTO’s rejection of patents purporting to regenerate hair on the ground that the inventions lacked credible utility.⁹⁵ As the science of hair regeneration evolved, however, and treatments for baldness gained increasing acceptance, the USPTO and the courts reconsidered those early determinations and found that certain treatments for baldness were credibly

93. *Newman*, 877 F.2d at 1577–78. See also *Ex Parte* Heicklen, 16 U.S.P.Q.2d (BNA) 1463 (B.P.A.I. 1990) (disallowing a patent for a method that purportedly slowed the human aging process).

94. *Newman*, 877 F.2d at 1581.

95. See *In re* Ferens, 417 F.2d 1072, 1074–75 (C.C.P.A. 1969) (holding that a hair growth potion was not credibly useful and so could not be patented because the utility of the claimed invention was based on allegations which “border[ed] on the incredible in light of contemporary knowledge”); *In re* Oberweger, 115 F.2d 826, 829 (C.C.P.A. 1940) (affirming USPTO decision refusing to patent a hair growth stimulant on the grounds that it lacked credible utility).

useful and so could be patented.⁹⁶

It is important to note, however, that that transformation from credibly useless—and so unpatentable—to credibly useful—and so patentable—appears to be unidirectional. Whereas a particular result may be impossible given contemporary understandings of natural law, but may become possible as new scientific discoveries force us to reconceptualize the bounds of possibility, a particular result cannot go from being naturally possible to being naturally impossible, provided that we assume that the natural world does not itself change, but only our *understanding* of how that natural world works.

Extrapolating from the baldness example discussed earlier, hair regrowth from topical applicants was considered naturally impossible in the then-contemporary world as we knew it.⁹⁷ As science evolved, and our understanding of preexisting chemical compounds became more sophisticated, however, hair regrowth spurred by topical applicants suddenly became possible.⁹⁸ This transformation makes sense, given that we went from a subjective evaluation that a particular result (artificially stimulated hair growth) was impossible, to an objective determination that the result was indeed possible as scientific advancements illuminated a broader realm of objective possibility. By contrast, it is more difficult to imagine moving from an objective determination that a particular result is possible to a subsequent determination that the result is, in fact, objectively impossible. Something that is affirmatively and objectively possible at time one generally cannot become objectively impossible at time two. A baldness cream that regenerated hair in the 1990s and was therefore credibly useful, for example, could not later become credibly useless unless the world—and the ways in which particular chemicals naturally react—itsself changed.⁹⁹

96. *In re Cortright*, 165 F.3d 1353, 1356–57 (Fed. Cir. 1999) (recognizing that Rogaine® and Propecia® are recognized as effective in treating baldness). *See also* U.S. Patent No. 5,777,134 (filed Oct. 24, 1996) (issued July 7, 1998); U.S. Patent No. 5,767,152 (filed May 4, 1995) (issued June 16, 1998); U.S. Patent No. 4,139,619 (filed Aug. 19, 1977) (issued Feb. 13, 1979) (all dealing with hair regrowth and treatments for baldness).

Notice, however, that after hair regrowth becomes objectively possible, a proposed hair regrowth tonic that actually *does not* regrow hair will not pass through the patent filters, although it likely will clear the *credible* utility bar. The inventor would likely not be able to satisfy the § 112 disclosure requirements, for example, and the invention may not clear the specific utility hurdle if that is the case.

97. *See Ferens*, 417 F.2d at 1074–75; *Oberweger*, 115 F.2d at 829.

98. *Cortright*, 165 F.3d at 1356–57.

99. *See discussion supra* note 96 (it is important to note that even if a proposed hair regrowth tonic actually *does not* regrow hair, but it has been determined that hair regrowth is objectively possible, the functionally useless hair regrowth tonic will likely clear the *credible* utility hurdle,

That unidirectionalism is perhaps a good explanation for why the utility bar, as a whole, has been consistently lowered over the years. As scientific knowledge constantly evolves, the realm of objective possibility presumably expands, and the realm of subjective impossibility correspondingly contracts. Patent examiners can be certain that a finding that a particular invention is useful because it effectuates a tangible result will mean that that invention will never become useless, at least as defined by § 101. Put another way, a patent examiner who determines that an invention is credibly useful can safely assume that he or she made the correct decision, given that the invention should never fail to produce a tangible result, even if that result later becomes illegal.

That assurance, however, does not exist in the tax strategy setting, where a particular patented tax strategy that was once credibly useful could subsequently fail a post-patent-grant utility analysis if the tax law changes. First, note that our tax law is an entirely artificial implementation of our government. Because our tax system is a purely artificial implementation of our government, moreover, tax strategists can detail particular ways to reduce taxes within that artificially implemented system without effectuating a nontax result. Certain planning strategies available to tax professionals, for example, effectuate a particular *tax* result without producing a tangible non-tax-related result.

For example, under certain circumstances, when there is a taxable corporate acquisition that is officially characterized as a stock purchase, the parties to the acquisition can mutually make a § 338(h)(10) election, and they will be *deemed*, for tax purposes, to have engaged in an asset purchase.¹⁰⁰ It is important to note, however, that for all other real world purposes (like allocation of liabilities) the acquisition is still characterized as a stock purchase; the characterization as an asset purchase is a tax driven fiction that does not effectuate any result outside of the tax arena.

Take another example: Just a few years ago, Congress agreed to temporarily repeal the U.S. estate tax. As it currently stands, estate and generation skipping taxes will be repealed in 2010 and reinstated in 2011.¹⁰¹ Presently—prior to the scheduled repeal—tax planners employ a multitude of tax strategies designed to exploit loopholes in the estate tax law. When the repeal goes into effect in 2010, however, those once-useful

although it will not pass through the other patent filters).

100. 26 U.S.C. § 338(h)(10) (2000).

101. See, e.g., Jonathan Weisman, *House Passes Permanent Estate Tax Repeal*, WASH. POST, Apr. 14, 2005, at A4.

estate planning techniques will not only be practically useless to the implementer, but the implementation of those techniques will not manifest *any* tangible result in the absence of the law that provided the once-exploitable loopholes.¹⁰² Like the § 338(h)(10) election, thus, many contemporarily employed estate planning techniques foster *purely* tax-related results and do not manifest any other tangible real world results.

