

TAX PATENTS: AT THE CROSSROADS OF TAX AND PATENT LAW

Linda M. Beale†

I. INTRODUCTION

In the United States today, the tax practitioner community has belatedly become fully aware of the availability of patents for business method processes and financial transactions—including computer-driven processes that have tax-minimizing possibilities and even tax-advantageous methods of structuring transactions. The United States Patent and Trademark Office (“the Patent Office”) has been granting business method patents for a number of years.¹ *State Street Bank & Trust Co. v. Signature Financial Group*, a seminal case for business method patents, was perhaps one of the earliest tax-related patent decisions: the Federal Circuit held that a computerized system for managing mutual funds’ pooling of investments through a tax partnership was patentable subject matter.² In the decade since *State Street*, a number of business method patents with tax implications have been granted, and even more business method tax patent applications are pending.³

† Visiting Associate Professor, Boston College Law School and Associate Professor, Wayne State University Law School. An earlier version of this paper was presented at the Boston College Tax Colloquium. The article covers developments concerning tax strategy and business method patents through March 2008. The author wishes to express her gratitude for comments of colleagues James Repetti, Diane Ring, David Olson, Alfred Yen and Joseph Liu.

1. See U.S. PATENT & TRADEMARK OFFICE, A USPTO WHITE PAPER: AUTOMATED FINANCIAL OR MANAGEMENT DATA PROCESSING METHODS (BUSINESS METHODS) (2000), available at <http://uspto.gov/web/menu/busmethp/whitepaper.doc> (discussing the history of business method patents) [hereinafter, WHITE PAPER].

2. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998) (reversing the District Court determination that the patent claim fell within either the mathematical algorithm or business method exception). It is interesting to note that the Patent Office’s White Paper asserts a continuous pattern of granting business method patents, in spite of the purported business method exception to subject matter patentability, claiming that “*State Street* merely modified the test used to determine ‘statutory subject matter.’” *White Paper*, *supra* note 1, at 3 n.6.

3. See, e.g., ABA Section of Taxation Task Force on Patenting of Tax Strategies, Listing of Patents Classified as Tax Strategy Patents by PTO (as of 06-14-08), <http://www.abanet.org/tax/patents/issuedtaxstrategy Patents.pdf>; ABA Section of Taxation Task Force on Patenting of Tax Strategies, Listing of Published Tax Patent Applications Classified as Tax Strategy Patents by PTO (as of 06-14-08), <http://www.abanet.org/tax/patents/publishedtaxstrategyapp.pdf>. Of course, the number of unpublished tax strategy patent applications is likely to be considerably larger than the published list, since applications need not be published in any case until eighteen months after submission and in many cases no publication is necessary until the patent is granted. Anecdotal evidence, including tales of tax practitioners whose clients have later filed patent applications on tax planning strategies that were developed in the course of the attorney-

Needless to say, the availability of patents for tax planning methods has come under significant scrutiny within the tax bar and accountancy organizations, as well as the Treasury Department and Internal Revenue Service (“IRS”).⁴ That consideration began with a rude awakening to the new crossroads between tax and patent law at a tax section meeting of the American Bar Association (“ABA”), at which an estate planning method, using a grantor retained annuity trust, was discussed.⁵ Many of the participants were shocked later to receive a letter indicating that the method under discussion had been patented—the Stock Option Grantor Retained Annuity Trust patent (“SOGRAT”)—and that taxpayers who had set up such an entity would have to pay a royalty or face suits for patent infringement.⁶

In the aftermath of the meeting, as the existence of tax strategy patents became better known, tax practitioners expressed deep concerns about the novel idea of tax planning patents.⁷ Understandably, those concerns reflect typical worries of any profession in connection with fundamental changes to the nature of the professional practice, and accompanying worries about the costs and the ability to adjust appropriately to new considerations in developing planning ideas for clients and the new costs associated with tax planning in a world of tax strategy patents.⁸ Changes might include the need to conduct due diligence research on the existence of patents for similar tax planning methods to those being proposed and the possibility of having to consider filing patent applications to protect intellectual property developed at considerable effort separately from client representations. The ethical implications of tax patents are not clear. This is a special concern in the context of recent changes to the tax provisions governing penalties and reporting standards⁹ and of substantial revisions to the rules governing practice

client relationship, suggests that there may be a substantial number of pure tax-structuring patent applications at the Patent Office that have not yet been made public.

4. See, e.g., Alison Bennett, *Solomon Says Rules Not Enough to Fix Tax Patent Problem; Other Issues Discussed*, DAILY TAX REP. (BNA), Jan. 23, 2008, at G-6 (reflecting continuing government concern about tax strategy patents); Alison Bennett, *IRS Remains Concerned About Tax Patents as Work Continues on Rules*, *Korb Tells BNA*, DAILY TAX REP. (BNA), Jan. 4, 2008, at G-2 (same) [hereinafter Bennett, *IRS Remains Concerned*]; Alison Bennett, *AICPA Urges Passage of Bill to Prohibit Tax-Planning Invention, Strategy Patents*, DAILY TAX REP. (BNA), Nov. 20, 2007, at G-1 (regarding accountancy organization concerns about tax planning method patents).

5. ABA TAX SECTION, PATENTING OF TAX STRATEGIES TASK FORCE, available at <http://www.abanet.org/tax/patents/home.html> (last visited Aug. 10, 2008).

6. *Hearing on Issues Relating to the Patenting of Tax Advice before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Ellen P. Aprill, Associate Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax law, Loyola Law School), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5106> [hereinafter, Aprill Statement]. The SOGRAT patent covers the use of a grantor retained annuity trust funded with stock options, described as “[a]n estate planning method for minimizing transfer tax liability with respect to the transfer of the value of stock options from a holder of stock options to a family member of the holder.” U.S. Patent No. 6,567,790 (filed Dec. 1, 1999).

7. See Aprill Statement, *supra* note 6 (demonstrating that tax planning patents could pose a problem).

8. See, e.g., *id.* (addressing concerns about changes and burdens for the tax profession).

9. See, e.g., Small Business and Work Opportunity Tax Act, Pub. L. No. 110-28, § 8246, 121 Stat. 112, 203 (2007) (changing the level of confidence required for tax return preparers under I.R.C. § 6694 for advising undisclosed positions from “realistic possibility of success on the merits” to “more likely than not”); American Jobs Creation Act of 2004, Pub. L. No. 108-357, §§ 812, 815, 816, 819, 118 Stat. 1418, 1577-85 (2004) (generally toughening taxpayer understatement penalty standards and replacing an older and less workable tax

before the IRS, commonly known as “Circular 230.”¹⁰ In an effort to combat marketing of tax shelters, the Circular 230 rules were modified to include strict requirements for tax opinions that are considered “covered opinions.”¹¹ Patent licensing agreements, or perhaps even tax planning patents themselves, might come within those rules.¹²

More significantly, the tax bar generally found it contrary to their understanding of the tax laws that it should be possible to grant a patent on a tax planning method developed in accordance with those laws.¹³ Tax planning methods are most often specific steps for creating or eliminating entities, and moving client assets into or out of those entities, or for creating new financial instruments.¹⁴ The goal is to establish business structures or issue financial products that merit beneficial tax treatment as provided by specific provisions of the tax laws (e.g., a tax-free reorganization under Section 368, a real estate mortgage investment conduit (“REMIC”) under Sections 860A through 860G, or a debt instrument eligible for an interest deduction under Section 163). These concerns thus extend well beyond new difficulties in working with clients or the worry that tax strategy patents would likely be granted indiscriminately by a Patent Office unfamiliar with tax law, inexperienced with tax planning, without access to critical resources available to expert tax lawyers, and unable to recognize the broad implications of the granting of tax strategy patents for the understanding of the tax laws, for tax compliance and for tax administrability. Further, tax avoidance transactions have been a

shelter registration and list maintenance regime with rules that comported with a new reportable transaction regime developed through the regulatory process); see I.R.C. § 6111 (2005) (material advisor reporting requirement, defining material advisor as persons who advise or assist in planning or implementing reportable transactions for fees of at least \$50,000 for individuals or \$250,000 if advising an entity); *Id.* § 6112 (material advisor list maintenance requirement); *Id.* § 6662A (providing new taxpayer 20% understatement penalty for reportable transactions with significant tax avoidance purposes, increased to 30% if not disclosed); *Id.* § 6700 (increasing organizer penalty for a false statement from \$1,000 to 50% of the gross income derived from the activity); *Id.* § 6707 (replacing \$500 penalty for failure to register with penalty for failure to report reportable transactions of \$50,000 (or \$200,000 or 50% of gross income derived, for listed transactions)); *Id.* § 6707A (providing new taxpayer penalty for failure to report a reportable transaction, ranging from \$10,000 to \$200,000); § 6708 (providing new penalty replacing \$50 penalty for failure to maintain lists under § 6112 with \$10,000 a day penalty for failure to turn over information after twenty days, without reasonable cause).

10. 31 C.F.R. pt.10 (2008) [hereinafter Circular 230].

11. Treasury proposed new opinion standards for shelter opinions in 2001 but finalized other modifications to Circular 230 without adopting those new standards. Prop. Treas. Reg. § 10.33, 66 Fed. Reg. 3276 (Jan. 12, 2001). Additional modifications were proposed in 2003 and finalized in 2004. Prop. Treas. Reg. § 10.35, 68 Fed. Reg. 75,186 (Dec. 30, 2003) (including standards for covered opinions and other written opinions). See generally Linda M. Beale, *Tax Advice Before the Return: The Case for Raising Standards and Denying Evidentiary Privileges*, 25 VA. TAX REV. 583, 619 (2005) (discussing the Circular 230 requirements for covered and other written opinions) [hereinafter Beale, *Before the Return*].

12. Linda M. Beale, Tax Patents and Circular 230 (2007) (presentation outline on file with the author, from the May and September 2007 meetings of the ABA Tax Section). See, e.g., Jeremiah Coder, *Practitioners Discuss Intersection of Tax Patents and Ethics*, 117 TAX NOTES 114 (Oct. 8, 2007) (reporting on Beale’s analysis of Circular 230 issues at Fall ABA meeting and other ethics issues raised in connection with patented tax strategies).

13. See, e.g., Bernard Wolfman, Letter to the Editor, *Tax Strategy Patents: An Idea Whose Time Should Never Come*, 115 TAX NOTES 505 (2007) (“[C]ornering an interpretation of the law and a use to which it may be put has to be unlawful.”) (emphasis in the original).

14. Evelyn McDowell, *Tax Strategy Patents: Truth and Consequences*, THE CPA JOURNAL, Feb. 2008, available at <http://www.nysscpa.org/cpapjournal/2008/208/essentials/p46.htm> (last visited July 10, 2008).

significant focus for two decades,¹⁵ and patents on tax planning methods could exacerbate that problem. In essence, patents on tax planning methods appear inherently problematic, given the fundamental differences between innovations in tax and, for example, innovations in designing a better manufacturing product such as a motorcycle helmet.

Furthermore, many practitioners considered it irrational—even assuming, *arguendo*, that it might be appropriate to grant patents on some tax planning methods—that a patent could be granted on claims such as the one in the SOGRAT patent that appeared obvious to most competent tax attorneys in the financial products and estate planning area.¹⁶ Most such attorneys were well aware of the possibilities of using trusts for various client assets, including stock options. Nevertheless, litigation in connection with the SOGRAT patent was settled out of court a year ago based on a presumption of validity (although the settlement order stipulated that there were facts whereby a trier of fact might have found the patent to be invalid).¹⁷ It is generally understood that various users of the method ultimately paid significant royalties to the patent holder, even though they may have developed the method independently.

In the wake of these many concerns about tax strategy patents, the ABA Tax Section established a task force whose objective was to consider the implication of tax strategy patents for tax practitioners, provide information to practitioners and respond to developments in the field.¹⁸ In addition, various ABA Tax Section meeting sessions over the last two years have addressed a number of vexing issues in connection with tax strategy patents, including the applicability of the ethics rules, the Circular 230 rules for practice before the IRS, the reportable transaction rules promulgated under Section 6011 of the Internal Revenue Code (“the Code”), the Patent Office’s methods of assessing patent applications, and the appropriateness of tax planning methods as subject matter for patents.¹⁹ Similar discussions have taken place among various state bar and accountancy associations.²⁰

15. See, e.g., Brant K. Maller, *Structuring a Sale-Leaseback Transaction*, 15 REAL EST. L.J. 291 (discussing the potential of a sale-leaseback transaction as a tax avoidance transaction).

16. *Testimony Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 110th Cong. (2003) (statement of Dennis I. Belcher, Partner, McGuire Woods LLP).

17. See *Wealth Transfer Group v. Rowe*, Docket No. 3:06-CV-00024 (AWT) (D. Conn.) (Mar. 9, 2007), available at http://tax.aicpa.org/NR/rdonlyres/D62E55BF-474B-4E5C-94A9-AF140F9D5604/0/WTG_ROWЕ_FINALCONSENTJUDGMENT.pdf.

18. Further information on the membership, goals, and work of the ABA Tax Section Patenting of Tax Strategies Task Force is available at its Web site at <http://www.abanet.org/tax/patents/home.html>. In the interest of transparency, the author is a member of the Task Force who has actively opposed tax strategy patents during her participation in panels at ABA Tax Section meetings, in the development of Task Force comments, and in an earlier article on this issue.

19. Tax patents were a significant topic of discussion at the ABA Tax Section Annual Meeting in Washington, D.C. in May 2007, the Fall Joint CLE Meeting in Vancouver, BC in September 2007, and the Mid-Year Meeting in January 2008 in Lake Las Vegas, Nevada. See, e.g., Coder, *supra* note 12, at 114 (reporting on ABA panel discussion on Circular 230 and ethics issues in connection with patented tax strategies).

20. See, e.g., Alison Bennett, *Colorado Bar Group Opposes Tax Patenting, Voices Big Support for Legislative Remedy*, DAILY TAX REP. (BNA), Mar. 15, 2007, at G-1; Letter from Mark E. Holcomb, Chair, Tax Section of the Florida Bar, to Sen. Norm Coleman, Sen. Carl Levin & Sen. Barack Obama (Apr. 23,

Perhaps not so obvious is the intense interest of the intellectual property (“IP”) bar in tax-strategy patents and the “deep divide” between the IP and tax bars on the subject,²¹ as illustrated by the two companion articles in this volume.²² Anecdotally, their response to the concerns of tax lawyers is almost uniformly along the lines of what an IP colleague said to me early on when I objected to the granting of patents on tax planning methods: “Get over it!” Tax practitioners’ admonitions about the inadequacy of Patent Office staff to the task of comprehending complex tax laws that generally require substantial study and “real-world” practice to develop expertise are countered with an almost naïve optimism that examiners can be trained through a few focused workshops to deal with tax in the same way that they have acquired greater expertise in the much less technical area of general business methods.²³ IP lawyers frequently take an avuncular pose, comparing tax strategy patents to other new frontiers in patent law and insisting that tax lawyers merely need to understand the patent system better²⁴ so that they can pass from aversion of to adaptation to the new demands at the crossroads of tax and patent law, just as those dealing in computer software, communications technology or other issues have done, leading to beneficial new innovations and economic growth.²⁵

2007), available at http://www.floridatlawyers.org/pdf/patentability_taxadvice_bill681.pdf; Letter from Todd Welty, State Bar of Texas, to Eric Solomon, Treasury Dept. (Jan. 29, 2007) (on file with author) (recommending that patented strategies be identified as transactions of interest and patent applicants and holders be treated as material advisors under the reportable transaction rules); Letter from Bradley M. Roof, Chair Virginia Society of CPAs to Leslie Murphy, Chair, AICPA (Oct. 6, 2006) (on file with author) (stating that patenting tax advice does not represent good public policy).

