

## PATENTS ON TAX STRATEGIES: JUST ANOTHER HARMLESS SUBJECT

CHRISTOPHER C. ANDERSON

*This Note analyzes the subject matter eligibility of patents on tax strategies. In 2003, the United States Patent and Trademark Office issued the first patent explicitly covering a tax strategy. Since this decision, many other tax practitioners have attempted to patent tax strategies. The requirements to have a patentable tax strategy are not entirely clear, and commentators have voiced strong opinions on both sides of the patentability argument. Indeed, some feel that patents covering tax strategies are not constitutional or might otherwise not fit under the policy rationales upon which the patent system was built.*

*The Note first addresses the statutory requirements that all patent applications must satisfy before receiving patent allowance. Next, the Note analyzes the policy rationales implicit in the patent system. Considering this background, the author explains how patents covering tax strategies fall within the constitutional requirements of patent-eligible subject matter and how tax strategy patents would be in line with the various policies and purposes underlying the patent system. After considering the practical implications of allowing tax strategy patents, the author concludes that recognizing tax strategy patents would be appropriate, so long as Congress took action to limit the remedies available to a holder of a tax strategy patent.*

### I. INTRODUCTION

Concerns over the scope of the United States patent system are as old as the patent system itself. They have ranged from concern over allowing “foreigners” to receive patents<sup>1</sup> to concern that granting an exclusive patent on an original invention will prevent others from improving on that invention.<sup>2</sup> Prevalent among these concerns are “shock waves”<sup>3</sup>

---

1. Levi Lincoln, Patents for Inventions, 1 Op. Att’y Gen. 110, 110 (1802) (“The authority given by law to grant patents is unquestionably confined to the citizens of the United States. The privilege is a monopoly in derogation of common right, and, as it is not, ought not to be extended to foreigners. Were it to be, it would be subject to endless abuses, privations, and embarrassments to our citizens. I have no doubt on the question.”).

2. Letter from James Rumsey to Thomas Jefferson (June 6, 1789), in 15 JEFFERSON PAPERS 170, 171–72 (Julian P. Boyd ed., 1958) (“The dispute between Mr. Fitch and myself has Caused many of the gentlemen of our Country to be very tenacious about giveing [sic] grants, so much so that the assembly of New York, and Some others, would not give me a grant for the principle of my boiler, but only for one formed like the drawing laid before them (which was intended only to Explain its prin-

of change created in affected industries by the incremental evolution of eligible subject matter in the patent system.

Such has been the case with the recent so-called Pandora's Box<sup>4</sup> of tax strategy patents endorsed by the United States Patent and Trademark Office (USPTO). In 2003, the USPTO issued the first patent explicitly covering a tax strategy.<sup>5</sup> With the United States Court of Appeals for the Federal Circuit approving business method patents in its 1998 *State Street Bank & Trust Co. v. Signature Financial Group* opinion,<sup>6</sup> clever tax practitioners recognized an opportunity to obtain patents covering tax strategies—"i.e., methods, techniques, systems, or transactions whose sole purpose is to minimize or avoid tax liability—as a type of business method."<sup>7</sup> Both academics and practitioners alike have voiced strong opinions opposing the issuance of this type of patent.<sup>8</sup> These opinions have been based on most every source of patent law theory; from unconstitutionality, to policy, to suggestions of carving out a statutory exception excluding patents covering this area.<sup>9</sup>

In 2006, the Supreme Court of the United States dismissed a writ of certiorari as improvidently granted in the case of *Laboratory Corp. of America Holdings v. Metabolite Laboratories, Inc.*<sup>10</sup> In an eight-page dissent, Justice Breyer, joined by Justices Stevens and Souter, argued that certiorari should not have been dismissed because the issue of eligible patent subject matter is not a difficult one and many "might well benefit from [the Supreme Court's] authoritative answer."<sup>11</sup> With three Justices seeking to grant certiorari and Chief Justice Roberts not participating in the consideration or the decision of this case, the Supreme Court is well-positioned to provide guidance in the area of subject matter eligibility for

---

ple more Clearly than Expressions Could, [sic] alleging that any other kind of grant, would Cut of others from improving [sic] on it . . .").

3. See generally Paul A. Beck, *State Street Bank Case Causes Shock Waves in Banking and Financial Industry*, 147 PITTSBURGH LEGAL J. 7 (1999).