A particular tax strategy that seeks to exploit a tax-driven fiction without effecting any other tangible real world result, thus, can be credibly useful at a time when the Internal Revenue Code exists in a form that can be exploited in a particular manner, but can then become credibly useless if the Internal Revenue Code changes and can no longer serve as a conduit for the exploited result. Notice that this is different from saying that an invention becomes useless because a change in the Internal Revenue Code makes a once-legal tax-saving strategy illegal.¹⁰³ After all, a tax strategy that is not morally useful, but is still credibly useful because it effects a tangible *result* will still clear the § 101 utility bar. By contrast, theoretical problems crop up if a particular tax strategy that at one time produced a tax result, but no other nontax result, suddenly fails to produce *any* tax result because the portion of the Internal Revenue Code that created the availability to exploit the tax fiction is altered. Indeed, the presumably impossible happens: a once credibly useful invention becomes credibly useless because it does not produce a tangible *result*.

If that is a theoretical possibility, then one of the justifications for having such a low bar for what constitutes utility suddenly seems less salient. After all, a patent examiner who determines that an invention is credibly useful can no longer safely assume that he or she made the correct decision in the tax strategy setting, given that particular changes to the Internal Revenue Code can transform a once-credibly useful invention into a credibly useless one that does not produce a tangible result. Moreover, whereas it is generally safe to assume no inventions will be incapable of producing a tangible result after they are patented, that maxim deteriorates when applied to tax strategies. It is easy to imagine, for example, a number of credibly useless, but patented, tax strategies languishing in a future where patents for tax strategies are permissible and the Internal Revenue

102. That the implementers of those once-useful tax-saving techniques may be economically happier when the estate tax is entirely repealed than when they were able to implement the tax-reduction strategies is irrelevant. The important point is that the strategies themselves will be credibly useless after the repeal.

103. See, e.g., discussion *supra* Part III.A (stating that a particular tax strategy that effects an illegal result is not in itself sufficient grounds for determining that it is useless pursuant to § 101).

Code has undergone particular changes.

C. OTHER BUSINESS METHODS DO NOT SUFFER FROM THE SAME
PROBLEM

The problems that arise in assessing the utility of tax strategies under the current patent regime, discussed *supra* Part III.B, do not similarly exist in the area of other business method patents. A determination that tax strategy patents should be excluded from patent protection, thus, does not mean that business methods as a class should be deemed unpatentable as some commentators have suggested.¹⁰⁴

Although the continuing credible utility of certain tax strategies can never be confidently ascertained, patent examiners can be certain that almost all other business methods that they determine are credibly useful will continue to remain so throughout the life of the patent. As Schwartz points out, for instance, many business method patents improve economic efficiency by reducing transaction costs and saving time, and many others “are practical applications of algorithms or pure mathematics.”¹⁰⁵ Even if a proposed business method did not improve economic efficiency, moreover, the implementation of that method would still produce a tangible *result* regardless of the legal structure of the community in which it was implemented. While the substance of the result may depend upon the laws of the community in which the business method is enacted, a patent examiner can be confident that a result will ensue irrespective of positive law restraints and changes, given that natural market forces will elicit a result when any operating method is enacted.

For example, look at the patented invention in *State Street Bank*. The patented “Hub and Spoke®” data processing system purports to facilitate a structure in which mutual funds pool their assets in an investment portfolio

104. See, e.g., Posting of Andrew Oh-Willeke to Wash Park Prophet, <http://washparkprophet.blogspot.com/2006/07/tax-shelter-patents.html> (July 21, 2006, 07:54 EST) (commenting on the *Wealth Transfer Group* case and stating that “the baby really should be thrown out the [sic] with the bathwater, by simply ending business method patents entirely”). Cf. *Lab. Corp. of Am. Holdings v. Metabolite Labs., Inc.*, 126 S. Ct. 2921, 2928–29 (2006) (questioning the propriety, or at least the current scope, of business method patents) (Breyer, J., dissenting).

Note, moreover, that other countries do not recognize business methods as patentable subject matter. See, e.g., European Patent Convention, Art. 52(2)(c), (3) (2007), available at <http://www.epo.org/patents/law/legal-texts/html/epc/1973/e/ar52.html>; Craig Groeschel, *Tax Strategy Patents Considered Harmful*, 8 HOUSTON BUS. & TAX L.J. (forthcoming 2008), available at http://www.hbtlj.org/content/HBTLJ_Symposium2007_E-Binder.pdf.

105. Schwartz, *supra* note 32, at 372.

organized as a partnership.¹⁰⁶ As the abstract in the patent application details, the data processing system “determines the percentage share . . . that each fund has in the portfolio,” and “calculates each fund’s total investments based on the concept of a book capital account.”¹⁰⁷ The patented data processing system will always produce a tangible result given that the patented process applies principles of pure mathematics and is designed to effect economic efficiency in some manner. Whether a business actually experiences a net gain or a net loss by implementing the “Hub and Spoke®” system is irrelevant; the patent examiner examining the *State Street Bank* patent can be sure that the process will always produce a tangible result.

In short, a patent examiner who examines a pure business method invention can be certain that the credible utility of the invention will persist throughout the life of the patent because the implementation of that method would produce a tangible *result* regardless of the legal structure of the community in which it is implemented.

D. CONCLUSION

Hence, an initial look at the issue of patenting tax strategies suggests that our patent system should be able to accommodate tax strategies because many of the traditional filters of patent law should serve to prevent potentially improper tax strategies from achieving patent protection. A closer look, however, reveals that our patent system most likely is incapable of accommodating tax strategies because patent examiners cannot legally employ one of the filters that is designed to sift out bad inventions.

Namely, because the continuing credible utility of some tax strategies can never be confidently ascertained, it does not make sense to run them through the existing utility filter. And if one of the filters designed to prevent improper patents from achieving patentability seems less useful in the tax strategy setting, then perhaps tax strategies should not be patentable processes.