21. Jeremiah Coder, *IRS Reg Hearing on Tax Patents Highlights Divide*, 118 TAX NOTES 894 (Feb. 21, 2008).

22. Richard S. Gruner, *When Worlds Collide: Tax Planning Method Patents Meet Tax Practice Making Attorneys the Latest Patent Infringers*, 2008 J.L. TECH. & POL’Y 35 (2008) [hereinafter *Worlds Collide*]; Max Stul Oppenheimer, *Patents, Taxes and the Nuclear Option: Do We Need a ‘Tax Strategy Patent’ Ban Treaty?*, 2008 J.L. TECH. & POL’Y 1 (2008) [hereinafter *Nuclear Option*].

23. See, e.g., Lucas Osborn, *Tax Strategy Patents: Why the Tax Community Should Not Exclude the Patent System*, 18 ALBANY L.J. SCI. & TECH. (forthcoming 2008) (manuscript at 31, on file with author) (“[A]ny lack of tax strategy expertise has already been, or will quickly be, remedied”); *Worlds Collide*, *supra* note 22, at 66 (suggesting presentations to Patent Office examiners); *Nuclear Option*, *supra* note 22, at 4-5 (finding the difficulties for the Patent Office in analyzing tax strategies no different from the problem it faced with other fields, requiring a “learning curve”).

24. See, e.g., *Nuclear Option*, *supra* note 22, at 7 (“Much of the concern arises from a misunderstanding of the patent system, which is nearly as complex (although considerably more rational) than the tax system.”).

25. See, e.g., Christopher R. Rizek, *Firm Sees No Need for Proposed Regs on Patented Transactions*, 2008 TNT 8-14, Jan. 11, 2008, available in LEXIS, TNT file (“[M]ainstream view, at least among intellectual property lawyers, . . . that methods of complying with the internal revenue laws are no different from other types of business methods for complying with other legal requirements, such as environmental regulations, pure food or drug laws, communications technology licenses, etc., all of which are certainly appropriate subject matter for patenting.”); see also David Randolph, *View on Patentability of Tax Strategies Differs Greatly Between Tax, Patent Bars*, DAILY TAX REP. (BNA), Aug. 14, 2007, at G-5 (outlining differences of opinion on the issue); Stephen T. Shreiner & George Y. Wang, *Discussions on Tax Patents Have Lost Focus*, IP LAW 360 (July 21, 2006), http://www.hunton.com/files/tbl_s47Details%5CFileUpload265%5C1551%5CTaxArticle_IPLaw360_7-21-06.pdf (“Tax patents—which are really just a type of business-method patent—are no different.”).

Some IP attorneys appear openly hostile to the tax bar’s skepticism about the validity of tax strategy patents. One extreme example is provided by the Koresko Law Firm commentary, which reads like an intemperate tirade against a meddling Congress and tax administration that it views as under inordinate pressure from special interest lobbying by tax practitioners who are mostly concerned with the potential impact of royalty

The IP perspective, although not monolithic, tends to two broad conclusions. First, it suggests that the various hurdles in the patent law that must be overcome before a tax strategy claim would be eligible to be patented are significant and will likely prevent patentability of many claims currently under consideration.²⁶ Second, assuming that some tax strategies will nonetheless be eligible for patents, the IP perspective suggests that tax strategy patents provide appropriate and needed economic incentives for valuable tax innovation that implements the underlying policy of patent law to incentivize innovation for the public good and that the tax bar's concerns do not distinguish tax from other areas.²⁷

This article responds to those two main threads of IP commentary. This Part serves as an introduction to the problem. Part II briefly reviews patent law requirements and the history of the issuance of tax strategy patents as a subclass of business method patents. Part III addresses recent developments in the last year—and especially in the last seven months—that point to potential resolutions of the issue as Congress, the courts, and the Patent Office work to more carefully delineate the subject matter requirement for patentability and other requirements that are directly relevant to tax strategy patents. It also addresses the effort by the IRS to create a new category of required disclosure for transactions that involve patented tax planning methods. Part IV considers the issues that are most worrisome from a tax perspective if, in spite of these developments, tax strategy patents continue to be issued. Different issues arise in respect to more aggressive tax strategies compared to ordinary tax minimization planning strategies, but each demands a similar solution to prevent the balkanization of the tax system. Part V concludes that the fundamentally different purposes of tax and patent laws suggest that the

expenses on their own lucrative fees. Koresko Law Firm, *A Reply to Congress: Facts and Fiction of Legislative Proposals Regarding Patents for Tax-Related Strategies* (Sept. 1, 2007), Tax Analysts Doc 2008-4572; see also John Kheit, *More Bad News at Tax Time?*, BUSINESSWEEK.COM (Feb. 26, 2008), at <http://www.msnbc.msn.com/id/23335842/> (inveighing against the IRS's actions on patented transactions as a "meddler" in a "regulatory land grab" that "would threaten an explosion of innovation and technology in the financial-services industry that has produced astonishing productivity gains, directly and substantially feeding U.S. economic growth over the last decade.").

26. This is the primary thrust of Oppenheimer's commentary. See *Nuclear Option*, *supra* note 22, at 2 (describing the patent law as presenting "significant hurdles to patentability"); see generally Andrew Schwartz, *Tax Strategies are not Patentable Inventions*, 25 ABA IPL NEWSLETTER 35 (2006) (discussing various reasons that tax planning methods should not be patentable).

27. See, e.g., *Worlds Collide*, *supra* note 22, at 47-49 (concluding that the innovation incentive under the patent law overrides the various tax bar objections to patenting of tax strategy patents); *Id.* at 49 ("[T]he proper scope of patent protections for new types of innovations such as new tax planning methods should be interpreted in light of these [patent law] goals [of incentivizing innovation]"); see also *Issues Relating to the Patenting of Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Richard S. Gruner, Professor of Law, Whittier Law School), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5105> [hereinafter, *Gruner statement*] ("[P]atentable subject matter standards have been steadily expanding in scope. Federal court standards have recognized over the past two decades that our patent system should encourage and reward advances in fields as divorced from traditional physical engineering and chemistry as bio-engineering, computer software, communication information processing, accounting record keeping, financial investment strategies, and business methods. In this march towards ever broader patent system scope, it is a small step to extend patents to advantageous tax planning methods, which produce important financial results for taxpayers.").

conflict must be resolved, one way or another, through prohibition of patents on tax strategies.

II. A BRIEF HISTORY OF BUSINESS METHOD AND TAX STRATEGY PATENTS

Tax practitioners have become painfully familiar with the chronology of the development of patent law governing business method patents and, in particular, tax strategy patents. The relevant provision of the Patent Act limits eligibility for patent protection to claims whose subject matter is a “process, machine, manufacture, or composition of matter, or any new and useful improvement thereof.”²⁸ Patent claims must also satisfy additional conditions to be patented, three of which—utility, novelty, and nonobviousness—are often thought of as key requirements in the analysis.²⁹ Utility merely requires that the patented invention be “useful.”³⁰ Novelty is defeated by the existence of prior art either before the date of the invention or before one year prior to the time the invention was filed.³¹ A patent claim that satisfies the nonobviousness requirement would not be considered obvious by someone of ordinary skill in the field who has complete knowledge of prior art.³² Each of these hurdles to patentability is important in assessing tax strategy patents.

The subject matter of patents represents a threshold eligibility requirement to patentability. Business method (and tax strategy) patent claims are typically set out as process claims, although some computerized algorithmic applications may appear as machine claims.³³ Although certain types of business methods that were clearly technological inventions were patented early in the development of the country,³⁴ the courts and the Patent Office have traditionally considered there to be a “business method” exception to patentability for any business method claims that were neither scientific nor technological.³⁵ The Supreme Court, however, construed the subject matter requirement in a series of important cases in the late 1970s and 1980s that laid the way for the current state of business method patentability. Although it had reiterated in *Diamond v. Chakrabarty* that “laws of nature, natural phenomena and abstract ideas” are not eligible subject matter,³⁶ the Court nonetheless permitted the patenting of computerized applications of mathematical

28. 35 U.S.C. § 101 (2000).

29. *See id.* §§ 101-103 (discussing patent requirements).

30. *Id.* § 101; *see also infra* note 96 and accompanying text (discussing utility).

31. *See* § 102(a)-(b).

32. *Id.* §103(a); *see In re Winslow*, 365 F.2d 1017, 1021 (C.C.P.A. 1965) (describing a test for obviousness).

33. Osborn, *supra* note 23, at 5 n.16 (“Process (or method) patents generally cover a series of steps or actions, as opposed to the remaining categories which cover things having various components.”).

34. *See* WHITE PAPER, *supra* note 1, at 2-3.

35. Osborn, *supra* note 23, at 6.

36. *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980) (“[L]aws of nature, physical phenomena, and abstract ideas have been held not patentable.”); *see also* *Parker v. Flook*, 437 U.S. 584 (1978) (holding not patentable a catalytic conversion method featuring a new mathematical algorithm for updating alarm limits); *Gottschalk v. Benson*, 409 U.S. 63 (1972) (holding that a mathematical algorithm for converting binary coded decimal form to pure binary form cannot be patented).

algorithms in the 1981 *Diamond v. Diehr* case.³⁷ Interpreting the *Diehr* precedent in *In re Allapat*, the Court of Appeals for the Federal Circuit finally permitted patenting of computer programs, differentiating between ineligible disembodied abstract concepts and eligible machines or processes by looking to whether the claim produced a “useful, concrete, and tangible result.”³⁸ Finally, in *State Street*, the Federal Circuit opened the floodgates to new patent applications by holding business methods subject to the same patentability requirements (novelty, nonobviousness, utility, etc.) that apply to consideration of any other process or method.³⁹

Some commentators have interpreted *State Street* to rely on the utility assessment to redefine the scope of the threshold subject matter requirement.⁴⁰ There is thus a clear line of expansion in scope of patent subject matter from the Supreme Court’s decision in *Chakrabarty* permitting patentability of life forms,⁴¹ through the Federal Circuit’s decision in *State Street* permitting patentability of a computerized accounting process business method,⁴² and culminating in the Supreme Court’s rejection of review in *Laboratory Corp. of American Holdings v. Metabolite Labs*, a case that could have provided an opportunity to pull back from overly generous subject matter review.⁴³

The immediate result of *State Street* was approval of a business method/financial accounting patent that might force any business embarking on a multi-tiered partnership portfolio investment structure to use the newly patented accounting system.⁴⁴ An even more significant result was the priming of the patent machinery to grant additional business method and tax

37. *Diamond v. Diehr*, 450 U.S. 175, 184-87 (1981) (finding that an improved press for curing rubber that used a computerized algorithm for checking the appropriate temperature was a patentable process).

38. *In re Allapat*, 33 F.3d 1526, 1544-45 (Fed. Cir. 1994) (holding computer programs patentable and asserting that “programming creates a new machine, because a general purpose computer in effect becomes a special purpose computer.”).

39. See *State St. Bank & Trust v. Signature Fin.*, 149 F.3d 1368 (Fed. Cir. 1998). The floodgates are evident in a recent empirical study of patent applications that found that “the single largest class [of patent applications] was class 705, covering business method and financial services patents.” Mark Lemley & Bhaven Sampat, *Is the Patent Office a Rubber Stamp?* 32 (Stanford Public Law and Legal Theory Working Paper Series Research Paper No. 999098, July 2007) available at <http://ssrn.com/abstract=999098>. This number may be understated because many business methods patents attempt to avoid the level of scrutiny applied to class 705. See John R. Allison & Emerson H. Tiller, *The Business Method Patent Myth*, 18 BERKELEY TECH. L.J. 987 (2003) (citing different patent procedures for business method patents as a possible reason for this).

40. See, e.g., Robert King, Comment, *Only in America: Tax Patents and the New Sale of Indulgences*, 60 THE TAX LAWYER 761, 766 (2007) (stating that “*State Street Bank* collapses the traditional test for determining statutory subject matter into the untenable test of whether the subject matter of the claim has any practical utility”) (emphasis in original).

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

42. *State St.*, 149 F.3d at 1368.

43. *Lab. Corp. of Am. Holdings v. Metabolite Lab., Inc.*, 126 S. Ct. 2921 (2006) (involving a patent for testing for a vitamin deficiency based on a mere finding of a natural law correlation between vitamin deficiency and levels of homocysteine). *But see id.* at 2927 (Breyer, J., dissenting) (suggesting that the *State Street* standard is not consistent with Supreme Court precedent).

44. See *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 927 F. Supp. 502, 514-16 (D. Mass. 1996). (“If Signature’s invention were patentable, any financial institution desirous of implementing a multi-tiered funding complex modeled on a Hub and Spoke configuration would be required to seek Signature’s permission before embarking on such a project. This is so because the ‘056 Patent is claimed sufficiently broadly to foreclose virtually any computer-implemented accounting method necessary to manage this type of financial structure.”).

patents, some of which may not include any technological component.⁴⁵ In the 2004 *Ex Parte Lundgren* decision, the Board of Patent Appeals & Interferences (“BPAI”) ruled that the “technological arts” test that had been followed to distinguish patentable subject matter from non-patentable concepts was not a separate and distinct test for statutory subject matter.⁴⁶ Understandably, commentators read this as generally eliminating a “technology” requirement for tax strategy patents.⁴⁷

At about the same time, Patent Office Commissioner Godici acknowledged at a Senate Finance Committee hearing on the tax gap that the Patent Office considered tax strategies to be types of business methods that are potentially patentable.⁴⁸ In 2006, the Patent Office extended its business method classification (Class 705) by adding a new subclass (36T) to cover tax planning methods.⁴⁹ The Joint Committee on Taxation reported in mid-July 2006 on tax patents, noting a potential concern with tax strategy patents that do not involve computerized application.⁵⁰ One recent study examined five tax-related patents that are not computer implemented and concluded that the strategies either should have failed the patentability requirements for nonobviousness or lack of novelty, or were so clearly ill-conceived as tax products that they would not produce the tax benefits claimed.⁵¹ Yet as

45. See, e.g., *AT&T Corp. v. Excel Commc’n., Inc.*, 172 F.3d 1352, 1353 (Fed. Cir. 1999) (stating lack of an “invariable requirement” for physical transformation in assessing patentability of a mathematical algorithm).

46. *Ex parte Lundgren*, 2005 Pat. App. LEXIS 34, at *10-11 (BPAI 2005) (“Our determination is that there is currently no judicially recognized separate “technological arts” test to determine patent eligible subject matter under § 101. We decline to create one.”), available at <http://www.uspto.gov/web/offices/dcom/bpai/prec/2003-2088.pdf>.

47. See, e.g., King, *supra* note 40, at 768 (“*Lundgren*, when combined with *State Street Bank*, allows for the patenting of tax strategies without the patent having to claim any sort of a computerization of the steps to avoid a ‘technological arts’ rejection.”).

48. *Bridging the Tax Gap: Hearing Before the S. Comm. on Finance*, 108th Cong. 703 (2004) (statement of Nicholas P. Godici, Commissioner of Patents, U.S. Patent and Trademark Office), available at <http://finance.senate.gov/hearings/95484.pdf>.

49. *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. 77 (2006) (statement of James Toupin, General Counsel, U.S. Patent and Trademark Office), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5103> [hereinafter, *Toupin Statement*] (noting in July 2006 that the new tax subclass had been “recently” added). The Patent Office uses a numerical system to classify patents and patent applications. Most patents with tax-related claims are classified under the Business Method classification and the tax-related patent subclass, but some patent applications with tax-related claims may well be classified elsewhere, because of the vagueness with which claims are written and the potential desire of some patent applicants to obscure the tax-centric nature of their patent claims.

50. See, e.g., STAFF OF J. COMM. ON TAXATION, 109TH CONG., BACKGROUND AND ISSUES RELATING TO THE PATENTING OF TAX ADVICE 2 (Jul. 12, 2006), <http://www.house.gov/jct/x-31-06.pdf> (noting that Patent Office procedures had appeared to require some computerized applications “until recently” and listing the SOGRAT patent as an example of a tax strategy patent rather than a computerized application).