4. Andrew A. Schwartz, *The Patent Office Meets the Poison Pill: Why Legal Methods Cannot Be Patented*, 20 HARV. J.L. & TECH. 333, 349 (2007).

5. Establishing and Managing Grantor Retained Annuity Trusts Funded by Nonqualified Stock Options, U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003). While this is the first patent that identifies itself as claiming a tax strategy, it has not been uncommon in the past to obtain a patent on ineligible subject matter by masking the application as claiming eligible subject matter. 1966 REP. OF THE PRESIDENT'S COMMISSION ON THE PATENT SYS. 12–13.

6. 149 F.3d 1368 (Fed. Cir. 1998).

7. Schwartz, *supra* note 4, at 346.

8. See, e.g., Schwartz, *supra* note 4; Brian C. Banner, Note, *Patenting Tax Strategies: The Case for Excluding Legal Methods from the Realm of Patentable Subject Matter*, 15 TEX. INTELL. PROP. L.J. 491 (2007).

9. See Matthew A. Melone, *The Patenting of Tax Strategies: A Patently Unnecessary Development*, 5 DEPAUL BUS. & COM. L.J. 437, 457–85 (2007) (presenting policy concerns of allowing tax strategy patents); Malla Pollack, *The Multiple Unconstitutionality of Business Method Patents: Common Sense, Congressional Consideration, and Constitutional History*, 28 RUTGERS COMPUTER & TECH. L.J. 61 (2002) (presenting multiple arguments for finding business method patents unconstitutional); Banner, *supra* note 8, at 501 (arguing that tax strategy patents should be excluded from the realm of patentable subject matter).

10. 548 U.S. 124 (2006).

11. *Id.* at 126.

patents. Indeed, the Supreme Court has recently shown an increased interest regarding substantive patent law issues,<sup>12</sup> indicating it may be willing to take on this growing issue. In addition, three recent cases decided by the Federal Circuit denying patentability based on nonstatutory subject matter may create opportunity for review by the Supreme Court. Specifically, in *In re Nuijten*,<sup>13</sup> the court denied patentability for claims of a signal containing a “watermark” without being tied to a specific type of signal or any physical or tangible technology; in *In re Comiskey*,<sup>14</sup> the court denied patentability for claims of a method of arbitration that does not necessarily require any physical or tangible technology; and, perhaps most prominently, in *In re Bilski*,<sup>15</sup> the court denied patentability for claims covering a method of hedge fund risk management, again not requiring any physical or tangible technology. Considering this recent activity, this Note demonstrates how patents covering tax strategies should be recognized as valid subject matter under 35 U.S.C. § 101 and how Congress should carve a narrow exception to the damages and remedies available to a patent holder in a tax strategy infringement case by amending 35 U.S.C. § 287.

Part II provides background for later discussion by explaining the substantive content of a typical tax strategy patent, the basic statutory requirements for obtaining any patent, and the practical implications of having a patent. Part III analyzes how patents on tax strategies fall within the legal scope of patent-eligible subject matter established by the Constitution, statutes, and case law; how tax strategy patents satisfy the policies and purposes underlying the patent system; and the practical consequences of allowing patents on tax strategies. Finally, Part IV advocates for recognizing patents on tax strategies as eligible subject matter under the Constitution and 35 U.S.C. § 101, while proposing congressional action to limit their enforceability under 35 U.S.C. § 287.

## II. BACKGROUND

This Part first explores the various types of tax strategy patents and the common threads running through each patent in this class.<sup>16</sup> It is then

---

12. See, e.g., *Quanta Computer, Inc. v. LG Elecs., Inc.*, 128 S. Ct. 2109 (2008); *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007) (addressing the issue of foreign installments of potentially infringing patent software manufactured domestically); *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398 (2007) (addressing the issue of nonobviousness); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006) (addressing the issue of permanent injunctions in patent disputes).

13. 500 F.3d 1346 (Fed. Cir. 2007), *reh'g denied*, 515 F.3d 1361 (Fed. Cir. 2008), *cert. denied*, 129 S. Ct. 70 (2008).

14. 499 F.3d 1365 (Fed. Cir. 2007), *vacated*, 2009 WL 68845, at \*11 (Fed. Cir. Jan. 13, 2009), *re-manded to* 2009 WL 162408 (Fed. Cir. Jan. 26, 2009).