The point, of course, is unpersuasive absent other, more tangible, evidence that tax strategies should not be patented. Indeed, the potential to transform from credibly useful to credibly useless, albeit atypical in the patent context, is likely not alone enough to condemn tax strategies to

106. Data Processing Sys. for Hub and Spoke Fin. Servs. Configuration, U.S. Patent No. 5,193,056 (filed Mar. 11, 1991).

107. *Id.*

unpatentable status. The point, however, is still important in that it highlights that tax strategies are different from other patentable processes given that the utility filter cannot ensure the continuing credible utility of tax strategies that sift through its sieve. And when we couple that atypicality with the strong policy concerns¹⁰⁸ cutting against allowing patents for tax strategies, suddenly those atypical concerns seem less ephemeral.

IV. GRANTING TAX STRATEGY PATENTS IS NOT CONSISTENT WITH THE OVERARCHING GOALS OF PATENT LAW

As discussed *supra* Part III.B, one reason to disallow patent protection for tax strategies is that one of the traditional filters of patent law cannot serve to ensure the continuing credible utility of tax strategies that pass through its sieve. Perhaps an even more persuasive reason to deny patent protection for tax strategies, however, is that granting patents for tax strategies, as a class, is antithetical to the policy that has driven patent law and fostered its adaptability since its inception in the eighteenth century.

From the beginning, the purpose of patent law has been to encourage innovation.¹⁰⁹ Consistent with that purpose, patent law has been driven by two understandings: (1) in many subject areas, the government needs to offer an artificial inducement to innovate because without such an inducement, people will not invent, and (2) increasing innovation in those subject areas will ultimately benefit society.¹¹⁰ Notice that granting a patent for an illegal product can still be consistent with the second understanding. After all, while encouraging innovation in a particular subject area may yield *some* socially detrimental inventions, it will also likely yield a net social benefit because it will encourage the proliferation of many more legal and socially beneficial inventions. If encouraging innovation in a particular subject area, however, will always yield a net social detriment, then the argument can be made that the entire subject area should not receive patent protection.

Initially, one must understand that the U.S. patent system operates as an exception to our free-market society that promotes societal well-being by discouraging monopolies and fostering vigorous competition among businesses. Patent law is driven in part by the understanding that the government must sometimes artificially induce innovation because market

108. See discussion *infra* Part IV.

109. SCHECHTER & THOMAS, *supra* note 34, § 1.3.1.

110. See *id.*

forces will not yield an optimal level of innovation.¹¹¹ Allowing individuals to obtain a proprietary interest in their inventions, proponents of our patent system maintain, incentivizes innovation by granting an exclusionary right, which helps eliminate free rider problems.¹¹² Conversely, in the absence of the ability to exclude others from cheaply imitating an individual's invention, inventors will be discouraged from inventing, and society will be worse off because too few inventions will materialize.¹¹³ A person who holds a patent, thus, can either wholly exclude others from using a particular product or utilizing a particular method of doing business, or can allow others to use that product or method if they pay a specified fee. That exclusionary right acts as an artificial inducement for individuals to invest in invention. And while that artificial inducement operates as an exception to our free-market society, it is worthwhile to note that numerous government policies seek to artificially encourage investment in knowledge that would not otherwise occur in the absence of those government-mandated incentives.¹¹⁴

Beyond just offering an inducement to invent from scratch, our patent system also incentivizes constant improvement of already-patented products. For example, it promotes constant refinement of already-patented products, given that issued patents may “point the way for others to develop improvements” and encourages people to “invent around” patented technology.¹¹⁵ Hence, our patent system exists in part to artificially induce innovation—both novel and adaptive—where the incentives to innovate might not otherwise be present.

Patent law does not, however, just serve to spark innovation for innovation's sake; it serves to spark innovation in order to effectuate a net social benefit. From a utilitarian perspective, patent law serves to promote net social well-being by encouraging innovation at the cost of creating a monopoly that can be licensed out to others for a fee. Logically, patent law

111. *See id.*

112. *Id.* *See also* Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1031 (2005).

113. Rebecca S. Eisenberg, *Patents and the Progress of Science: Exclusive Rights and Experimental Use*, 56 U. CHI. L. REV. 1017, 1024–27 (1989) (explaining the “incentive to invent” theory).

114. *See* JOINT COMM. REPORT, *supra* note 17, at 17 (pointing out that policies like “public provision of elementary and secondary education, public libraries, public support of State universities, public support of basic research at universities through direct grants, and public support of private research through the research and experimentation tax credit” are all artificial implements designed to “offset the underinvestment in knowledge that would otherwise occur if the full costs of such investments were borne by individuals”).

115. SCHECHTER & THOMAS, *supra* note 34, § 1.3.1.

will only serve its desired end if the benefit to society that results from increased innovation exceeds the costs to society of granting the monopoly.¹¹⁶ Take an ideal example: A talented chemist might be discouraged from spending long hours in the lab developing a cure for prostate cancer in the absence of a patent system because the development costs might be very high and the end product would likely be easily duplicable. Absent overwhelming altruistic motives, the chemist will not invent, and society will not benefit from a cancer-curing drug. If that chemist knows in advance that she will reap the profits from her invention, however, she is more likely to spend those long hours developing the drug. In a patent law system, then, the chemist will invent, and society will benefit because it has a new cancer-curing drug. Even if the chemist will only license the drug at a high price, the net benefit to society will likely outweigh the costs associated with the grant of the monopoly. The important point is that the innovation that patent law attempts to artificially induce is supposed to provide a net societal benefit.

In the tax arena, the government likely does not *need* to increase innovation, and even if it does, tax strategies likely still fall outside the scope of patentable subject matter because increased innovation in the subject matter area would not yield a net social benefit.

A. WE MAY NOT NEED TO INCREASE INNOVATION IN THE TAX ARENA

As discussed earlier, one of the primary rationales in support of the patent system is that it promotes innovation with the prospect of a licensable monopoly when the incentives for innovation would not otherwise be present. Hence, in the example of the chemist above, patent law gives her an incentive to research and create a cancer-curing drug when she might not otherwise do so because it might cost too much up front to develop the drug and/or the drug would be easily copied, destroying her profit potential.