51. A 2007 study by Wade Chumney examined tax-related patents and concluded that most are not tax strategy patents but rather have tax as a secondary issue or deal with computer-implemented systems for tax efficient investment portfolio management or something similar, while five patents were tax strategy patents in which the creator claimed to invent a financial product that would reduce taxes, and a followup study examines each of the tax strategy patents for nonobviousness and novelty. See ROBY SAWYERS, WADE CHUMNEY & DAVID L. BAUMER, WHEN WORLDS COLLIDE: APPLYING THE NONOBVIOUSNESS AND NOVELTY REQUIREMENTS OF PATENT LAW TO TAX STRATEGY PATENTS (2008) (for a discussion of the study see power point presentation, slides 5-7, available at https://aaahq.org/ata/meetings/midyear-meetings/2008/ppt/Sawyers_ATAPresentation.ppt). The deferred § 1031 exchange deedshare patent discussed here, U.S.

recently as May 2007, the Patent Office explicitly asserted that “patents will play a role in the tax strategy industry” and “[p]atents for tax planning strategies will remain a part of the patent landscape for some time to come.”⁵² The very fact that tax planning to assist businesses in properly structuring their business activities could appropriately be considered a “tax strategy industry” by the Patent Office rings warning bells harking to the tax shelter industry that mushroomed through the 1990s with the aid of tax shelter promoters.⁵³

III. RECENT DEVELOPMENTS AFFECTING TAX STRATEGY PATENTS

Although the number of published tax-related patent applications is still quite small compared to the overall number of patent applications and the number of pure strategy patents is apparently even more limited,⁵⁴ the potential for future issuance of large numbers of patents covering tax aspects of major categories of financial and business transactions remains a significant worry.⁵⁵ Three recent developments, however, suggest some possibility of relief. Congress has seriously begun to consider enactment of legislation to ban tax planning patents. At the same time, the federal courts in recent decisions have pulled back from the broad approach to the subject matter, utility, and nonobviousness requirements that appeared to pave the way for unfettered patentability of tax strategy patents. The IRS has also promulgated regulations to require disclosure of tax strategy patent applications.

A. Legislation Banning Tax Strategy Patents

The concerns of the tax bar echoed in mainstream media, as journalists reported on the “hot button” issue of patent-eligible tax strategies.⁵⁶ The tax concerns augmented more widespread perceptions of patent abuses and stifling of innovation in an overweening patent system that now appears to favor

Patent No. 6,292,788, is one that I mentioned at the first ABA tax section meeting dealing with the potential application to patented tax transactions of the Circular 230 rules for practice before the IRS. The patent includes tax statements one would expect in a tax opinion; accordingly, licensing agreements executed in connection with such patented tax strategies may well be “covered opinions” under Circular 230 § 10.35 that are subject to especially rigorous requirements and potentially subject their authors to severe sanctions from the Office for Professional Responsibility.

52. Letter from Mindy B. Fleisher to Bernard Wolfman (May 16, 2007), in Bernard Wolfman, *Patenting Tax Strategies*, TAXES, Mar. 2008, at 43 Ex. B. The Patent Office letter also demonstrated the somewhat flippant view of IP specialists towards those who complain about expansion of the patent field. *Id.* (“Like participants in other fields where business method patents have altered the competitive landscape, taxpayers and tax advisers must modify how they approach the risks of implementing selected tax strategies.”).

53. See, e.g., U.S. Dept. of the Treasury, *White Paper: The Problem of Corporate Tax Shelters, Discussion, Analysis and Legislative Proposals* (1999), <http://www.treas.gov/offices/tax-policy/library/ctwhite.pdf>.

54. See *Toupin Statement*, *supra* note 49.

55. The Patent Office does not publish statistics on unpublished tax strategy patent applications. The number of business method patents surged after the *State Street* decision. *Id.* It can be expected that tax strategy patents likewise have surged after the possibility of patenting tax planning became better known. *Id.*

56. AMY E. HELLER, PATENTING TAX ADVICE: GRAT CASE STIRS DEBATE, ABA RPPT EREPORT 1 (Oct. 2006), http://www.abanet.org/rppt/publications/ereport/2006/1/heller_patenting.shtml. See also Gary C. Bubb, *Commentary: Patented Tax Strategies—Are You Serious?*, 35 MASS. LAW. WKLY. 2663, 2663 (Aug. 6, 2007) (noting the oddity of tax strategy patents).

patent holders at the expense of the general public.⁵⁷ The tax practitioners' concerns about tax strategy patents were therefore soon brought into the several years-long, congressional consideration of major patent law reforms. In its 2007 consideration of patent reforms, the House Judiciary Committee paid attention to the calls for banning tax strategy patents.⁵⁸ The House Ways and Means Committee held hearings that covered the complex issues in depth.⁵⁹ A major patent reform bill, the Patent Reform Act, similar to bills considered in prior years, was introduced in both the House and Senate.⁶⁰ In September 2007, the House passed an amended version of the bill, which prohibits patenting of tax planning methods;⁶¹ but Senate action remains uncertain.⁶²

The overall patent reform package is clearly controversial in itself.⁶³ The tax strategy patent prohibition component of that package may prove too controversial to pass in spite of the considerable support it apparently has at this point. The IP bar objects to special legislation prohibiting tax strategy patents, claiming that it "would run counter to the unitary nature of the U.S. patent system, which generally applies the same rules and standards in a technology-neutral manner."⁶⁴ In addition to widespread opposition from the IP bar to any ban, prohibition of tax strategy patents faces the same descriptive difficulties that beset most tax anti-abuse proposals—how to draw lines between acceptable business behavior and behavior that constitutes abusive tax practices.⁶⁵ Even opponents of tax strategy patents agree that there are accounting or computerized data manipulation techniques with tax components that should be patentable (e.g., Turbo Tax or other tax preparation software), but they are adamant that tax planning strategies that represent the abstract ideas of tax planners applying interpretations of tax law to proposed

57. See, e.g., Steve Seidenberg, *Reinventing Patent Law*, ABA J., Feb. 2008, http://www.abajournal.com/magazine/reinventing_patent_law/ (quoting patent litigator James Foster of Wolf, Greenfield & Sacks).

58. Alison Bennett, *House Judiciary Panel Explains Stance on Tax Strategy Patent Ban in New Report*, DAILY TAX REP. (BNA), Sept. 6, 2007, at G-1.

59. *Hearing on Issues Relating to the Patenting of Tax Advice*, H. Rep. Subcomm. on Select Revenue Measures of the Comm. on Ways & Means, 109th Cong. 77 (2006).

60. Patent Reform Act of 2007, H.R. 1908, 110th Cong. (2007); S. 1145, 110th Cong. (2007).

61. H.R. 1908, § 10.

62. See, e.g., Brett Ferguson, *Efforts to Ban Tax Patents at Risk of Being Watered-Down in Congress, Attorney Says*, DAILY TAX REP. (BNA), Oct. 12, 2007, at G-81; Sanford Warren & Brandon Lee, *Prospects for Patent Reform in 2008 and Beyond*, IRMI.com (Feb. 2008), <http://www.irmi.com/Expert/Articles/2008/Warren02.aspx#6>.

63. Analysis of the overall patent reform is beyond the scope of this article. Suffice it to say that it includes substantial changes to patent requirements, among them a controversial change from "first to invent" to "first to file" to harmonize U.S. patent requirements with E.U. patent requirements. See PatentlyO.com, http://www.patentlyo.com/patent/2007/04/patent_reform_a.html (last visited Aug. 10, 2008) (listing the major changes introduced in the patent reform bill).

64. Crystal Tandon, *Increased Awareness of Tax Patent Risks Needed, Say Practitioners*, 115 TAX NOTES 304 (2007) (reporting comments of Stephen Schreiner, an IP attorney in the Washington office of Hunton & Williams).

65. See Letter from Marcia S. Wagner, Managing Director, The Wagner Law Group, to Senator Arlen Specter regarding the Senate Tax Patent Bill (Mar. 24, 2008) (on file with author) ("The complexities involved in integrating the operation of two of the most arcane areas of the law, tax and patents, was underestimated by the House when it added its provision as an amendment.").

transaction structures should not be.⁶⁶ Some of those may be abusive of the tax laws (e.g., a highly technical derivative financial product with computerized accounting requirements that is intended to achieve an illicit interest deduction for a profit stream considered an equity return for tax purposes), but many may simply be undesirable as patented strategies because they are nothing more than abstract interpretations of particular tax provisions (e.g., a computerized method of allocating cost-recovery reductions in a limited partnership). Most commentators do not object to tax preparation software or even to the patenting of software that provides a method for making necessary tax determinations that are required as basic steps in computing tax liabilities in respect of a transaction.⁶⁷ The difficulty lies in adopting language that clearly prohibits “pure” tax strategy patent claims that are conceptual business structuring strategies, even though they may be cast as requiring computerized application. Thus, there will undoubtedly continue to be consultation and development in respect of these ideas as the major reform package reaches a final decision, perhaps later in 2008.

Concern that the larger controversies involved in passage of major patent-reform legislation may derail the provisions banning tax strategy patents has led to introduction in the Senate and House of various stand-alone bills intended to prohibit tax strategy patents.⁶⁸ Senators Baucus and Grassley, and Senators Durbin, Coleman, and Obama have introduced two different stand-alone bills in the Senate.⁶⁹ Representatives Doggett and Boucher have sponsored different stand-alone bills in the House.⁷⁰ Again, the language in the existing bills is generally quite broad. The Baucus bill, for example, prohibits patenting of inventions that are “designed to reduce, minimize, avoid, or defer or has, when implemented, the effect of reducing, minimizing, avoiding, or deferring a taxpayer’s tax liability or is designed to facilitate compliance with tax laws”⁷¹ It is expected that the provision prohibiting tax strategy patents will be offered as an amendment to the overall patent reform bill when it comes to the Senate floor.⁷²

66. See, e.g., Matthew A. Melone, *The Patenting of Tax Strategies: A Patently Unnecessary Development*, 5 DEPAUL BUS. & COM. L.J. 437, 457-58 (2007) (“[W]hether a software program . . . to determine . . . tax credit position is entitled to patent protection should be determined under the standards applicable to a business method claim in general. The inventions that raise special issues are those whose claims are broad enough to encompass the underlying tax planning technique itself.”).

67. *Id.*

68. See generally Alison Bennett, *Baucus, Grassley, Others Crafting Legislation Solely to Ban Tax Strategy Patents, Aides Say*, DAILY TAX REP. (BNA), Sept. 13, 2007 at GG-1 (discussing tax patents); Alison Bennett & Carol Oberdorfer, *Levin, Coleman, Obama Introduce Measure to Curb Foreign Abuses, Stop Tax Patents*, DAILY TAX REP. (BNA), Feb. 21, 2007, at G-2 (reporting the introduction of the Stop Tax Haven Abuse Act by Senators Carl Levin, Barack Obama and Ron Coleman on February 17, 2007).

69. A Bill to Provide that Certain Tax Planning Inventions Are Not Patentable, S. 2369, 110th Cong. § 1 (2007); Stop Tax Haven Abuse Act, S. 681, 110th Cong. § 1 (2007).

70. H.R. 2365, 110th Cong. (2007) (as introduced by Rep. Boucher, May 17, 2007) (limiting liability for patent infringement rather than prohibiting tax strategy patents); H.R. 2136, 110th Cong. (2007) (as introduced by Rep. Doggett, May 3, 2007) (prohibiting tax strategy patents).

71. S. 2369, 110th Cong. § 1(b)(2)(A) (2007).

72. See *Hill Watch: Tax Legislation*, DAILY TAX REP. (BNA), Mar. 31, 2008, at GG-11. S. 1145, 110th Cong. (2007). The general patent reform bill in the Senate has not yet come to the Senate floor, although it was introduced in 2007. *Id.*

In the aggregate, this legislative activity suggests that there is considerable interest in Congress in enacting some kind of a prohibition on the patenting of tax strategies. Even the White House has stated its understanding of the “concerns surrounding patent protection for tax planning methods” and its willingness to “work with Congress to address those concerns.”⁷³ The context of a large and controversial patent reform bill makes it more difficult, however, to predict the final legislative outcome.

B. Court Cases on the Determination of Subject-Matter Eligibility and Nonobviousness for Business Method Patents

Another series of important recent developments have taken place in the courthouse. The first is a more nuanced understanding of the obviousness test for patentability, briefly addressed in Part III.B.1 (and discussed further in the context of Patent Office competence to analyze tax strategy patents for obviousness, in Part IV.B.1). The second is the apparent narrowing of subject matter standards under recent Federal Circuit decisions, addressed in Part III.B.2.

1. KSR and the Obviousness Test

A major objection to the SOGRAT patent was tax practitioners’ sense that the patented planning structure—combining nonqualified stock options with a grantor retained annuity trust—did not represent an innovative development that competent estate tax planners could not achieve in the ordinary course of business.⁷⁴ In fact, most of the tax bar considers the SOGRAT structure an example of typical planning activity undertaken by estate planners in considering possible combinations of the various tax vehicles available (e.g., partnerships, grantor retained annuity trusts, grantor trusts) with the various types of assets held by their clients. This is basically an objection to the Patent Office’s inadequate understanding of obviousness in consideration of patent applications for tax planning methods.

In April 2007, the Supreme Court decided *KSR International v. Teleflex, Inc.*,⁷⁵ a case dealing with the patentability requirement of nonobviousness. The Court held that a test employed by the Federal Circuit for combining prior

73. Statement of Administration Policy on H.R. 1908, Patent Reform Act of 2007 from the Executive Office of the President, Office of Mgmt. & Budget, (Sept. 6, 2007), <http://www.whitehouse.gov/omb/legislative/sap/110-1/hr1908sap-r.pdf>.

74. Tax Patents: High Court Limits Obviousness, http://ataximgmatter.blogs.com/tax/2007/05/tax_patents_hig.html (May 1, 2007) (“Practitioners have argued, for example, that the SOGRAT patent, for which a patent infringement claim was recently settled, should not have been issued—even assuming arguing that patents for tax strategies are legitimate—because the patented technique would have been obvious to any well-versed tax practitioner.”). The patent law applies a hypothetical standard, generally referred to as PHOSITA—a person having ordinary skills in the art. See, e.g., PHOSITA, The Free Dictionary (2007), <http://acronyms.thefreedictionary.com/PHOSITA> (defining PHOSITA). Thus, one might think that combining nonqualified stock options with GRATs after the change in the SEC rules on transferability could have required an unpredictable creative leap for a small-town practitioner who did not routinely handle estate planning, but that it would have been a “no-brainer” for most practitioners who specialized in estate tax issues.

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

references—called the “teaching, suggestion, or motivation” test for combining prior art—was too “rigid”: the test provided insight but was inadequate to determine nonobviousness in the case of a patent claim for attaching a sensor to an accelerator pedal.⁷⁶ Instead, the Court noted the importance of recognizing the role of market pressures in pushing inventors to adapt and combine existing technologies.⁷⁷

As various IP commentators have recognized, the *KSR* decision represents an important step for claims in respect of tax strategies by establishing parameters that “will make it easier to find an invention obvious and thus unpatentable.”⁷⁸ Thus, one patent commentator describes the impact of *KSR* upon tax-related claims such as the SOGRAT patent in the following terms:

Before the *KSR* decision, many courts would have required a specific statement in either Law #1 [grantor retained annuity trusts] or Law #2 [change in Rule 16b-3 permitting transferability of nonqualified stock options], such as a statement in the legislative history of Law #2 that the amendment will permit stock options to be transferred to trusts, to provide a motivation to combine Law #1 and Law #2. Absent such a statement in the prior art itself, many courts would have ruled that there was no motivation to combine the references. Under *KSR*, in contrast, one might demonstrate a motivation to combine the laws through literature or testimony demonstrating a market demand to minimize tax consequences relating to the stock options affected by the change in Law #2.⁷⁹

Accordingly, if Patent Office examiners are able to apply *KSR*'s stricter nonobviousness analysis appropriately, it should have a positive impact on future assessments of tax-related patent claims. The Patent Office has already issued new guidelines for determining obviousness in view of *KSR*,⁸⁰ but it remains to be seen whether examiners will be successful in making appropriate obviousness determinations in tax strategy applications. Under the new guidelines, examiners should be less willing to find nonobviousness based on a very narrow concept of, and limited search for, prior art rather than a broad assessment of existing analogous planning strategies and changes in the market or interests of clients that could have led ordinary tax planners to develop the new technique.