In the tax setting, however, there may not be the same need to artificially inspire innovation. Ample incentives exist, in the absence of patent protection, for individuals to seek out new compliant tax-saving strategies. The New York State Bar Association Tax Section pointed out,

116. The detrimental costs of granting a monopoly arise from the economic inefficiency that results under monopolies. Basically, a monopolist's profits are maximized by setting a price well above the marginal cost of additional production. The result is that there are some consumers who are willing to pay an amount to use the product *above* the marginal costs of the product, but *below* the monopolist's price, and those people are left entirely unserved. See JOINT COMM. REPORT, *supra* note 17, at 22 & n.85.

for example, that “tax advisors do not need the protection of the patent laws to develop tax strategies,”¹¹⁷ and other opponents of tax strategy patents have echoed similar sentiments.¹¹⁸ Indeed, many business decisions are primarily driven by tax concerns,¹¹⁹ and business professionals and tax planners are constantly finding inventive ways to reduce taxes in business transactions.¹²⁰

Proponents of tax strategy patents point out, however, that many of those incentives are individualized, and do not encourage tax strategists to develop tax-saving techniques that benefit anyone other than their individual clients.¹²¹ From that perspective, then, issuing a licensable monopoly in the form of a tax strategy patent could serve to encourage tax professionals to invest in tax strategy research that would benefit a wide group of taxpayers; research, moreover, that would not be conducted in the absence of potential patent protection.¹²² As one commentator has pointed out, for example, in the absence of patent protection for innovative tax strategies, firms will only pursue developments of new tax-saving strategies to the extent that they will be paid back from their own clients in

117. Letter from the N.Y. State Bar Ass’n to selected members of the House Comm. on Ways & Means & the Senate Comm. on Fin., Patentability of Tax Advice and Tax Strategies (Aug. 17, 2006), available at <http://www.abanet.org/tax/patents/articles/nysbaletter.pdf>.

118. See, e.g., *Hearing on Issues Relating to the Patenting of Tax Advice*, supra note 2, at 41 (statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles) (“Existing economic incentives already provide ample inducement for the development, promotion, and implementation of tax-planning strategies.”); *id.* at 17 (testimony of Mark Everson, Comm’r, Internal Revenue Service) (explaining that some individuals have articulated that “[r]egardless of whether tax strategies are socially beneficial, there is no need for patent protection”).

119. Examples include decisions about how to structure a transfer of property from a corporation to a shareholder, how to characterize nonliquidating distributions, and how to characterize a merger or acquisition, to name a few.

120. See, e.g., STEPHEN A. LIND ET AL., *FUNDAMENTALS OF BUSINESS ENTERPRISE TAXATION: CASES AND MATERIALS*, 466–81 (3d ed. 2005) (detailing that the tax advantages associated with debt financing of a corporation prior to the time when qualified dividends first were taxed at the same preferential rate as a long term capital gains inspired many corporations to formulate “hybrid instruments” that gave some benefits of equity financing and other tax-related benefits of debt financing).

For further evidence that the tax-planning arena does not suffer from lack of innovation, look at the plethora of articles published each year trumpeting new tax-saving techniques. For example, see Forbes.com, <http://search.forbes.com/search/find?MT=Tax+savings> (last visited Apr. 8, 2008) (listing numerous articles published in Forbes Magazine that deal with tax-saving issues).

121. See, e.g., Wieland & Marshall, supra note 13, at 127 (noting that the existing monetary incentives may not “provide sufficient incentives for conducting pure tax strategy research” and that “[o]utside of the representation of specific clients, therefore, tax strategy research arguably may be under funded”).

122. *Id.*

later transactions.¹²³ Furthermore, those firms will likely not disclose those tax-saving strategies to competitors for the competitors to market to other clients. Conversely, if patent protection is possible, that same firm will be encouraged to develop increasingly sophisticated tax-planning strategies, knowing that all taxpayers (not just its clients) who want to benefit from using the method will have to pay.¹²⁴ Taking this approach, it is not difficult to imagine the proliferation of tax strategy “think tanks” funded both by tax planning firms and by private enterprises. Whether such a development is socially desirable, however, is questionable.¹²⁵ Nevertheless, the point is at least salient: just as patent protection fosters innovation in other areas, it may be able to foster innovation in the tax-planning arena.

B. INCREASING INNOVATION IN THE TAX ARENA WILL NOT YIELD A NET SOCIAL BENEFIT

Even if we need to foster innovation in the tax-planning field, the question still remains whether that innovation creates a net social benefit. In other areas of patent law, that question is often rhetorical. Few would doubt that the benefits of encouraging energy firms to develop cleaner burning fuels outweigh the costs of issuing a particular firm a monopoly for an especially successful technique. Similarly, the social benefits of the cancer-curing drug discussed above outweigh the economic efficiency losses that result from issuing a licensable monopoly to the inventor. In the tax arena, however, the scale is not so unbalanced. First, it is likely that encouraging tax planners to “invent around” existing patented tax strategies will lead to tax compliance problems that are not socially desirable. Second, encouraging tax practitioners to develop increasingly sophisticated tax planning strategies may result in treasury losses that will have to be compensated for by increasing the tax burden of other compliant taxpayers, or by reducing government benefits.

First, encouraging tax planners to “invent around” tax strategy patents that have already been granted may lead to tax compliance problems that are not socially desirable. Recall that one of the primary policy rationales driving patent law has been that exposing new products to the public encourages other inventors to constantly improve those products by

123. See *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 25–26 (testimony of Richard S. Gruner, Professor of Law, Whittier Law School).

124. *Id.*

125. See discussion *infra* Part IV.B.

“inventing around” the primary patent.¹²⁶ To that end, proponents of tax strategy patents point out that allowing tax strategies to be patented could further foster innovation by exposing once-unknown tax-saving techniques to the public, and allowing other practitioners to invent around the patented technique and further refine tax-saving strategies.¹²⁷

Notice, however, that this innovation-oriented benefit is precisely what the IRS is worried about regarding the proliferation of tax strategy patents. As discussed earlier, IRS Commissioner Mark Everson pointed out that many abusive tax transactions develop the same way: first, somebody structures a compliant transaction; next, somebody slightly modifies the transaction to obtain even more tax-reduction benefits; and eventually somebody modifies the initial strategy a bit more so that it crosses the line into illegality.¹²⁸ If tax strategies remain patentable, the idea that inventing around a patented product creates a snowball effect of socially desirable innovation can become a nightmare for the IRS as each patented tax strategy spawns a litter of increasingly questionable transactions. Put simply, one of the principal benefits of the patent system—that public disclosure fosters increased innovation—becomes a burden in the tax arena where experience dictates that increased innovation often fosters noncompliance with the tax laws.¹²⁹

Artificially induced innovation in the tax-planning arena may also create other problems that produce a net loss for society from a utilitarian perspective. Assuming that the primary function of tax law is to raise money for the government, then encouraging people to seek out new ways to reduce their tax burden by tempting them with a government sanctioned monopoly will likely result in a reduction of federal tax revenues. Indeed, in the wake of *State Street Bank*, after the court rejected the contention that business methods were per se unpatentable, the USPTO saw a nearly 600 percent increase in the number of patent filings for business methods over a three-year period.¹³⁰ One can expect a similar increase in the number of

126. SCHECHTER & THOMAS, *supra* note 34, § 1.3.1. See also JOINT COMM. REPORT, *supra* note 17, at 23 (pointing out that “mandatory public disclosure and its role in improving the dissemination of information is often highlighted as one of the principal benefits of the patent system”).

127. See Wieland & Marshall, *supra* note 13, at 127.

128. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 18 (testimony of Mark Everson, Comm’r, Internal Revenue Service). See also discussion *supra* Part II.C.1.

129. Notice, moreover, that the Treasury Department and IRS proposed regulations—creating a new category of reportable transaction—would not remedy this problem, given that an “invented-around” transaction would not constitute a “patented transaction” under the proposed regulations’ definition of a “patented transaction.”

130. *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 8 (statement of James Toupin, Gen. Counsel, U.S. Patent and Trademark Office).

filings seeking patent protection for tax strategies in the absence of congressional or judicial decree that tax strategies are unpatentable. Moreover, assuming that the holder of a legal tax strategy patent agrees to license his patented strategy to other taxpayers, the number of people who actually *use* patented tax strategies will grow even more quickly.

For example, imagine a United States in which Congress (through inaction) affirms, and the courts confirm, that tax strategies are within the scope of patentable subject matter. In the year leading up to that judicial affirmation, assume that there were 100 patents that dealt with tax strategies.¹³¹ In the wake of that affirmation, we could expect to see a surge in patent filings for tax strategies similar to the surge in patent filings for business method patents that occurred in the wake of *State Street Bank*. Hence, three years after judicial affirmation, we could expect to see, likely at a minimum, 600 patents that dealt with tax strategies.¹³² Now, assuming that the holders of those patents were willing to license the use of patented methods to other taxpayers, one can imagine a large number of hopeful licensees. If the patent holders are economically motivated, after all, they will license use of the tax strategies at a price that makes a licensee's final tax burden attractively below the licensee's tax burden absent implementation of the strategy. Moreover, if there is no other feasible way for the potential licensee to lower his or her tax burden to a comparable level, the licensee will purchase the right to use the patented tax strategy. Assuming the patented strategy is legal,¹³³ it is not difficult to imagine a large number of people lining up to pay to use the patented tax strategy in order to reduce their overall tax burdens. Finally, if a whole host of people line up to use each of the 600 patented tax strategies, the number of people noticeably reducing their tax burdens could grow exponentially. Corresponding to those reduced individual tax burdens, of course, would be a reduction in federal tax revenues.¹³⁴

131. This number is not unreasonable given that, in 2005, the IRS conducted a search of the 6.8 million patents in the USPTO database and found that approximately 100 of those 6.8 million patents dealt with business methods patents that computed tax impact or effect, but were not necessarily "tax strategies." *See id.* at 13 (statement of Mark Everson, Comm'r, Internal Revenue Service).

132. I say "at a minimum" because one would expect filings for tax strategy patents to surge even more sharply given that taxes are not confined to the business world; everyone has to pay taxes, so one could expect more people to seek out patents for tax strategies than might seek out other business method patents, which are likely more industry specific.

133. It is always important to remember that receiving a patent for a tax strategy is not tantamount to receiving IRS approval of the strategy. *See id.* (statement of Mark Everson, Comm'r, Internal Revenue Service). Hence, in our example, a person could have a patent for a tax strategy that the IRS later deems illegal. In that case, few people, if any, would pay to use the patented strategy.

134. *See id.* at 41 (statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles) (explaining that many

This potential problem is magnified if allowance of tax strategy patents spurs the proliferation of tax think tanks. As suggested *supra* Part IV.A, if patent protection is possible, firms will be encouraged to develop increasingly sophisticated tax-planning strategies, knowing that all taxpayers (not just their clients) who want to benefit from using the method will have to pay.¹³⁵ Moreover, because particularly effective tax-reduction strategies can have such mass indiscriminate appeal, it is not far-fetched to imagine the proliferation of privately funded tax think tanks charged solely with the task of developing increasingly sophisticated ways to reduce tax burdens. While market forces would ensure that not too many of those private think tanks crop up, and would ensure that only those that develop functioning and economically attractive tax strategies stay in business, the end result would still be noticeable: more people would be investing in research to uncover more ways to reduce more people's tax burdens.¹³⁶ That means, of course, an even greater reduction in federal tax revenues.

The net benefit of increased innovation spurred by government-granted monopolies in the form of tax strategy patents may not be enough to offset the detriment caused by undermining a key federal function. If that is the case, then we likely do not want to artificially encourage that innovation. And if we do not want to artificially encourage that innovation, then one of the primary purposes of patent law is not served by granting patents for tax strategies.

V. POSSIBLE REMEDIES

Given that patent examiners cannot be certain of the continuing credible utility of any tax strategy, and allowing individuals to patent tax

tax lawyers anticipate that if tax strategy patents proliferate, there will be a reduction in federal tax revenues).

135. See discussion *supra* Part IV.A; *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 25–26 (testimony of Richard S. Gruner, Professor of Law, Whittier Law School).