2. *Comiskey and the Threshold Statutory Subject Matter Requirement*

Another judicial development is the Federal Circuit's harder look at the threshold statutory subject matter requirement for process claims in the *In re Comiskey* case, involving a patent application for a process of mandatory

76. *Id.* at 1741.

77. *Id.* at 1742.

78. Seidenberg, *supra* note 57; *Nuclear Option*, *supra* note 22, at 24-26.

79. Osborn, *supra* note 23, at 35.

80. Examination Guidelines for Determining Obviousness under 35 U.S.C. 103 in View of the Supreme Court Decision in *KSR International Co. v. Teleflex, Inc.*, 72 Fed. Reg. 57,256 (Oct. 10, 2007).

arbitration.⁸¹ James Toupin, General Counsel of the Patent Office, had filed a supplemental letter brief in *Comiskey* on behalf of the Patent Office.⁸² The brief specifically asked the court to consider the subject matter issue and noted the Patent Office's concerns that patenting of a mandatory arbitration process would result in an "invention that depends for utility on positive law, rather than laws of nature," and therefore may not be patentable subject matter.⁸³ Although the BPAI had rejected the patent claims on obviousness grounds, the Federal Circuit went further, holding that at least some of the claims were not even eligible subject matter.⁸⁴ Emphasizing that "[t]he very cases of this court that recognized the patentability of some business methods have reaffirmed that abstract ideas are not patentable," the *Comiskey* court stated that "an algorithm or abstract idea can state statutory subject matter only if, as employed in the process, it is embodied in, operates on, transforms, or otherwise involves another class of statutory subject matter, *i.e.*, a machine, manufacture, or composition of matter."⁸⁵ Thus, *Comiskey* appears to move the subject matter doctrine back towards a requirement of some type of technological intervention, not unlike the earlier "technological arts" test that had been so roundly rejected in *Lundgren*.⁸⁶

Following the September 2007 *Comiskey* decision and a similar decision in *In re Nuijten* that same month that rejected a business method process claim that appeared to involve only abstract ideas, the Federal Circuit took a further step that may potentially lead towards at least a partial course reversal on business method patents.⁸⁷ It decided in favor of an en banc rehearing of *In re Bilski*, a case involving a process claim for a business method for hedging energy risk.⁸⁸ The BPAI had determined that the *Bilski* claims were both non-transformational and merely a "disembodied abstract idea" and therefore non-patentable.⁸⁹ Much of the immediate blog commentary suggested that the decision represented a tug of war between judges who had won in the precedential *Lundgren* decision and the losers in that split decision who were on the *Bilski* panel, with the result that the unsettled law was "flipping" between those positions.⁹⁰ The May 8, 2008 *Bilski* rehearing⁹¹ will directly

81. *In re Comiskey*, 499 F.3d 1365, 1365 (Fed. Cir. 2007).

82. Supplemental Letter Brief, *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007) (No. 2006-1286).

83. *Id.* at 12.

84. *Comiskey*, 499 F.3d at 1381.

85. *Id.* at 1367.

86. See *supra* note 46 and accompanying text. Gruner suggests, I believe erroneously, that the courts' move to "disengage" the subject matter requirement from "old notions of technologies or industrial practices" is an appropriate one that permits the patent law to evolve to suit modern demands. *Worlds Collide, supra* note 22, at 44. The trend prior to *Comiskey* was clearly to broaden subject matter beyond technologically implemented inventions, however, and that trend may yet resurface, unless the Supreme Court definitively settles the issue. See *infra* note 106 and accompanying text.

87. *In re Nuijten*, 500 F.3d 1346, 1346 (Fed. Cir. 2007) (allowing patenting of a signal encoding technique for reducing distortion from the introduction of watermarks into audio signals but finding the signal claim itself not patentable).

88. *In re Bilski*, No. 2007-1130, Slip Op. at 1 (Fed. Cir. Feb. 15, 2008) (ordering rehearing *en banc* of *Bilski*'s energy risk management method following oral argument Oct. 1, 2007).

89. *Ex parte Bilski*, No. 2002-2257 (B.P.A.I. Sept. 26, 2006), at 6, available at www.uspto.gov/web/offices/dcom/bpai/its/fd022257.pdf.

90. Comments, *BPAI 'Informative' Opinion on Business Method Patents*, PatentlyO.com,

address the issue of subject matter eligibility for business method claims. The rehearing order specifically requests amicus briefing on the issue of whether the court should overrule *State Street*.⁹²

In light of these court decisions, the Patent Office has indicated that it expects to issue new guidance on the patentability of tax strategy patents.⁹³ Although no timing has been indicated, it is likely that the Patent Office guidance will await the release of the Federal Circuit's opinion following the rehearing in *Bilski*. It remains unclear whether the guidance will clearly prohibit patents on business and tax strategies, or merely set out a more restrictive test for providing such patents.

Accordingly, it is possible that the courts and the Patent Office will soon effectively ban tax strategy patents through a new understanding of the subject matter requirement for tax patents. One drawback, of course, is the possibility for further reversals of position on the issue. Different judges and new situations could lead the trial courts and Federal Circuit to retreat to a laxer variant of the *State Street* position, unless the Supreme Court sets out clear guidance.⁹⁴

Whether this undercurrent of change will be sufficiently vigorous to lead the Patent Office to refuse to patent tax planning methods that are not necessarily carried out by computer technology is uncertain. Even if only tax planning methods with computerized implementation are ultimately patentable, there are still significant concerns stemming from the ubiquitous role of computers in ordinary business processes and the potential inability of the Patent Office examiners to distinguish tax-related applications on the borderline that are truly technological from those that are not.⁹⁵

C. Proposed Reportable Transaction Regulations Governing Patented Transactions

In 1999, the Federal Circuit also decided another case that casts a long shadow over the patenting of tax planning strategies. In the now (in)famous *Juicy Whip v. Orange Bang* decision, the Federal Circuit held that the utility threshold requirement is not high, and it is satisfied if there is "some identifiable benefit."⁹⁶ Accordingly, the Patent Office does not assess the utility of patent claims, such as tax planning strategies, in terms of their usefulness in providing a public benefit or in furthering public policies.

http://www.patentlyo.com/patent/2007/02/bpai_informativ.html (Feb. 16, 2007).

91. See Audio Tape: *In re Bilski* Oral Arguments (May 8, 2008), available at <http://www.cafc.uscourts.gov/oralarguments/mp3/2007-1130-2.mp3>, <http://www.cafc.uscourts.gov/oralarguments/mp3/2007-1130-3.mp3> (providing digital recordings of the May 8 oral arguments at the CAFC).

92. *In re Bilski*, No. 2007-1130, Slip Op. at 1.

93. See Alison Bennett, *Sowell Expects U.S. Patent Office to Issue Guidance Curbing Tax Patents*, DAILY TAX REP. (BNA), Jan. 23, 2008, at G-8 (stating that Sowell expects guidance to be issued "indicating that tax strategies that are not associated with technology may not be patented").

94. See Comments, *supra* note 90 (discussing blog commentary on flip flopping).

95. See Dustin Stamper, *IRS Proposes Making Tax Patent Use a Reportable Transaction*, 117 Tax Notes 9 (Oct. 1, 2007) (discussing the need to define the line between strategy and mechanical processes).

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

Rather, it leaves such determinations to other federal agencies that are directly involved in setting and enforcing those policies.⁹⁷ As a result, the Patent Office can issue patents on devices—such as drag racing cheating devices⁹⁸—that may be illegal to use within some jurisdictions.⁹⁹

The IRS and the Patent Office thus each operate within their own jurisdictions to make appropriate determinations.¹⁰⁰ That territoriality creates a potential for both misperceptions about validity of tax planning patent claims, as noted by various commentators,¹⁰¹ and abuse of the patent process to promote abusive tax shelter transactions.¹⁰²

Although tax strategy claims that are designed to further abusive tax sheltering transactions could receive patent approval, there is no clear evidence that they have been used, to date, to further abusive tax planning transaction methods, as the IP bar readily points out.¹⁰³ Patent applications are generally publicized after the initial eighteen-month period, but it is possible for applications to remain confidential throughout the application review process if there is no intent to file for similar protection abroad.¹⁰⁴ Thus, there may be applications in the pipeline that are abusive, but that would not be known at this point.

The grant of a patent does not assure the licensee of a patented planning method that the tax consequences of the method as set out in the patent are correct. The fact that a government agency has approved a patent for the tax-saving method may, however, be seen by both tax practitioners and taxpayers as certifying that the patented planning method provides the tax benefits claimed. This is a particular problem for the tax system, because taxpayers are obligated to report the tax consequences of each of their transactions and

97. *Id.* at 1368.

98. Family Software, *What You Need to Know About—Electronics and Cheating*, RACINGARTICLES.COM (2000), http://racingarticles.com/article_racing-11.html (regarding patent issued in 1991 for computerized device to cheat in drag car races).

99. *See also Worlds Collide*, *supra* note 22, at 68 (listing patents on gambling devices, radar detection devices, cock fighting devices and alcoholic production devices issued during prohibition).

100. *Compare Toupin Statement*, *supra* note 49 (Patent Office makes its determinations without regard to validity under tax laws), with *Hearing on Issues Relating to the Patenting of Tax Advice Before the Subcomm. On Select Revenue Measures of the H. Comm. On Ways and Means*, 109th Cong. (2006) (statement of The Honorable Mark W. Everson, Commissioner, Internal Revenue Service), available at <http://waysandmeans.house.gov/hearings/asp?formmode=view&id=5104>.

101. *See, e.g.*, Charles F. Wieland & Richard S. Marshall, *Tax Strategy Patents—Policy and Practical Considerations*, 35 TAX MGM'T MEMO 499 (2006), updated in 35 TAX MGM'T COMP. PLANNING J. 123 (2007); AICPA, *AICPA Urges Congress to Address Tax Strategy Patents* (2007), <http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm>; ABA Section of Taxation, *Comments Concerning a New Category of Reportable Transaction Covering Patented Tax Strategies* (2007), available at <http://meetings.abanet.org/webupload/commupload/TX800000/relatedresources/CommentsonaNewCategoryofReportableTransactionsCoveringPatentedTaxStrategies.pdf> (supporting treating patented transactions as a new category of reportable transactions) [hereinafter ABA, *Comments*].

102. *See, e.g.*, Osborn, *supra* note 23 (similarly concluding that the patent process may permit patenting of abusive schemes).

103. Commissioner Everson stated as recently as 2004 that the IRS had not seen an abuse of the patenting process in its review of patent applications. *See Worlds Collide*, *supra* note 22, at 54 n.99 (citing Everson statement at Ways and Means hearing).

104. Linda M. Beale, *Tax Shelters and the Tax Minimization Norm: How Does the Patenting of Tax Advice Transform the (Global) Playing Field?*, J. L. SOC'Y (forthcoming 2008), available at <http://ssrn.com/abstract=1073152> [hereinafter Beale, *Tax Shelters*].

activities in accordance with the tax law. Any perceived government sanction of an illegal or ineffective method of reporting tax liabilities would have a strong ability to mislead or confuse taxpayers in carrying out this duty. That is quite different from an individual citizen's choice to purchase a licensed device for conducting illegal activities, when they are clearly under no obligation to take part in such activities. This voluntary compliance aspect of the tax system and the universal applicability of the tax laws distinguish tax from other areas of law and make the granting of tax strategy patents especially worrisome. Furthermore, a required disclaimer for promotions of patented transactions that the granting of a patent does not confirm that the planning method provides the tax benefits claimed might not alleviate the confusion caused by the apparent stamp of governmental approval. Similar disclaimers required under the new Circular 230 written opinion requirements are appended to so many materials that tax practitioners question whether they may well be disregarded and ignored by most readers.¹⁰⁵

The IRS has responded to these additional concerns—both the potential that taxpayers could be misled by the existence of a patent to consider the patented strategy necessarily valid and the possibility that tax planning method patents could be used to promote abusive tax avoidance transactions—by promulgating proposed regulations that require disclosure for patented transactions under the IRS's reportable transaction rules.¹⁰⁶ This is an important step, though one that complicates the reportable transaction regime and may ultimately create a considerable volume of material that the IRS, with its currently restricted resources, may be unable to process efficiently.¹⁰⁷

In brief, the reportable transaction regulations were developed over the last decade as a means of providing greater transparency and more timely information about tax planning to the IRS, so that it can better assess the validity of innovative tax planning methods based on aggressive interpretations of the Code that have a potential for tax avoidance and undertake timely audits of participating taxpayers.¹⁰⁸ Not every transaction is required to be reported; instead, the regulations promulgated under Code Section 6011 establish a small

105. DEBORAH L. PAUL & BRYAN C. SKARLATOS, REPORT ON CIRCULAR 230 REGULATIONS, REP. NO. 1081, N.Y. STATE BAR ASS'N TAX SEC. 4 (2005), available at <http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1081rpt.pdf>.

106. The notice of proposed rulemaking expressed the IRS's concerns about the potential patentability of tax shelter transactions, the potential to mislead taxpayers about legitimacy of patented transaction strategies, and the possibility that patenting of tax strategies might impede the efforts of tax administrators to obtain information about tax shelters at the same time that it could have a negative impact on tax administration. Patented Transactions, 72 Fed. Reg. 54615 (proposed Sept. 25, 2007) (to be codified at 26 C.F.R. pts. 1 & 301) [hereinafter, NPRM]; see also Stamper, *supra* note 95 (describing reaction to the proposal).

107. This is another area in which the IP bar misjudges the importance of the issue. For example, Gruner states that patent applications can be "easily . . . analyzed and publicly characterized as abusive" and thus the impact of patents on sheltering transactions is "illusory." *Worlds Collide*, *supra* note 22, at 54. Even with the improved transparency that the reportable transaction regime has provided, and the enhanced penalty structure, the IRS must constantly struggle to fight the development of abusive shelters, in part because of the existing incentives to innovate.

108. See T.D. 9017, 2002-2 C.B. 815 (setting out disclosure requirements); T.D. 9018, 2002-2 C.B. 823 (setting out list maintenance requirements applicable to "material advisors"); T.D. 9046, 2003-1 C.B. 614 (finalizing the reportable transaction regulations); see generally Beale, *Before the Return*, *supra* note 11, at 613-17 (discussing the chronology of the statutory and regulatory changes under the anti-tax shelter initiative).

number of filters to identify for special disclosure those transaction types that are most likely to involve aggressive tax planning. The filters include listed transactions, confidential transactions, transactions with contractual protection, loss transactions, and transactions involving a brief asset holding period.¹⁰⁹ Listed transactions are transactions that the IRS has identified as abusive tax avoidance transactions through notice or other published guidance.¹¹⁰ Additional regulations promulgated under Code Sections 6111 and 6112 govern reporting and list maintenance by material advisors.

In 2006, the Treasury Department amended the reportable transaction regulations and issued proposed and temporary regulations adding a category of reportable transaction called “transactions of interest.”¹¹¹ In the commentary on the proposed regulation, the IRS and Treasury Department noted that tax strategy patents might be interpreted as approval by the government for the patented transaction and expressed concern that such patents could impede tax administration.¹¹² They asked for comments on the potential creation of a new category of reportable transactions to cover patented tax strategies. After receiving various comments, including from the ABA Task Force,¹¹³ suggesting that there be some method of disclosure for patented tax strategies, the IRS and Treasury Department released a notice of proposed rulemaking with proposed regulations treating patented transactions as reportable transactions.¹¹⁴

The proposed regulations with respect to tax strategy patents expand the categories of transactions that must be reported by adding a category of “patented transactions” to the reportable transaction filters and by treating most patent holders as material advisors.¹¹⁵ There are two subparts for the definition of patented transactions that are designed to require disclosure by both patent users and patent holders or their agents. Thus, patented transactions are transactions (i) for which a patent user pays a fee for the legal right to use a patented tax planning method, and (ii) for which a patent holder (or patent holder’s agent) has the right to payment for another person’s use of a patented tax planning method.¹¹⁶ Reporting is triggered by inclusion of a patented transaction item (including deduction of payments to the Patent Office to apply for a patent) on a tax return.¹¹⁷

The definition of the critical term, “tax planning method,” is quite broad, but does provide an exemption for tax preparation software:

[T]he term tax planning method means any plan, strategy, technique,

109. Treas. Reg. § 1.6011-4(b)(1) (as amended in 2007).

110. *Id.* § 1.6011-4(b)(2) (as amended in 2007).