136. Note also that the proliferation of privately funded tax think tanks might also serve to benefit the upper class more than the middle or lower classes. After all, tax reduction strategies are likely worth more—dollar for dollar—to the rich, and so the rich will likely pay more—dollar for dollar—to use tax reduction strategies. Given that understanding, private firms motivated by profit might develop only those tax strategies that disproportionately help the very wealthy.

On the other hand, of course, there may also be some benefits that stem from the proliferation of tax think tanks. Think tanks that publish publicly available materials detailing particular ways to comply with the Internal Revenue Code, for example, might lead to greater net compliance with the Internal Revenue Code, which might serve to offset some of the treasury losses that stem from the implementation of tax reduction techniques. While the scope of the benefits that might stem from a proliferation of tax think tanks is beyond the scope of this Note, it is important to recognize that potential benefits do exist.

strategies is likely not consistent with the foundational pillars of U.S. patent law, the question remains: what do we do about tax strategy patents? One approach would be for Congress to enact legislation similar to the Physicians Immunity Statute.¹³⁷ This would not forbid issuance of tax strategy patents, but would preclude a patent holder from enforcing a patent against licensed tax practitioners with respect to the utilization of a tax strategy that constituted infringement of a process patent. Patented tax strategies, however, are different from patented medical techniques, given that almost anyone can implement a tax strategy, whereas only a licensed medical practitioner can implement a complicated medical procedure.¹³⁸

Another approach is for Congress to pass legislation that forbids the USPTO from issuing a patent for a pure process invention to be used solely to reduce an individual's or entity's tax burden. This approach would be analogous to the way in which Congress barred the patenting of nuclear technologies by enacting 42 U.S.C. § 2181.¹³⁹ As explained *infra* Part V.B, this is likely the best approach, provided that one thinks the patenting of tax strategies yields a net detriment to society.

A. STATUTORY PROTECTION AGAINST ENFORCEMENT OF TAX STRATEGY PATENTS

A congressional act precluding enforcement of tax strategy patents against particular individuals in a manner similar to the way in which the Physicians Immunity Statute¹⁴⁰ precludes enforcement of medical process patents against licensed medical practitioners and related health care facilities would face a number of significant hurdles. Such an act would likely inspire strong opposition from some members of Congress. Moreover, there has been some speculation that such safe harbor legislation offends the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement").¹⁴¹ Furthermore, even absent those hurdles,

137. 35 U.S.C. § 287 (2000).

138. Indeed, while a licensed tax practitioner would likely invent a complicated tax reduction strategy, and a non-tax-savvy layperson may not understand that strategy, that layperson could still implement the strategy at the advice of a tax planner. It is more difficult to imagine an open-heart surgeon instructing a layperson about how to properly implement an intricate open-heart surgical procedure.

139. 42 U.S.C. § 2181 (2000).

140. 35 U.S.C. § 287 (2000).

141. See, e.g., Aprill, *supra* note 68, at 22–23, 26, 34–36. A full text of the TRIPS Agreement is available at http://www.wto.org/english/docs_e/legal_e/27-trips.pdf (last visited Apr. 8, 2008).

It is important to note, however, that while some commentators have suggested that a safe harbor provision similar to the Physicians Immunity Statute would violate the TRIPS Agreement, Congress has

such an act would likely not be practically administrable. Indeed, it would be exceedingly difficult to fashion the scope of such an act in a way that would not be so underinclusive as to make it easily circumventible, and so make the act ineffective at protecting the intended tax practitioners. Similarly, it would be equally as difficult to fashion the scope of such an act in a way that would not be so overinclusive as to make the grant of tax strategy patents superfluous.

The Physicians Immunity Statute, for example, mandates that a patent holder generally cannot enforce a medical process patent against a licensed medical practitioner or related health care facility if that practitioner employs the patented process in a way that would normally constitute infringement of the patent.¹⁴² The statute seeks to promote the free utilization of the best-known medical procedures without fear of infringement suits. Notice, however, the scope of the statute: it only protects licensed medical practitioners and related health care facilities from infringement suits.¹⁴³ This makes sense given that only licensed medical practitioners are likely to employ complicated medical procedures, like, for example, a particular method of conducting open-heart surgery. The statute, thus, is neither overinclusive nor underinclusive.

An act that similarly sought to preclude infringement related to tax strategy patents, however, could not be so neatly tailored. Imagine an act—suppose, the Tax Practitioners Immunity Statute (“TPIS”)—that sought to preclude infringement actions against particular persons. Mirroring TPIS after the Physicians Immunity Statute, by only precluding enforcement against licensed tax practitioners, would be so underinclusive as to make passage of the act ineffective in protecting its intended beneficiaries. Unlike complicated medical procedures that can only be performed by well-trained and licensed medical practitioners, any given tax strategy can be *implemented* by almost anyone. Indeed, even if a particular person does not understand *how* the particular strategy is going to reduce her tax burden, and that person’s licensed tax practitioner tells her that it will reduce her tax burden, it will ultimately be that person—not the tax practitioner—who implements the proposed tax strategy. A statute that protects only licensed tax practitioners from infringement actions would be so underinclusive given that it would protect almost none of the people who actually implement the patented tax strategies.

intimated that the TRIPS Agreement does not apply to tax strategy patents. See H.R. REP. NO. 110-314, at n.37 & accompanying text (2007).

142. 35 U.S.C. § 287 (2000). See also JOINT COMM. REPORT, *supra* note 17, at 15.

143. § 287.

Similarly, drafting TPIS to protect the people who actually implement the tax strategies (individuals and entities) would be so overinclusive as to make the grant of tax strategy patents superfluous. Who would the holders of tax strategy patents sue for infringement if all of the infringers are protected from enforcement actions? At first blush, this objection seems equally applicable to the Physicians Immunity Statute. Who, after all, can a medical process patent holder sue for infringement if the only people employing the procedure are the very people the medical process patent holder is precluded from suing? A doctor who patents a medical process, however, can also patent a new device that is to be used (and may be necessary) during the medical procedure. While that doctor may be precluded from suing for infringement those who use the medical process, he can still sue for infringement for use of the patented device.¹⁴⁴ It is not difficult to imagine that in many medical cases the medical process may be functionally useless without the patented device. Hence, patent holders will still likely have some recourse in the medical arena. That is likely not going to be the case, however, in the tax strategy arena where any “device” (like a computer-implementation scheme) is likely incidental to the patented process.

Look, for example, at the SOGRAT patent at issue in the *Wealth Transfer Group* case. Recall that the patented process includes at least one step being performed by a computer.¹⁴⁵ It is not difficult to imagine, however, using nonqualified stock options to fund a grantor retained annuity trust without utilizing the particular computer method detailed in the SOGRAT patent application.¹⁴⁶ That is because the process, not the means of computer implementation, is the crux of the patent. A tax strategist who holds a patent for a tax strategy, thus, would likely not be able to enjoy any of the rights that accompanied his or her patented process if TPIS was drafted to protect all the people who implement the strategy against infringement actions. An act that protected the people who actually implement tax strategies from infringement actions would be so overinclusive as to make the grant of the tax strategy patent superfluous.

144. See JOINT COMM. REPORT, *supra* note 17, at 15–16 (citing SCHECHTER & THOMAS, *supra* note 34, § 3.4 (2004)); Wieland & Marshall, *supra* note 13, at 141.

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

146. By contrast, it is much more difficult to imagine a surgeon implementing a process of performing open-heart surgery that is dependent upon utilization of a particular patented tool without using that particular tool.

B. STATUTORY EXCLUSION FROM PATENTABILITY

A second remedy would be for Congress to pass legislation that forbids the USPTO from issuing a patent for a pure process invention that would be used solely to reduce an individual's or entity's tax burden. This approach would be analogous to the way in which Congress barred the patenting of nuclear technologies by enacting 42 U.S.C. § 2181.¹⁴⁷ If one believes that patenting tax strategies provides a net detriment to society, in part by reducing federal tax revenues,¹⁴⁸ then this approach may be a good remedy for the problems that might stem from the proliferation of patented tax strategies.

Title 42, § 2181(a) of the United States Code details, in pertinent part, that “[n]o patent shall hereafter be granted for any invention or discovery which is useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon.”¹⁴⁹ The Atomic Energy Act excludes inventions that are solely useful in atomic weapons from patentability by providing that such inventions are not statutorily patentable subject matter.

The legislative history of the Atomic Energy Act of 1954 reveals Congress's intent in enacting the legislation. First, the history details congressional findings that explain, “[t]he development, utilization, and control of atomic energy for military and for all other purposes are vital to the common defense and security.”¹⁵⁰ It continues, articulating that “[t]he processing and utilization of source, byproduct, and special nuclear material must be regulated in the national interest . . . to protect the health and safety of the public.”¹⁵¹ Given those findings, Congress explained that the *purpose* of the Act was to effectuate a “program for Government control of the possession, use, and production of atomic energy and special nuclear material so directed as to make the maximum contribution to the common defense and security and the national welfare.”¹⁵² That language of the Act implies that Congress undertook a balancing analysis, weighing

147. *But see* Aprill, *supra* note 68, at 25 (suggesting that “[t]he precedent prohibiting patents for nuclear material and atomic energy is not” closely analogous to proposed congressional prohibition on patents for tax strategies).

148. *See Hearing on Issues Relating to the Patenting of Tax Advice, supra* note 2, at 41 (statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles).

149. 42 U.S.C. § 2181(a) (2000).

150. Atomic Energy Act of 1954, ch. 1, § 2(a), 68 Stat. 919, 921 (1954) (codified as amended at 42 U.S.C. § 2012 (2000)).

151. *Id.* at ch. 1, § 2(d).

152. *Id.* at ch. 1, § 3(c).

the potential benefits that might stem from allowing nuclear material to be privately patented against the detrimental effects that would flow from such government-granted monopolies. Denying patent protection for nuclear technologies, Congress determined, would yield the “maximum contribution” to public welfare. Put another way, Congress barred individuals from patenting nuclear technologies because it determined that such a bar would yield a net public benefit.

In the tax setting, Congress could pass similar legislation to forbid the USPTO from issuing a patent for a pure process tax strategy, on the grounds that issuing patents for tax strategies will likely yield a net public loss. After all, allowing individuals to monopolize a tax-reduction technique may lead to treasury losses that would have to be compensated for by either raising taxes or cutting government benefits.¹⁵³ As discussed *supra* Part IV.B, that detriment likely outweighs the innovation-oriented benefits that accompany patent protection in the tax arena. That is particularly true given that patented tax strategies would likely be highly licensed, and the number of individuals and entities employing certain tax-reduction techniques would proliferate almost exponentially.

Indeed, Congress has initiated such an approach. On September 7, 2007, the House of Representatives passed H.R. 1908, which was a broad patent reform bill that included a ban on tax strategy patents.¹⁵⁴ Additionally, on February 17, 2007, Senators Carl Levin, Norm Coleman, and Barack Obama¹⁵⁵ proposed a similar ban on tax strategy patents in the Senate.¹⁵⁶ Senate Bill 681 would prevent the patenting of tax strategies by amending 35 U.S.C. § 102 to define any invention “designed to minimize, avoid, defer, or otherwise affect the liability of Federal, State, local, or

153. See *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 41 (statement of Ellen Aprill, Assoc. Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax Law, Loyola Law School, Los Angeles); discussion *supra* Part IV.B.

154. Patent Reform Act of 2007, H.R. 1908, 110th Cong. (1st Sess. 2007). See also Bennett, *supra* note 14.

The House Judiciary Committee, to whom the bill was referred, articulated its concerns regarding the appropriateness of tax strategy patents in the House Report recommending that the bill pass: (1) tax strategy patents conflict with the primary purpose of U.S. tax laws, (2) granting tax strategy patents would undermine key federal functions, (3) tax strategy patents would likely have adverse consequences for taxpayers and would undermine public confidence in the tax system, and (4) tax strategy patents would foster a more secretive and less cooperative tax-compliance landscape. H.R. REP. NO. 110-314, at 38 (2007).

155. The bill has since acquired other cosponsors; an updated list is available at <http://www.govtrack.us/congress/bill.xpd?bill=s110-681> (last visited Apr. 8, 2008).