111. *Id.* § 1.6011-4(b)(6) (as amended in 2007).

112. 71 Fed. Reg. 64,488 (Nov. 2, 2006) (to be codified at 26 C.F.R. pt.1).

113. ABA, *Comments, supra* note 101; see also Alison Bennett, *ABA Tax Section Says IRS Should Require Reporting of Transactions Using Tax Patents*, DAILY TAX REP. (BNA), No.35, at G-5 (Feb. 22, 2007) (discussing the ABA Task Force comments).

114. NPRM, *supra* note 106.

115. Prop. Treas. Reg. §1.6011-4(b)(7), 72 Fed. Reg. 54,617 (Sept. 26, 2007).

116. *Id.* § 1.6011-4(b)(7)(i).

117. *Id.* § 1.6011-4(c)(3)(i)(F).

or structure designed to affect Federal income, estate, gift, generation skipping transfer, employment, or excise taxes. A patent issued solely for tax preparation software or other tools used to perform or model mathematical calculations or to provide mechanical assistance in the preparation of tax or information returns is not a tax planning method.¹¹⁸

For patent users, the definition of patented transactions requires knowledge or reason to know that the planning method is the subject of a patent.¹¹⁹ Fees include any form of consideration, but do not include settlement of, or payment of damages in, an infringement suit.¹²⁰ Thus, persons from whom the IRS could not be expected to receive valuable information in a timely fashion, such as a person who uses a patented tax strategy without knowing about the patent or an infringer, are not subject to the disclosure requirement.

The ABA Task Force has commented on the proposed regulations, noting the importance of requiring reporting at the time of application for tax strategy patents as a means of allowing tax administrators a timely opportunity to assess covered transactions and determine whether some further action, either within the agency or in Congress, is necessary.¹²¹ For example, a tax method claim for which a patent is sought may be clearly erroneous as a matter of law under existing authorities. In that case, the IRS could perhaps issue a notice or some other published guidance that describes the components of the transaction and sets out the settled interpretation of the law under which the patent claims fail. If the IRS can issue such guidance expeditiously, such a notice should not be viewed by the Patent Office as irrelevant merely because it is issued after the patent application is made available to the IRS. The IRS's statements of settled law, demonstrating that the tax planning method does not achieve the claimed tax benefits, should guide the Patent Office in its understanding of the prior art relevant to the patent claim and permit the Patent Office to reject the application on the basis of lack of utility.

Patent claims that present non-novel or obvious extensions of current law that would have been accessible to ordinary tax practitioners may also present an opportunity for the IRS to assist the Patent Office in deciphering prior art. Attorneys within the Office of Chief Counsel could review such applications and submit prior art references to the Patent Office. Those references, again, should lead the Patent Office to conclude that persons having ordinary skill in the art could have developed the tax planning method presented in the patent claim and thus to reject the patent application.

As the IP bar has suggested, if a tax method claim in a patent application is abusive, the IRS could issue a notice identifying the tax planning technique

118. *Id.* § 1.6011-4(b)(7)(ii)(F).

119. *Id.* § 1.6011-4(b)(7)(i).

120. *Id.* § 1.6011-4(b)(7)(ii)(A).

121. ABA SEC. OF TAXATION, COMMENTS CONCERNING PROPOSED REGULATIONS UNDER SECTIONS 6011 AND 6111 OF THE INTERNAL REVENUE CODE RELATING TO PATENTED TRANSACTIONS 6 (2008), available at <http://www.abanet.org/tax/pubpolicy/2008/080129proposedregulationsundersection6011and6111relatingtopatentedtransactions.pdf> [hereinafter, ABA PROPOSED REG., COMMENTS].

as a listed transaction, thus alerting taxpayers and tax advisors that the IRS does not consider the method a valid interpretation of the tax laws.¹²² Although the listing process generally takes some time and each potential listed transaction requires extensive review within the IRS, that process is considerably more responsive than legislative changes, which often require several congressional terms to achieve.¹²³ The listing process should eventually provide a means of discouraging use of an abusive method patent. Practitioners are wary of recommending listed transactions to their clients, so that merely requiring reporting with respect to a transaction structure has been successful in discouraging its use.¹²⁴ It is therefore likely that the IRS's notice listing a patented transaction as abusive would discourage taxpayers from participating in the transaction if a patent were granted and would similarly discourage promoters from developing similar transactions.

To facilitate discovery of abusive transactions, the reportable transaction regulations already require reporting of confidential transactions, as noted above. Those rules may be avoided by taxpayers and advisers intending to take their chances with the audit lottery, however, by eliminating any contractual requirements for confidentiality while maintaining confidentiality "in fact."¹²⁵ Patents could also facilitate promoters in maintaining secrecy about the use of a tax strategy. Although the patent would be published upon issuance, there is no patent provision requiring disclosure of licensing agreements.¹²⁶ Required reporting by licensed users of patented transactions and by patent holders as material advisors under the proposed reportable transaction regulations will therefore more likely ensure that potentially abusive transactions are disclosed to the IRS and bring full scrutiny to those who use such transactions.

Several commentators have objected to the reportable transaction mechanism as too burdensome for patent holders and licensees and have urged

122. See, e.g., *Worlds Collide*, *supra* note 22, at 58 (discussing changes in tax regulations).

123. If additional action by the IRS or Congress is necessary beyond a listing notice, it may be difficult to take necessary steps in a timely fashion. The IP bar tends to misunderstand the nature of the legislative process for tax changes. See, e.g., *Nuclear Option*, *supra* note 22, at 27 ("The IRS does not need to infringe the patent to destroy its value—it can adopt regulations making use of the strategy unacceptably risky or it can lobby Congress to amend the tax statute to make the strategy unworkable."). Regulatory projects are subject to extraordinarily long delays, and Congressional action is subject to delays as well as the vagaries of the political process, providing no assurance that changes can be put into effect as needed. In addition, a change to one area of the Code or regulations inevitably has implications for other areas and cannot be undertaken without understanding those consequences. Thus, even for abusive transactions it could take years before a legislative or regulatory remedy could be enacted. Nonabusive transactions offer an even more difficult scenario for remedy, since the problem is the issuance of the patent itself, not the tax law provisions. See *infra* Part IV.B for further discussion of this issue.

124. Stamper, *supra* note 95, at 10 (reporting ABA task force chair Dennis Drapkin's comment that "just the act of making a transaction reportable has often affected its use").

125. Robert A. Rizzi, *Tax Shelters Invade: Corporate Transactions and the Anti-Shelter Crusade*, CORP. TAX'N, July-Aug. 2004, at 23 (suggesting one response to required disclosure of confidential transactions is to execute transactions with documents that disclaim any confidentiality requirement but that "remain confidential in fact").

126. See Diane Freda, *Attorneys Advised Tax Strategy Patents Nothing New*, DAILY TAX REP. (BNA), Nov. 2, 2006, at G-12 (noting statement by Georgetown professor Jay Thomas that tax attorneys say they use patents "so they don't have to make it confidential").

that the IRS defer to congressional action instead.¹²⁷ Similar objections were voiced when the IRS first proposed the reportable transaction regulations for other types of transactions,¹²⁸ yet that regime has been in operation for some time without the strong negative repercussions that critics projected. The reportable transaction regime permits a speedier response to abusive transactions than would otherwise be available. Without the regulations, the IRS would not learn about abusive patented transactions until the patent issued. Some issued patents for tax shelter transactions might avoid close scrutiny by the IRS due to their classification or manner of stating claims or other means.¹²⁹ Even for those that the IRS does scrutinize, the IRS would require some time to assess fully the patented transaction, and in that time transactions would have the opportunity to go forward. The IRS could also develop legislative proposals to address abuses that exploit a perceived loophole in the current tax provisions, but there would likely be a considerable time lag before Congress could or would take action. A particular tax shelter is typically undertaken by relatively few taxpayers only in the period before the tax administration becomes aware of it, so delayed Congressional action to obsolete the transaction would not provide a sufficient hurdle. Thus, a patent on a tax shelter transaction would likely have considerably more value if there is not some mechanism such as the reportable transaction regulations to provide information to the IRS at the time of the patent application.

If the proposed regulations are finalized substantially in their current form, they will provide an important tool in the arsenal of the tax administration to deal with tax shelter transactions. It would be difficult to exploit the patenting process to avoid the restraints on confidential tax advice that promotes abusive transactions. The additional transparency provided by requiring reporting to the IRS by the patent applicant at the time of fee payments in connection with the patent application should give tax administrators a timely opportunity to evaluate the validity of the transaction under current interpretations of the tax laws.¹³⁰ That evaluation could result in listing the transaction set forth in the underlying patent claims and thus act as a significant deterrent to use of the abusive transaction method.¹³¹

The reportable transaction regulations will not, however, resolve all of the

127. See, e.g., Internal Revenue Service, *Unofficial Transcript of IRS Hearing on Patented Transactions is Available*, TAX NOTES TODAY, Feb. 21, 2008, LEXIS, 2008 TNT 41-26 [hereinafter *IRS Hearing*].

128. E.g., Warren Rojas & Sheryl Stratton, *Tax Shelter Regs. Too Burdensome, Practitioners Tell Government*, 97 TAX NOTES 1509, Dec. 19, 2002; Michael Fleming, *Leasing Group Expresses Concern over Tax Shelter Reporting Regs.*, 2002 TAX NOTES TODAY 249-15, Nov. 27, 2002; Douglas J. Antonio, *Bar Panel Criticizes Corporate Tax Shelter Regs.*, 2000 TAX NOTES TODAY 102-27, May 17, 2000.

129. See Allison & Tiller, *supra* note 39, at 1021 (noting the possibility that many applications are presented in ways to avoid classification as business method patents in order to avoid the second review required for such patent applications).

130. The Texas tax bar noted, however, that a patent applicant could decide not to deduct the fee payments and thus avoid reporting on the technicality of not having a deduction. See *IRS Hearing, supra* note 127 (statement of Kevin Thomason). The IRS will likely amend the proposed regulations to address this issue, perhaps by requiring reporting at any time that a taxpayer is eligible to take a deduction related to a patented transaction on a return.

131. The IRS's listing of a transaction does not make it an illegal position to take on a tax return, and taxpayers remain able to litigate any assessment of tax liability in court.

concerns of the tax bar and tax administration with the issuance of patents for tax strategies.¹³² A number of difficult issues remain, in particular for those patented transactions that would not result in identification as listed transactions. These issues are addressed in Part IV.

IV. WHY TAX STRATEGY PATENTS MATTER

A patent is a grant of a monopoly in the patented technology for the life of the patent.¹³³ Benefits from holding a patent therefore include the ability to charge a fee or royalty for others to use the patented technology or, if the holder chooses, the ability to exclude others from using the technology covered. If a tax strategy patent is valid, taxpayers who do not arrange a license with the patent holder (and pay the related royalty) to use the tax-structuring technique covered by the claims of the patent would face the possibility of a patent infringement suit (assuming their use of the patented method becomes known to the patent holder).¹³⁴ Even if a tax strategy patent is not valid and could be overturned through litigation, many or even most taxpayers will likely not be able to engage in the patented tax-structuring technique without paying a royalty, because of the high costs of challenging a patent once it has been granted by the Patent Office.¹³⁵ A patent provides these exclusionary rights for twenty years from the date of filing.¹³⁶

This Part restates the primary objections to tax strategy patents granting these exclusionary rights if, in spite of the hopeful signs outlined in the prior Parts, tax strategy patents continue to be issued. The intent is to provide a better grounding of the rationales, which have been addressed by a number of tax commentators, in the foundational principles of the tax system and the institutional role of tax in our democracy. Part IV.A considers the impact of these exclusionary rights in the case of patented tax claims that provide a strategy for an abusive tax shelter transaction. Part IV.B addresses their impact in the case of legitimate tax planning strategies.

A. Patenting of Abusive Tax Planning Strategies

The ability of any person to receive royalties for licensing use of a patent on an abusive tax avoidance strategy would be particularly offensive. To the extent that such patents avoided the IRS's scrutiny and were successfully

132. See, e.g., Bennett, *IRS Remains Concerned*, *supra* note 4, at G-2.

133. If a patent issues, the patent holder obtains the right to exclude others from making, using, selling, or offering to sell or importing the patented invention. 35 U.S.C. §§ 154(a)(1), 271(a) (2000).

134. *Id.* § 281.

135. Litigating patents is expensive. See, e.g., William A. Drennan, *The Patented Loophole: How Should Congress Respond to this Judicial Invention?* 59 FLA. L. REV. 229, 293 (2007) ("Based on a survey of intellectual property lawyers in 2000, the cost of defending a . . . case[] with less than \$1 million at risk . . . was \$300,000 to \$750,000 or about half the amount in dispute."); WENDY R. SCHACHT & JOHN R. THOMAS, PATENT REFORM: INNOVATION ISSUES, 7 (2007) (noting average costs of patent enforcement as high as \$1.2 million, with higher stakes litigation costing as much as \$4 million to each party).

136. The maximum term is ordinarily twenty years from the date the patent application is filed. 35 U.S.C. § 154(a)(2).

promoted to select groups of users, the Patent Office would have become an enabler of promoters of tax shelters, at the same time that the IRS continues to expend considerable resources in fighting such shelter promotions.¹³⁷ The IRS's reportable transaction rules have provided greater transparency to make it harder to profit from tax shelters, and Congress's recent strengthening of penalty provisions has encouraged greater compliance.¹³⁸ Although the IRS is still hindered by insufficient resources for enforcement, it has made enforcing its tax shelter rules a priority. Anecdotal reports suggest that the anti-tax shelter focus has gained some traction in the struggle against the shelter industry as tax chiefs at public corporations are paying attention and avoiding tax shelter promotions.¹³⁹ Congress has continued the trend by changing the tax return preparer provision to force tax advisers to balance their tax minimization planning with a proper regard for the integrity of the tax laws, requiring a confidence level of more likely than not for tax return preparers' work.¹⁴⁰

Patenting tax shelter strategies is fundamentally inconsistent with this effort to squelch tax shelter promotion. If patent applications are not available for review by the IRS (either through the reportable transaction regime or some other mechanism for opening applications for IRS review), shelter promoters could develop new shelter transactions and apply for patents, without publishing the application (to avoid IRS scrutiny). Assuming a patent issued, the holder could reap substantial economic benefits from the promotional value of the patent, prior to any action by the IRS to list or challenge the transaction. Consider, for example, the various provisions enacted by Congress to end inappropriate deductions for equity-like returns that are legally in the form of interest on debt.¹⁴¹ An inventive investment banker may create a new financial derivative product that applies a hyper-literal interpretation to the Code to claim success in again characterizing an equity-like payment as interest eligible for an interest deduction. The IRS's determinations regarding claimed tax benefits of derivatives historically require considerable time and internal review. The patent holder might well reap substantial profits before the IRS determines that the product is not taxable as claimed. Even if those deals can be challenged through audits and litigation, the anti-shelter enforcement drive suffers and, with it, the federal fisc.

137. See generally Linda M. Beale, *Putting SEC Heat on Audit Firms and Corporate Tax Shelters: Responding to Tax Risk with Sunshine, Shame and Strict Liability*, 29 J. CORP. L. 219 (2004) (discussing the interrelated problems of financial accounting fraud and corporate tax shelters and the effort by the IRS to address the issues).

138. *Id.* at 221.

139. See generally *id.* at 239-40 (relating legal, accounting, and other costs associated with defending tax strategies against "disgruntled taxpayers, shareholders, and the IRS").

140. Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-28, § 8246(b), 203, 121 Stat. 190 (2007) (revising the confidence level required to avoid penalties under Code § 6694 from realistic possibility of success to more likely than not). The author proposed this change in an earlier article on ethical responsibilities of tax advisers. Beale, *Before the Return*, *supra* note 11, at 638-44.

141. See, e.g., I.R.C. § 163(e)(5) (2007) (high yield discount obligation rules); I.R.C. § 163(l) (2007) (equity-linked debt rules).

B. Patenting of Legitimate Tax Planning Strategies

Tax practitioner concerns with tax strategy patents extend over a range of issues that have been addressed repeatedly in a number of published articles and commentary.¹⁴² This article will not reiterate all of the many arguments that have been made. It will, rather, focus on several broad points. As a threshold matter, the tax bar concern that the Patent Office is not equipped to apply the nonobviousness standards and other patentability requirements to sophisticated tax transactions is not an insubstantial concern that can be lightly dismissed. The Patent Office has not hired, and will not be able to hire, sufficient tax attorneys with the breadth and depth of expertise necessary to assess sophisticated tax planning techniques. Also, the tax bar is concerned about a variety of interrelated problems that are encompassed within the concept of private appropriation of the tax laws. These problems rest in the fundamental conflict between the tax law's goal of collecting revenues through a voluntary compliance system that depends on a system of laws that fairly demand sacrifice of the nation's residents to fund important governmental goals and the patent law's goal of providing temporary monopolies to private parties to incentivize beneficial innovations. Three particular manifestations of this fundamental conflict are addressed here: fairness issues, institutional concerns, and professional concerns.

1. Patent Office Competence to Assess Tax Strategies

Even if abusive transactions can be addressed through means such as the reportable transaction regulations, there remain substantial concerns about the competence of patent examiners—who are frequently scientists and engineers or, at best, economists or business specialists by training—to make appropriate patent eligibility determinations in the case of tax planning method patents.¹⁴³ The IP bar tends to understate these concerns and express unbounded optimism in the Patent Office's ability to adapt to this new challenge.¹⁴⁴ The tax bar is

142. E.g., Ellen Aprill, *Responding to Tax Strategy Patents*, USC TAX INSTITUTE—MAJOR TAX PLANNING (forthcoming 2007), available at <http://ssrn.com/abstract=980347>; Beale, *supra* note 104; Dennis I. Belcher & Dana G. Fitzsimons, *Tax Planners—Beware of Patented Estate Planning Techniques*, PROBATE & PROPERTY, Nov./Dec. 2006, at 24, available at <http://meetings.abanet.org/webupload/commupload/TX800000/newsletterpubs/BelcherRPPTmagazinearticle.pdf>; Bubb, *supra* note 56; Paul Devinsky, John Fuisz & Thomas Sykes, *Whose Tax Law Is It? Alarm Bells Should Ring over Risking Efforts to Patent Tax Strategies*, LEGAL TIMES IP MAG., Oct. 16, 2006, at S12; David A. Weisbach, *Disrupting the Market for Tax Planning*, 26 VA. TAX REV. 971 (2007); Wieland & Marshall, *supra* note 101; Letter from Kevin Thomason, Chair Section of Taxation for State Bar of Texas, to members of Congress (Sept. 14, 2007), available at <http://www.texastaxsection.org/letter2007.pdf>; Jack Cathey, Howard Godfrey & Justin Ransome, *Tax Patents Considered*, 204 J. OF ACCOUNTANCY 40 (2007); Drennan, *supra* note 135; Andrew A. Schwartz, *The Patent Office Meets the Poison Pill: Why Legal Methods Cannot Be Patented*, 20 HARV. J.L. & TECH. 333 (2007); Brant J. Hellwig, *Questioning the Wisdom of Patent Protection for Tax Planning*, 26 VA. TAX REV. 1005 (2007); Alan S. Lederman, *Tax-Related Patents: A Novel Incentive or an Obvious Mistake?*, 105 J. TAX'N 325 (2006).

143. See Beata Gocyk-Farber, Note, *Patenting Medial Procedures: A Search for a Compromise Between Ethics and Economics*, 18 CARDOZO L. REV. 1527, 1561 n.254 (1997) (noting that patent examiners are usually experts in the field).

144. See *Nuclear Option*, *supra* note 22, at 4-5 (expressing optimism about the Patent Office's ability to deal with new fields).

considerably less optimistic.¹⁴⁵ Sophisticated applications of tax law may be present in tax-related patent claims with respect to exotic financial derivatives or similar planning strategies. Engineers' ability to expand their repertoire to cover the data processing aspects of financial transactions and software bears little relation to the need for the Patent Office to acquire sufficient tax expertise to assess tax planning methods. Fields like banking, real estate analysis, sales, and business consulting simply do not have a foundational legal system as immense or as challenging as the Code and regulations and other authorities applicable to tax planning. Many tax partners in firms deal primarily with one or another area of the tax code—partnerships or corporations or trusts or financial products or individual taxation issues. It is challenging to acquire that in-depth expertise across all fields and generally requires years of experience, constant exposure to new transactions, and continuing education on relevant statutory and administrative authority changes. Consider the divisions within the IRS itself, where some deal with financial products, others with corporate tax, and still others with partnerships and other tax conduits.¹⁴⁶ Furthermore, practitioners that leave commercial practice to become academics, journalists or government officials face further difficulties. It is difficult, if not impossible, for them to stay in touch with current transactions and the new, aggressive techniques being developed, particularly with each of the many changes in the tax law, unless they also maintain a practice that continues to expose them to new developments.¹⁴⁷ Simply hiring a few patent examiners with backgrounds in tax, or holding special training sessions or presentations for those examiners, as suggested by the IP bar,¹⁴⁸ will not suffice; nonetheless, the Patent Office has in the past asserted that they consider themselves *already* competent to assess tax strategies.¹⁴⁹ This is an

145. See Floyd Norris, *Patent Law is Getting Tax Crazy*, INT'L TIMES HERALD, Oct. 10, 2006, at 12 (expressing concern over patent attorneys' tax expertise).

146. The IRS's Office of Chief Counsel is divided into six associate chief counsel offices corresponding to primary areas of tax technical expertise: international, corporate, pass-throughs and special industries, income tax and accounting, procedure and administration, and financial institutions and products; in addition, it includes experts in criminal tax as well as tax-exempt and government entities. B. John Williams, Jr., *The Office of Chief Counsel: A Renewed Commitment to Guidance*, THE TAX EXECUTIVE, Mar. - Apr. 2002 available at http://findarticles.com/p/articles/mi_m6552/is_2_54/ai_86472900. An attorney in the Office of Chief Counsel who specializes in financial institutions and products would be expected to know the tax laws relating to banks, thrift institutions, investment companies, insurance companies, real estate investment trusts, and similar institutions, as well as the tax laws governing the tax treatment of financial products, credit default swaps, contingent payment debt instruments, and various exotic derivatives. See, e.g., Press Release, IRS, Stephen Larson Named Acting Associate Chief Counsel (Aug. 22, 2007) (describing the tax matters covered by that Associate Chief Counsel office).

147. This is openly acknowledged by tax practitioners.

148. See, e.g., *Worlds Collide*, *supra* note 22, at 66 (suggesting that cooperation, presentations and submissions of prior art can resolve the problem).

149. See, e.g., Alison Bennett, *Patent Office Staying Out of Debate over Tax Strategy Patent*, *Official Says*, 74 PAT., TRADEMARK & COPYRIGHT J. (BNA) 498 (Aug. 24, 2007) (noting comment by Patent Office official Wynn Coggins that she expected tax patents to continue to issue based on the novelty test, and that her office has "great expertise" in the area). The question of the competence of the Patent Office examiners to deal with the intricate complexities of the tax law is dealt with in some detail in an earlier article. See generally Beale, *Tax Shelters*, *supra* note 104. Note that patent lawyers also have some concern about the ability of the Patent Office to apply the law as developed in *KSR* or other cases appropriately. See, e.g., Comments, *supra* note 90 (noting concern about patent examiners' ability to apply any new nonobviousness standard set by the *KSR* Court in blog commentary on *Bilski* BPAI decision).

area frequently misunderstood by the IP bar, members of which tend to assume that the lack of an adequate database can be remedied as easily it has been for very different categories like software, by simply encouraging more submissions of prior art or other relatively simple steps.¹⁵⁰

Finally, it may be especially difficult for Patent Office examiners to determine whether a particular tax-related claim merely implements statutory objectives (and therefore is obvious) or rather creatively extends the statutory provision to a novel structure that could only be understood to be comprehended within the statutory scope in hindsight. I have argued that the tax laws require a coherence-reinforcing interpretive approach that attempts to fit each provision into a structurally coherent system, to the extent possible and consistent with the purpose for the particular provision.¹⁵¹ This coherence-reinforcing interpretation is necessary to understand the capacity of the Code for governing new transaction structures that have not been explicitly considered during enactment. For example, some statutory provisions may apply only to very specific types of transactions. To take a simple case, the reorganization provision in Section 368(a)(1)(A) applies only to reorganizations that are effectuated under a valid merger or consolidation statute. An extraordinary amount of discussion has taken place over the years since the enactment of the provision to determine what mergers are actually covered by the provision.¹⁵² Multistep transactions may be integrated and recast as “A” reorganizations. The tax bar and IRS continue to discuss these issues, so it is clear that the Patent Office would struggle to make obviousness determinations about these complex transaction structures.

2. *Private Monopolies on Interpretations of the Tax Laws*

In its comments on the proposed patented transaction regulations, the ABA Task Force expressed its concern about the potential for tax strategy patents to effectively privatize provisions of the tax law by permitting the holder to exercise monopoly control over a legal interpretation as it applies to a novel financial transaction or structure.¹⁵³ The proposed regulations may

150. See, e.g., Richard S. Gruner, *In Search of the Undiscovered Country: The Challenge of Describing Patentable Subject Matter*, 23 SANTA CLARA COMPUTER & HIGH TECH. L.J. 395, 434 (2007) (asserting that temporary database shortages should not limit patentable subject matter); Osborn, *supra* note 23, at 41-42 (similar). Osborn also argues, contrary to my argument here, that patenting tax planning methods will benefit the profession by creating pressures to create databases of prior art accessible to Patent Office examiners, thus expanding information available to tax professionals. *Id.*, at 43-44.

151. See, e.g., Linda M. Beale, *Book-Tax Conformity and the Corporate Tax Shelter Debate: Assessing the Proposed Section 475 Mark-to-Market Safe Harbor*, 24 VA. TAX REV. 301, 359-70 (2004) (discussing the importance of coherence-reinforcing interpretations considering the tax system as a whole and the purpose for particular provisions in light of discoverable overarching principles); Beale, *Before the Return*, *supra* note 11, at 590-91, 590 n.17 (discussing the endogenous principle of structural coherence and self-assessment).

152. See generally Steven A. Bank, *A Transcontinental “A” Train? Foreign Mergers under Section 368(a)(1)(A)*, TAX LAW. 555 (2001) (discussing mergers); Randy A. Schwartzman, *Expansion of Merger and Consolidation Provisions*, CPA J. (June 2005), <http://www.nysscpa.org/cpajournal/2005/605/essentials/p58.htm> (same).

153. ABA PROPOSED REG., COMMENTS, *supra* note 121, at 5.

In our view, the principal benefit of tax patent reporting is that it will permit the IRS and the Treasury Department to identify the areas of the tax law for which patents are being claimed—and

provide notice to the IRS that a patented tax strategy may effectively privatize an area of the tax law's application; however, it is not clear how the IRS could respond to remedy the situation since it is endemic to the nature of the monopoly right granted by the issuance of a patent.

IP commentators argue that privatization of the tax laws on such a broad scale is not possible, "because the prior art embodied in the law itself (including the draft legislation) would either anticipate or render obvious all or most of the explicitly intended applications of the law" or that "patenting one method will not preclude other strategies involving the same assets or vehicles."¹⁵⁴ The problem is that while a number of strategies may have been foreseen when a statute was enacted and specifically contemplated by the drafters, the statute also clearly should be considered, from a coherence-reinforcing interpretive perspective, as intended to govern wholly new types of transactions that nonetheless come within its bounds. Are all of those "obvious" even though the development of a particular viable structure requires considerable work by investment bankers and tax planners and analysis by tax attorneys? I suspect that most tax lawyers would agree that some structures that do indeed implement statutory objectives are not obvious, even within the more rigorous *KSR* standard for obviousness. Thus, the SOGRAT strategy appeared obvious to most tax practitioners because it required only a simple extension of a known tax vehicle (the trust) and a known type of assets (stock options). The creation of guaranteed maturity classes for REMICs was not obvious, however, because it required a considerable stretch in application of the relevant rules (regarding the meaning of credit enhancement contracts and the contexts for permissible purchases of mortgage loans out of a REMIC vehicle) to accelerate payment to a specific date not determined by the maturity dates of the purchased mortgage loans. The ability to design such structures is the hallmark of an exceptional tax guru. Those innovations that fit within this group, though difficult to identify, would likely be considered a patentable "invention."

Recognition of the special attributes of the tax system argues against granting patents to inventors of tax reduction strategies who may either restrict or capture an interpretation regarding the applicability of a particular area of the law. The tax system exists to raise revenues appropriately from all citizens and residents to fund important government functions. To accomplish that purpose, the tax system requires compliance under a self-assessment system

thus the areas of the tax law that private parties are asserting the right to control. Only if the IRS and Treasury Department have this information available can they consider the impact of such claims, both individually and in the aggregate, and formulate whatever responses may appear to be necessary and appropriate to ensure the proper functioning of our tax laws.

Id.

154. Osborn, *supra* note 23, at 47. Elsewhere, Osborn refers to tax fears of preemption as a "straw man" argument. *Id.* at 49. Interestingly, in spite of the IP bar's devotion to a broad patent law with no exclusions, at least one IP commentator has proposed that neither the IRS nor the Congress should have the right to take away the benefit gained by a tax patent once a patent application using that benefit has been filed: the suggestion is that any legislation passed after the application is published should not be allowed to affect that patent. See Wagner, *supra* note 65 (memorandum objecting to proposed Senate bill). This proposal carries patent preemption of tax legislation to an obviously untenable extreme. *Id.*

that is often referred to as voluntary compliance: taxpayers report their tax items, determine their own tax liabilities and make payment to the government in accordance with that determination, subject to the possibility of an audit by tax administrators.¹⁵⁵ The tax system is universal, in that each and every taxpayer is required to determine their tax liabilities in accordance with all of the tax provisions that apply to the ordinary business, investment, and personal endeavors that the taxpayer has undertaken. Because it is a centrally important function of a democratic government, the tax system is grounded in fairness norms, including the ideal that taxpayers perceive the system as treating them fairly in comparison with other taxpayers (often referred to as a “horizontal equality” mandate that each taxpayer be treated the same as other taxpayers that are similarly situated).¹⁵⁶ The tax laws are enacted by Congress in complex packages, including various measures intended to act efficiently to stimulate activities in some areas or to discourage particular kinds of activities in other areas. These characteristics of the tax system are all interrelated. A taxpayer may be less compliant than otherwise expected because of perceived unfairness or may not report in accordance with the tax laws because of misunderstood opportunities for avoiding taxation.

The tax system also is the major tool available to Congress to shape and guide the economy. The tax laws affect taxpayer choices about lifestyles, careers, and investments. These public-oriented characteristics of the tax system are at the bottom of the worry about tax strategy patents that is summed up in the statement that tax patents “improperly grant[] private persons ownership of the public tax laws.”¹⁵⁷ Privatizing portions of the tax law weakens the usefulness of tax for accomplishing policy goals.

a. The Innovation Fallacy

Because of the requirement that everyone comply with the tax laws, this issue tends to be described by the IP bar as a failure of the tax bar to understand the way patented inventions serve the public good by providing a suitable means to comply with legal requirements.¹⁵⁸ This is an expression of what I call the “innovation fallacy” of the IP approach to patenting of legal strategies. If there is a private monopoly of the tax law, IP commentators say, it is necessarily fair because the benefit of innovation is the purpose of the patent law.¹⁵⁹

An example of the way that the patent law’s encouragement of innovation works to further legal goals provides an instructive contrast with the tax laws.