156. Stop Tax Haven Abuse Act, S. 681, 110th Cong. § 303 (2007). See also Press Release, *supra* note 15. A copy of the Bill is available on Senator Levin’s website, at <http://levin.senate.gov/newsroom/release.cfm?id=269479>.

foreign tax” as unpatentable subject matter.¹⁵⁷ As some commentators have pointed out, however, the Bill is not likely to pass in its current form, as its language is exceedingly broad. Indeed, the Bill provides no exclusion for software programs designed to facilitate compliant tax reporting, but which may lower an individual’s or entity’s tax burden, and it may arguably extend to other business method patents that only incidentally foster a favorable tax consequence.¹⁵⁸ Thus, in order for a congressional ban on tax strategy patents to gain traction, it must address the deficiencies that plague Senate Bill 681. Specifically, it must be narrowly tailored and distinguish between pure method tax strategies—which would be unpatentable—and software programs that help facilitate compliant tax reporting and planning—which would, and should, remain patentable. Moreover, it must be narrow enough that it does not include other business methods that only incidentally create a favorable tax outcome within its prohibitory ambit. If that is achieved, and we understand that tax strategies have the potential to become credibly useless and so are fundamentally different from other business methods that remain patentable, then a congressional bill banning pure process tax strategies from patentability may have a chance of enactment. Such a bill, moreover, much like the Atomic Energy Act, may help facilitate the “maximum contribution” to the public welfare.

Thus, if patenting tax strategies will yield a net detriment to society, in part by reducing federal tax revenues, then a well-tailored statutory approach may be an appropriate remedy to cauterize the problems stemming from an issuance of tax strategy patents before they proliferate.¹⁵⁹

VI. CONCLUSION

While many of the traditional filters of U.S. patent law are applicable to the tax strategy setting and should serve to prevent improper tax strategies from being patented, important parts of patent law are not adaptable to the tax strategy setting. Moreover, the goals of patent law may not be served by granting patents for tax strategies. For these reasons, tax strategies should not be patentable.

157. S. 681, § 303.

158. See, e.g., Wieland & Marshall, *supra* note 13, at 142; Stamper, *supra* note 68; Aprill, *supra* note 68, at 23 (also noting that patent practitioners will likely strongly oppose legislative action classifying tax strategies as unpatentable subject matter on “the grounds of good patent policy”).

159. Other commentators have suggested various alternative approaches to addressing the problems associated with tax strategy patents. See Wieland & Marshall, *supra* note 13, at 142–43; Aprill, *supra* note 68, at 20–45.

First, recognize that many of the traditional filters of U.S. patent law should serve to prevent improper and overbroad tax strategies from being patented. The disclosure requirements embodied in 35 U.S.C. § 112 should serve, for example, to discourage individuals from patenting abusive tax avoidance transactions,¹⁶⁰ and should also help the IRS to anticipate potentially abusive deviations from legally implemented tax-saving strategies. Moreover, the novelty requirement embodied in 35 U.S.C. § 102 should ensure that no one patents a common tax strategy and adversely impacts an individual's ability to comply with the Internal Revenue Code. Even though traditional sources of prior art may not be available in the tax strategy setting, § 102 should still serve as a functional filter because the development of alternative means of establishing a sufficiently complete collection of prior art for USPTO examiners to reference is possible.

Although these filters are transferable to the tax strategy setting, they are not sufficient grounds for validating tax strategy patents. First, the utility filter embodied in 35 U.S.C. § 101 does not serve as even a formal gatekeeper in the tax strategy setting because it cannot ensure the continuing credible utility of tax strategies that filter through its net. Unlike in the context of other inventions, where a patent examiner who determines that an invention is credibly useful can safely assume that he or she made the correct decision, in the context of tax strategies, a patent examiner cannot be so assured because a particular patented tax strategy that was once credibly useful could subsequently become credibly useless if the tax law changes. Put another way, because tax law is an entirely artificial implementation of our government, and because some tax strategies *only* effectuate a tax result, tax strategies *are* fundamentally different from other patentable processes given that the utility filter cannot ensure the continuing credible utility of tax strategies that sift through its sieve.

Second, granting patents for tax strategies is antithetical to the policy that has driven patent law and fostered its adaptability since its inception. After all, individuals and businesses likely do not need an artificial impetus to inspire them to reduce their taxes because ample incentives exist, in the absence of patent protection, to seek out new compliant tax-saving strategies. Moreover, even if one thinks there is a need to foster innovation in the tax-planning field,¹⁶¹ increasing innovation in that field will not yield

160. Indeed, recall that the limited statistics currently available reveal that no one has yet attempted to patent an ATAT. See *Hearing on Issues Relating to the Patenting of Tax Advice*, *supra* note 2, at 13–14 (statement of Mark Everson, Comm'r, Internal Revenue Service); discussion *supra* Part II.C.1.

161. See discussion *supra* Part IV.B.

a net social benefit given that it will likely lead to large treasury losses that will have to be compensated for by raising taxes or cutting government benefits. For these reasons, then, allowing people to patent tax strategies is improper.

What then do we do about patenting tax strategies? Tax strategy patents are, after all, currently allowable, even though the propriety of those patents is suspect. One possible remedy is a legislative solution designed to protect certain people from patent infringement suits, in much the same way that the Physicians Immunity Statute protects licensed physicians from patent infringement suits for employing patented medical methods. This, however, is an unsatisfying solution because, on the one hand, it would be all but impossible to craft such a statute in a way that would not be so underinclusive that it would not protect its intended beneficiaries. On the other hand, it would be difficult to craft the statute so that it is not so overinclusive as to make the grant of tax strategy patents superfluous.

The best solution, therefore, most likely would be congressional legislation that would forbid the USPTO from issuing a patent for a pure process invention to be used solely to reduce an individual's or entity's tax burden. This approach, if appropriately narrowly tailored, would be well-suited to cauterize the problems that stem from the issuance of tax strategy patents. Until Congress passes such legislation, however, the problems that stem from tax strategy patents will become more manifest as patents for tax strategies likely proliferate.