155. See Beale, *Before the Return*, *supra* note 11, at 607-12 (discussing infrequency of audits and resulting audit lottery problem that has exacerbated the tax shelter phenomenon).

156. See Sales & Use Tax Review Commission, http://www.state.nj.us/treasury/taxation/index.html?s_ucommish/commish.htm-mainFrame (last visited Aug. 10, 2008) (providing definition of “horizontal equity”).

157. Dana G. Fitzsimons, Jr., *The Rise and (with Hope) Fall of the Tax Strategy Patent*, ABA TRUST & INVS. 34, at 34, Jan.-Feb. 2008.

158. See Osborn, *supra* note 23, at 47.

159. *Id.*

Consider the fact that some jurisdictions require all motorcycle riders to wear appropriate protective headgear.¹⁶⁰ As IP commentators point out, the fact that headgear is required to comply with the law does not support prohibition of patents on motorcycle helmets.¹⁶¹ To the contrary, a patent on a new type of motorcycle helmet that is more protective than earlier types saves lives and allows those who purchase that patented invention to enjoy a new level of protection. Everyone is better off, even those who cannot afford the protection. Patent protection incentivized the discovery of a better helmet by encouraging researchers to spend more than they might otherwise have spent to develop the new protection. Once the patent expires, the new protection should be available to all without the added licensing cost. And because the patent is published, smart inventors will be able to use that discovery as a springboard to other discoveries. Even those who do not want to pay the royalty to use the invention are not unable to comply with the law—they are free to find another means of complying.

The tax bar, on the other hand, finds the IP perspective off base because the public good is not served by patenting tax avoidance. The law in the example relates to a choice that someone may or may not make—to ride a motorcycle. The public through its representatives has decided that the activity is sufficiently dangerous for participants to require certain protections. Everything that encourages the development of better protection, including patent protection for inventors, reinforces the underlying purpose of the law by providing better means of complying to ensure that the law's protective purpose is satisfied. Similar arguments apply in the case of patents on pollution control devices on smokestacks, which reinforce environmental laws even though they may initially prevent some from carrying out their manufacturing objectives if they cannot afford the appropriate devices.

In contrast, the complex and extensive tax laws include a limited affirmative mandate—that taxpayers report their taxable items appropriately, within the limits of the procedural requirements and confidence levels, and pay the corresponding tax liabilities. This is discussed extensively in an earlier article, as follows.

[U]nlike other legal regimes, tax is a set of rules that characterize the results of taxpayer transactions for purposes of determining appropriate assessment. It is not a set of prohibitory rules that are intended to ensure that a person's transactions stay on the legal side of a fixed line between legal and illegal conduct. Other legal regimes set out strict requirements that regulated entities must follow to avoid sanction for committing a proscribed act (such as insider trading under the securities laws) or for failing appropriately to implement a required act (such as maintenance of reserve funds for banking

160. Insurance Inst. for Highway Safety, *Current U.S. Motorcycle and Bicycle Helmet Laws*, Apr. 2008, <http://www.iihs.org/laws/HelmetUseCurrent.aspx>.

161. See, e.g., *Worlds Collide*, *supra* note 22, at 70 (judging that the tax bar has a “misplaced” concern about the capture of legal compliance methods, and comparing tax strategies to pollution control devices that are widely useful because they are needed to comply with environmental laws and are permitted to be patented to encourage innovations).

institutions or appropriate sanitation in hospital operating rooms). For these regimes, violators are subject to punishment. . . . In contrast, the Code neither proscribes nor mandates that taxpayers conduct their activities by means of particular transactions. . . . The choice as to mode of arranging affairs is the taxpayer's business, but the decision as to how those arrangements will be taxed is the government's business. Congress has legislated rules that are intended to be adequate to the taxpayer's self-assessment task of determining the tax consequences adhering to actions undertaken for non-Code reasons.

. . . .

There are only two coercive elements in the Code enforced through the audit process and penalty sanctions — tax reporting and tax payments. . . . This [is a] regime of rules that characterize and assess rather than label and punish.¹⁶²

The tax law applies to everyone and every-wealth producing activity. The tax system has hundreds of provisions that are intended to ensure that taxpayers can determine their tax obligations appropriately, whatever activities they undertake. The tax laws do not require taxpayers to undertake any particular transaction or deny taxpayers the right to undertake tax-disadvantaged transactions. Thus, the patenting of tax preparation software to help individuals report their tax liabilities is the best analogy for the tax regime to the role of motorcycle helmets in respect of a headgear law because such software smoothes the way for complying with taxpayers' reporting and payment obligations.

In contrast, tax planning is an attempt to develop a means of achieving a particular business or financial transaction in a way that will result in the least taxes possible, without claiming a tax benefit that is not allowable under the tax laws that apply to the transaction. Tax planning is neither good nor bad in itself, but the tax bar is under considerable market pressure from clients to push tax planning beyond its reasonable boundaries, creating an aggressive approach to tax planning that I have addressed extensively in prior articles—the “tax minimization norm”—which is appropriately discouraged by tax administrators.¹⁶³ In brief, the tax minimization approach to the tax adviser's role is not illegal, as the oft-quoted phrase from Learned Hand makes clear,¹⁶⁴ but the tax minimization norm does not further the underlying purpose of the tax laws to provide revenues for the federal fisc. Market demands press lawyers towards more aggressive tax planning methods, leading them to adopt hyper-literal interpretations of particular Code provisions or to twist the interpretation of Code provisions to yield the needed outcome, literally “finding (or manufacturing) loopholes.”¹⁶⁵ The result is often the grafting of

162. Beale, *Before the Return*, *supra* note 11, at 646-47 (citing Richard Lavoie, *Making a List and Checking It Twice: Must Tax Attorneys Divulge Who's Naughty and Nice?*, 38 U.C. DAVIS L. REV. 141, 196-97 (2004)).

163. *See id.* at 597-607 (discussing the basis for discouraging the tax minimization norm, even while accepting the legitimacy of tax planning within the context of particular clients' planned transactions).

164. *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd* 293 U.S. 465, 469 (1935).

165. B. John Williams, Jr., Chief Counsel, IRS, Address to the Chicago Bar Ass'n Fed. Tax'n Comm.

unnecessary and complex structures on ordinary business transactions in order to achieve tax savings objectives. There is no reason whatsoever to incentivize tax planning strategies among tax practitioners or taxpayers. In fact, there is strong reason to discourage tax minimization planning as a deadweight loss to society: it is inefficient and wasteful because it expends resources on devising complicated structures to slip through the interstices of tax categories in order to claim a more advantageous treatment than a straightforward transaction would have merited, at a considerable cost to the federal fisc.¹⁶⁶ The direct intent of tax minimization is to limit the ability of the government to collect taxes from the taxpayer's activities, not to reinforce that ability. Thus, incentivizing innovation in this area does not reinforce the proper functioning of the tax laws, but runs counter to it.

b. Inappropriate Capture

In addition to asserting that innovation in tax planning must be a good that should be encouraged, if tax planning is permissible at all, the IP bar also insists that the patent laws would not damage the coherence of the tax system by permitting patent trolls to monopolize areas of the law.¹⁶⁷ Let's consider some ways that capture might occur in a harmful way. If a planning strategy relates to a type of entity created by tax laws, then it may effectively capture an area of the law such that any taxpayer undertaking a particular transaction structure in order to come within an explicit tax-advantaged provision must pay a royalty to the holder of the patent (or may be refused a license to do the transaction). This would be true even when Congress enacted the provision to encourage such transactions by making it possible for taxpayers to receive that benefit. Partnerships, REMICs, real estate investment conduits, grantor trusts, and other tax-created vehicles might potentially be captured in this way.

Many patent applications for such strategies would likely be considered non-novel and obvious and would be appropriately rejected as ineligible for a patent,¹⁶⁸ but some of these methods would likely survive the novelty and obviousness tests. There are innumerable bright minds in the tax departments of corporations, investment banks, and law firms, many of whom have come up with new ideas in the financial derivatives and securitizations areas that interpret the tax laws to govern combinations of known structures in non-obvious ways.¹⁶⁹ A strategy most often will create transactions that require the

(Feb. 25, 2003), available at <http://www.irs.gov/pub/irs-utl/shelters-feb25.pdf>.

166. See David Weisbach, *It's Time to Get Serious About Shelters*, 88 TAX NOTES 1677, 1677 (Sept. 25, 2000) ("[T]ax planning deserves very little protection.")

167. See *Worlds Collide*, *supra* note 22, at 72 (arguing that compliance methods are no more of an issue for tax than for any other discipline).

168. The SOGRAT patent is one example. See *supra* notes 6 and 74 and accompanying text. I have suggested that the IRS may be able to assist the Patent Office in making these determinations through a broader use of notices, including notices that demonstrate that strategies in patent claims are non-novel extensions of settled law.

169. Indeed, since 1998, fifty-one tax strategy patents have been issued and eighty-five applications are pending. Dustin Stamper, *Tax Strategy Patents: A Problem Without Solutions?*, <http://www.taxanalysts.com/www/website.nsf/Web/TaxStrategyPatents?OpenDocument> (last visited Aug. 10, 2008).

application of a number of different Code provisions, and any one new provision may be relevant to a number of different structural transactions. Drafters may have publicly discussed a particular application of a new Code provision to a particular kind of transaction, but the types of transactions that are likely to be patented may be quite different from those specifically contemplated by the drafters, even though they may at the same time lead to useful results not unlike the uses the drafters did contemplate. Examples might include the invention of TruPS, a beneficial interest in a grantor trust that holds certain junior subordinated debt interests and is paid a preferred return out of the cash flows of the trust, so that it is considered an “equity-flavored interest” by credit agencies (although it is classed as debt for tax purposes),¹⁷⁰ or the invention of “guaranteed maturity classes” of REMIC regular interests, which permitted REMIC sponsors to issue REMIC debt with set maturities (unlike prior analysis of the REMIC provisions).¹⁷¹ The holder of a patent on the process for developing the instruments would have acquired private control over an area of the tax laws (certain REMICs; certain grantor trusts). The value of the patent would increase to the extent that taxpayers are limited to transactions encompassed within the patent or others held by the same patent holder on related transactions.

There would even likely be a race to the Patent Office in connection with each revision of the tax laws in that area, in an attempt to corner the patent market on additional innovative transactions using the new provision that were not obviously contemplated by the drafters. Given the complexity of the tax laws, there are likely to be such new uses (in this sense, tax law is like language—always ready to cover the unknown). That behavior could well result in a few major players holding key patents in entire areas of the law, such that any taxpayer engaging in ordinary activities in that area would need to structure their transactions under one of the methods governed by the patents. Unwary tax practitioners and taxpayers who did discover the method independently might find themselves faced with expensive infringement suits.¹⁷² Yet the provisions were intended to provide certainty about tax treatment of any instruments issued by these securitization vehicles that satisfied the requirements for that classification and to benefit any taxpayers that wanted to create such securitization vehicles. The only way to prevent patent holders from cornering the market on new ways to carry out the intent of Code provisions that are not explicitly contemplated (or easily derived by experts from information about ones that are explicitly contemplated) at the time the provisions are drafted appears to be to legislate a ban on tax strategy

170. See, e.g., Real Estate Trust Preferred Securities, Ocean Capital Pacific: Real Estate Trust Preferred Securities, <http://www.oceanpacificcapital.com/trups-financing.php> (last visited July 20, 2008) (noting that TruPS have characteristics of both debt and equity).

171. See Beale, *Before the Return*, *supra* note 11, at n.15 and accompanying text.

172. Richard Gruner suggests that the IRS can prevent unsophisticated taxpayers from being trapped this way by creating and maintaining a system for identifying and describing tax planning patents for the benefit of taxpayers and tax advisers. See *Worlds Collide*, *supra* note 22, at 71. This suggestion has no merit. It would be inappropriate for the IRS to serve as an agent of patent holders in advertising the strategies for taxpayers to use to avoid paying taxes. It would also be inappropriate for the IRS to use its limited resources in this fashion.

patents.

The conventional patent wisdom seems to be turned on its head in respect of the tax system. The basic requirements for patentability favor strong patent protection for inventions that are likely to be of broad utility. In our motorcycle helmet case, patents—and the concomitant ability to charge a reasonable royalty—would be desirable even if the new helmet were so advanced that individuals had no practical choice for complying with the headgear requirement other than the new (and expensive) model. But it would be fundamentally contrary to the intent and purposes of the tax system for a patent to grant similar rights to an interpretation of tax laws governing a particular strategy for structuring transactions, so that it cornered that legal interpretation for all those intending to carry out similar transactions.

c. Core Concerns

There are three additional aspects of the private monopoly of tax laws touched upon in this discussion that are cause for particular concern and merit focused consideration.

(1) *Fairness Concerns*

The tax system is built around normatively important concepts that are essential to its function even though not evident in every practical aspect.¹⁷³ I have suggested that these normative concepts must be viewed as including an external distributive justice principle that is “rooted in institutions of a democratic polity based on personal liberty and equal respect.”¹⁷⁴ Contextualized to rate structures and bases, this distributive justice framework supports a concept of fairness that is generally characterized as based on ability to pay. Like-situated taxpayers should bear similar tax burdens (horizontal equity) and better-off taxpayers should bear heavier burdens (vertical equity). Thus, I have argued that customized tax planning in itself threatens distributive justice because aggressive tax planning for those that can afford it reduces their tax burdens and ultimately results in a heavier burden on others.¹⁷⁵

IP attorneys argue that the fact that some taxpayers may be able to execute licensing agreements with a tax strategy patentee while others will have to forego taking advantage of the tax provisions governing the patented tax strategy because they cannot afford a licensing agreement is little different from the ability of some taxpayers to pay for sophisticated tax advice while others must do without.¹⁷⁶ The distortive effect of tax patents is, however,

173. The normative ideal of the tax system is considered in contradistinction to the political reality of the system with warts and all. This is similar to Noam Chomsky’s linguistic distinction between the grammatical and the acceptable. See NOAM CHOMSKY, *ASPECTS OF THE THEORY OF SYNTAX* (MIT Press 1965). The normative concepts are present, even though not realized in every practical context. The practical context translates back to the normative, however, and requires what I have called a “coherence-reinforcing” interpretive approach.

174. Beale, *Before the Return*, *supra* note 11, at 592 n.22.

175. *Id.*

176. See, e.g., *Worlds Collide*, *supra* note 22, at 75 (suggesting that differential access because of patents

much more severe than the availability to some taxpayers of hired tax advisers. Whether or not a taxpayer uses sophisticated advisers, the taxpayer may structure its transaction as desired and enjoy the resulting benefits if the transaction falls within tax provisions providing a particular tax benefit. The use of a tax adviser simply makes it more likely that the taxpayer will find tax-advantaged ways to structure the transaction. The differential access may relate to resources or to trade secrets, but it is not enforced by the government nor is it absolute. Unlike the election to use tax planning assistance, however, a tax patent may permit its holder to block all others from undertaking the planning technique governed by the patent—essentially fencing off a way of structuring a transaction based on an interpretation of a provision of law intended to be available and equally applicable to all. Ironically, that right is granted by the very government that sets the rules for determining tax liabilities based on a claim of universal application, and requires every taxpayer to determine their tax payments accordingly.

Further, the voluntary assessment that underlies the federal tax administrative structure depends in large part upon taxpayers' respect for the tax system and perception that it treats all taxpayers fairly. The existence of tax strategy patents that provide a boon to some from a particular interpretation of the laws that is not accessible to a taxpayer without paying a royalty—even if the taxpayer developed the same interpretation on her own—directly undercuts the perception of fairness necessary for voluntary assessment to work. It undermines the integrity of the tax system.

(2) *Institutional Concerns*

A tax strategy patent puts an aspect of the tax laws under the control of the patent holder rather than Congress. It makes access to certain tax-advantaged transaction structures more costly (through a toll charge) or it removes access completely if the patent holder determines not to license any other taxpayers to use the strategy. As we have seen, IP commentators treat this preemption concern lightly—"[t]o the extent that the law requires filing tax returns for certain business transactions, entities should avoid the transaction if the tax returns will run afoul of a patented strategy."¹⁷⁷ These key rights under the patent law directly conflict with the congressional role in setting economic and tax policy through legislation and ultimately undermine congressional authority. Patents on tax strategies ultimately gravely undermine congressional authority.

This is perhaps more so today than ever before, as Congress has turned to the tax code as a primary tool in establishing economic and even social policy. Tax provisions are set to discourage some activities (e.g., gambling is discouraged by prohibiting deductions for gambling losses in excess of gambling winnings)¹⁷⁸ and encourages others (e.g., business investment is

should be viewed no differently than differential access because of decisions to hire tax advisers).

177. Osborn, *supra* note 23, at 50.

178. I.R.C. § 165(d) (2000).

encouraged by providing cost recovery provisions that accelerate depreciation deductions in comparison with actual economic depreciation).¹⁷⁹ Patented tax strategies could hinder the ability of Congress to legislate economic incentives through the Code, thwarting congressional purpose.

Some might dislike Congress's tendency to use the tax Code to legislate its economic policies and prefer that Congress would legislate its economic policies and favors for various constituencies separately from the enactment of tax laws. Although such an approach might well be preferable in an ideal legislative system, it does not accord with the practical realities of today's political context. Adding tax patents to the issues that compromise and complicate the enactment of tax laws and considerations of appropriate economic policies is not advisable.

Even assuming *arguendo* that licensing arrangements result in no excessive rent extraction in the setting of royalties, the availability of patents undermines a fundamental premise of using the tax laws as a key factor in economic planning. Consider an economic stimulus package that is intended to operate for some period of time. Assume that over time, various patents are granted that capture a significant portion of the potential transactions and thereby limit the availability of the stimulus primarily to those paying a royalty to the patent holder. The existence of tax strategy patents effectively acts to divert a significant portion of the benefit from the stimulus: the patent holder, who is not the intended recipient of the benefit, receives a substantial portion of the benefit in the form of a royalty, and the taxpayers who are the intended recipients lose an equivalent amount.¹⁸⁰ To add insult to injury, diversion of those tax savings from the intended recipients to patent holders is regarded by the patent system as an appropriate reward for the costs of developing innovations to thwart the congressional intent.

Another case illustrating the thwarting of congressional intent is tax legislation that contemplates extraction of higher taxes through provisions that discourage certain conduct. Such provisions have two purposes—raising additional federal revenues and discouraging undesirable activity. Assume, again, that a tax guru develops an innovative tax planning method that circumvents the tax legislation. In this case, the existence of the tax strategy patent acts to privatize the revenue stream intended for the government, without deterring the activity that Congress had determined to be undesirable.

(3) *Professional Concerns*

Interpreting the numerous yet finite tax provisions to apply to the infinite variety of new activities that humans engage in is not easy, and for that tax lawyers develop expertise, attend conferences, write articles and books, and

179. *Id.* §§ 168, 179.

180. The marginal rate of the taxpayer utilizing a patented tax planning method will determine the ceiling on the royalty charged by the patentee. The taxpayer will have no motivation to enter into a license agreement if the royalty extracted exceeds the tax savings. Under ordinary market conditions, the patentee would "share" the savings with the taxpayer, so that the patentee profits from the royalty, and the taxpayer pays a royalty that is somewhat less than the tax liability that would have otherwise applied.

engage in professional panel discussions of the appropriate interpretation of tax laws. The idea that those interpretations could be patentable clearly strikes tax lawyers as “absurd,” as Wolfman notes.¹⁸¹ Tax practitioners are wary of the new burdens that researching tax patents will impose on them, the additional costs for their clients, and the additional complications that patents will impose on an already complex set of tax rules, making it harder to assist client compliance.¹⁸² If those were the only professional issues, I might complain about the change, but still accept it as inevitable. It would be dissatisfying if the tax bar’s indignity were merely aroused by the necessity of sharing a lucrative tax planning fee with a patent holder, as some of the more intemperate IP commentary has suggested.¹⁸³

Patenting tax strategies, however, will likely bring more detrimental consequences for the profession. If tax strategies are patentable, “patent prospectors” will increasingly hang out at professional meetings with hopes of coming upon a new strategy that can be mined for patent gold.¹⁸⁴ This will likely discourage public dialogue among professionals about novel interpretations of the law. Because trade secrets are not often revealed at public meeting sessions until some period after their development, those conversations are already somewhat restrained. Patent competition will likely impose additional constraints on the flow of information to the public and to government officials.

A significant corollary of the more limited interchange among tax professionals that could result from the proliferation of tax planning method patents is the lack of opportunity for tax professionals to test their ideas about interpretations of the tax law among their peers. That could lead to a form of balkanization—firms would develop specialty interpretations through internal discussion and analysis, but those interpretations would not be vetted through discussion with peers in the larger practitioner community. Over time, those insular interpretations, having been relied upon for particular deal structures, would be likely to be treated as settled, even though they lacked the deeper scrutiny currently undertaken. Firms might be less willing to pull back from a questionable interpretation, even when they began to discuss them with others, because of the transactions already executed for clients.

Similarly, patenting of tax strategies will likely spur competition for clients and for status as a recognized innovator rewarded with tax patents. The IP bar sees this signaling of status as an innovator as a benefit of the incentive system established by patent law.¹⁸⁵

181. Wolfman, *supra* note 13, at 505.

182. See Drennan, *supra* note 135, at 283-85 (discussing the social costs of tax patents).

183. See Koresko Law Firm, *supra* note 25, at 2-3 (blaming the concerns about tax strategy patents on special interest lobbying by tax planners mostly concerned with the impact of royalties on their advising fees).

184. The term “patent prospector” is one of a cluster of derogatory terms, including “patent troll” or “patent pirate,” used to describe patent holders as ones who prey on productive society in order to benefit from lucrative patents for processes that they did not discover.

185. See Osborn, *supra* note 23, at 43-44; Gruner statement, *supra* note 27 (suggesting positive benefits from patents generally include “signaling” the expertise of the inventor, differentiating the product of the inventor from competitors’ products, channeling competitors’ actions away from the activities of the inventor (or extracting “handsome royalties”), signaling future innovation strengths to customers and competitors,

[I]f a firm can count on patent protections for a new and highly innovative tax planning strategy, the firm will be able to afford to devote greater resources to the development of the method knowing that all taxpayers who wish the benefit of using the method will need to pay a royalty to gain this advantage. Under this latter type of system, the full range of taxpayer advantages from a given new technique will define the extent of development expenditures that are justified in producing it. It will also encourage firms to focus on the types of highly innovative, nonobvious extensions of prior designs that are capable of qualifying for patents This last analysis suggests why patents on tax planning methods . . . may ultimately be beneficial to this field.¹⁸⁶

I would argue, however, that the signaling advantages to firms that become known as patent innovators is a *detriment* to the professionalism of attorneys and to the proper functioning of the tax system as a central institution necessary to a functioning democratic government. The innovation fallacy inaccurately appraises the value of innovation in tax.

First, as many other tax commentators have indicated, tax advisers already have ample incentive to innovate.¹⁸⁷ They are hired to help structure their client's activities in a way that will minimize taxation. They compete with other firms on the basis of their ability to deliver. Firms already achieve "tax guru" status for having devised complicated strategies to deal with special situations. Innovation is, in other words, alive and well in the tax profession.

Recognizing this sentiment of the tax bar, IP commentators tend to argue that the additional incentives to innovate provided by patents will nonetheless "bring[] the level of innovation to a more optimal point."¹⁸⁸ This patent law bias towards innovation overlooks the negative impact of innovation in fields such as tax. It is important to balance the tax minimization norm with a duty to the court, which I believe should be interpreted to require a coherence-reinforcing approach to the law.¹⁸⁹ The availability of patents for tax minimization planning unbalances the endeavor, pushing towards a lopsided emphasis on planning at the cost of the tax system.

Furthermore, increasing the incentives to innovate in tax could well trigger another cycle of abusive tax shelter planning. The tax shelter promotions of the late 1970s and the 1990s were costly in diverting revenues from the government to shelter promoters and in requiring the expenditure of limited resources in the Treasury Department and IRS to counter the shelter trend.¹⁹⁰ This last cycle resulted in the reportable transaction rules that were codified and reinforced with penalty provisions and stricter tax shelter opinion

increasing innovation specialization, and rewarding innovators over non-innovators).

186. Gruner statement, *supra* note 27.

187. See, e.g., Drennan, *supra* note 134, at 235-36 (arguing that no patent protection is necessary as further incentive to innovate).

188. Osborn, *supra* note 23, at 43.

189. See *supra* notes 164-66 and accompanying text.

190. Daniel N. Shaviro, Commentary, *Evaluating the Social Costs of Corporate Tax Shelters*, 55 TAX L. REV. 445, 446-47 (2002).

requirements as part of the American Jobs Creation Act of 2004.¹⁹¹ Another cost of tax shelter activity is an increased number of anti-abuse provisions in the tax laws, further complicating compliance for the majority of taxpayers who do not engage in aggressive tax planning.

Second, if the developments in the interpretations of obviousness and subject matter patentability do not lead the Patent Office to reject pure tax strategy patents, the signaling effect of patents could lead to cross-licensing agreements among a few very large legal conglomerates that effectively control the tax strategy patent market. Tax practitioners not associated with those legal conglomerates would find themselves on the fringes of tax practice. They might be prevented from providing interpretations of the tax laws in most areas in which corporations or sophisticated taxpayers had interests, acting primarily as referrals to patent holders for licensing agreements. Again, the concentration of interpretive power in a few hands would be detrimental to the tax profession, to the integrity of the tax system, and to our democratic institutions. One can imagine a resurgence in the conglomerates of maverick groups such as the KPMG tax services groups that became cavalier about compliance with disclosure requirements.¹⁹² The power of an elite few over existing patents would likely tend to biased interpretations of the tax laws towards interpretations favorable to additional patents.

Third (and perhaps most important), innovations in minimizing tax liabilities are not a public good, even when they are not related to abusive tax shelter transactions.¹⁹³ Instead, they are countenanced by the tax system as a natural concomitant of any tax system that cannot be entirely prevented. The tax minimization norm prevalent among tax practitioners is, however, actively discouraged by disclosure rules, disqualified opinion rules, and special (onerous) written opinion rules and other requirements intended to disincentivize tax practitioners from advising taxpayers to undertake aggressive tax transactions.¹⁹⁴ I have argued that additional measures should be undertaken to further discourage the tax minimization norm among tax practitioners, because it pushes tax practitioners to focus on tax innovation instead of focusing on coherence-reinforcing interpretations of the law. Accordingly, I recommended that a better balance would be achieved between tax practitioners' duties to their clients and their duty to uphold the law with the adoption of a uniform more-likely-than-not confidence level for taxpayers' and tax advisers' reporting positions.¹⁹⁵ Congress enacted such a change to the

191. American Jobs Creation Act of 2004, Pub. L. No. 108-357, §§ 812, 815-16, 819, 118 Stat. 1418, 1577-84 (2004).

192. S. Rep. 109-54, at 6 (2005).

193. Cf. Osborn, *supra* note 23, at 44-45 (suggesting that tax opposition to greater innovation is based solely on concerns that patent innovations will lead to abusive transactions). In contrast, the arguments I have made do not rest solely on concerns about abusive transactions but rather on the importance to the tax system and profession of striving for coherence and maintaining a balance between duties to clients and duties to the integrity of the law.

194. See *supra* notes 108-14 and accompanying text.

195. See generally Beale, *Before the Return*, *supra* note 11 (arguing that evidentiary privileges should be denied for pre-return tax planning and confidence levels required for reporting positions on returns should be raised across the board to a more likely than not standard).

standard applicable under Code Section 6694 to tax return preparers in 2007.¹⁹⁶ Thus, there is a clearly discernible trend in the actions of the Treasury Department, the IRS, and Congress towards increasing transparency, heightening standards, and discouraging aggressive tax planning—not encouraging it. That appropriate attitude towards tax minimization innovations cannot be compared to the clear social benefit of development of new life-saving drugs that will become available to the world upon expiration of a patent and that may remain available for decades or even centuries (as in the case of the lowly aspirin). In fact, the Gruner statement quoted above describes a tax administrator's worst nightmare—patents threaten to undo the progress achieved over a decade of fighting corporate tax shelters and discouraging law and accounting firms from marketing tax strategies by over-rewarding tax minimization planning.

V. CONCLUSION

Patent law is premised on the concept of incentivizing innovation for the public good. The patent-centric view is that innovations in tax reduction strategies are likewise an overall good. The benefits will resemble those that are assumed to result from innovations in financial services, including increased risk taking and a skewing of efforts towards patentable activities and away from older business activities.

Tax law, on the other hand, is premised on providing certainty regarding the tax treatment of a taxpayer's undertakings, so that the taxpayer can appropriately report activities and make payment in respect of the tax liabilities that ensue from having undertaken them. Patents not only provide an unnecessary incentive to encourage tax minimization innovation, but they also provide an incentive that is directly counterproductive to the fundamental underlying policies of the tax laws. There is no inherent merit in tax reduction strategies and no overall public good from tax innovation. The polity would be better served if those sophisticated taxpayers who devote considerable resources to arranging their affairs to minimize their tax burdens would spend that energy and those resources on non-tax matters germane to their business. Learned Hand's famous statement that "[a]nyone may so arrange his affairs that his taxes shall be as low as possible"¹⁹⁷ has been taken as a tax minimization creed by tax practitioners, yet they often forget that the statement is part of the seminal case in the development of the judicial doctrine of economic substance, permitting courts to find that transactions undertaken solely to achieve tax planning results are a sham.

In these times, we might even pause to reconsider the wholehearted endorsement of incentives beyond the tax system for innovations that directly impact financial institutions and fiscal systems. Financial services innovation and excessive risk-taking are undoubtedly underlying factors in the current

196. See Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-28, 121 Stat. 190 (2007).

197. *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465, 470 (1935).

economic crisis. Investment banks devised increasingly risky derivatives and securitization vehicles. They used these instruments to move assets off their books in innovative ways. They originated risky subprime mortgage loans but innovated ways that were considered to shift the primary risk of loss to investors. Those innovations reduced the ability of mortgagors to negotiate modifications when their homes' values slipped below the principal due, and reduced the incentive for banks to undertake prudent lending activities without overleveraging their own obligations. Creating those kinds of incentives in the tax system could be equally detrimental. In some IP commentators' visions of the future, tax patents will provide the spur to the development of ever more sophisticated means of tax reduction. If it were accepted that innovation in this area were a public good, the advent of tax patents would likely be considered a boon by others as well because of the incentive effect for innovation.

I am convinced, however, that it is contrary to the public interest to encourage further innovations in tax planning. It deprives the fisc of funds, encourages taxpayers to be ever less compliant in reporting their tax liabilities, and ultimately perpetuates a deleterious tax minimization norm among tax professionals that hinders the development of an appropriate coherence-reinforcing view of the tax laws. Similarly, while the signaling effect of patents is a desired corollary of innovations that contribute to the public good, the signaling afforded by the patent system to tax strategy patents would merely deepen the negative effects of excessive tax minimization planning, as those firms that are most aggressive in developing tax minimization techniques will be the ones rewarded with the reputational boost. Tax patents bring both systems to a crossroads—and that crossroads is a place of conflict because the bedrock principle of patented monopoly rights undermines the fundamental purpose of fair tax collection. Patents on tax strategies simply should not be permitted.