15. 545 F.3d 943 (Fed. Cir. 2008) (en banc), *cert. granted*, 2009 WL 221232 (U.S. June 1, 2009) (No. 08-964).

16. Class 705 covers business method patents under the heading of “Data Processing: Financial, Business Practice, Management, or Cost/Price Determination.” U.S. Patent and Trademark Office, <http://www.uspto.gov/classification/uspc705/sched705.htm> (last visited July 23, 2009).

critical to understand the statutory requirements all patent applications must satisfy prior to allowance. Although it is impossible to give an exhaustive overview of all patentability requirements here,<sup>17</sup> it is appropriate to present a brief overview of the three basic hurdles each patent application must satisfy: utility, novelty, and nonobviousness.<sup>18</sup> As a prerequisite to these basic three criteria, only certain subject matter is eligible for patent protection;<sup>19</sup> as discussed below, subject matter eligibility is a threshold requirement whose satisfaction is merely an initial step toward patentability. Also, it is useful to discuss the “best mode” statutory requirement, because this will be pertinent to the analysis below. Underlying the statutory requirements for obtaining patents are various policy concerns. These policy concerns are valuable to keep in perspective when considering important decisions affecting the patent system. Finally, after satisfying the statutory requirements to obtain a patent and understanding the corresponding policy considerations, it is useful to understand the rights conferred by a patent on its owner.

#### A. *Tax Strategies and the Corresponding Patents*

Patents covering tax strategies may be divided into three categories: those that focus on the use of a computer as an essential element of the business method, those that rely on the tax structure itself, and those that refer to tax issues as only secondary claims to some other primary innovation.<sup>20</sup>

An example of a computer-based tax patent is U.S. Patent No. 5,966,693 (‘693 patent), which claims a computerized method of administering a leveraged split-dollar life insurance coverage plan.<sup>21</sup> This patent focuses on automating the integration of “employee factors with insurance and loan terms to select an integrated loan/insurance arrangement to schedule payments to meet maximum contributions and retirement and life expectancy expectations.”<sup>22</sup> It is interesting to note that while the claims of the ‘693 patent certainly reference the storage of variables in memory and programming a processor to automate the integration, the focus of the claims is the process of administering the leveraged split-dollar insurance coverage—the financial strategy—not any of the computerized elements themselves.<sup>23</sup> It is also interesting to note that the pa-

---

17. Other important requirements for patentability, such as the required elements of the patent specification or claims, are not directly relevant to the arguments made in this Note and are, therefore, not discussed here.

18. *Graham v. John Deere Co.*, 383 U.S. 1, 3 (1966).

19. 35 U.S.C. § 101 (2006).

20. JOINT COMM. ON TAXATION, BACKGROUND AND ISSUES RELATING TO THE PATENTING OF TAX ADVICE 19–20 (2006), <http://www.house.gov/jct/x-31-06.pdf>. The examples referenced in the following text are taken from this committee report.

21. Method for Combining Loan with Key Employee Life Insurance, U.S. Patent No. 5,966,693 (filed May 7, 1996) (issued Oct. 12, 1999).

22. *Id.* at Abstract.

23. *Id.* at cols.14–16.

tent application was filed in May 1996—a full two years before the Federal Circuit decided *State Street Bank*—demonstrating that business method patent applications had been filtering into the USPTO prior to *State Street Bank*.

An example of a patent that relies on the tax structure itself, rather than a computer process, is U.S. Patent No. 6,567,790.<sup>24</sup> This patent describes an estate planning structure designed to minimize estate and gift tax liability through use of a grantor retained annuity trust (GRAT) funded with nonqualified stock options.<sup>25</sup> Though claims 1, 13, and 25 (the only independent claims) mention performing the method “at least in part within a signal processing device,”<sup>26</sup> it is mentioned merely as an aside. There is no further mention in the claims of any sort of computerized interaction. Instead, the claims focus almost exclusively on the tax structure and only do lip service to any computer interaction.

Finally, an example of a patent that refers only secondarily to a tax strategy is U.S. Patent No. 6,772,128.<sup>27</sup> This patent describes “a method for providing financial assurance for decommissioning a nuclear power plant using insurance.”<sup>28</sup> Although dealing primarily with insurance, the patent also describes tax benefits reaped by using trust funds qualified under I.R.C. § 468A, which makes contributions to these funds immediately deductible in computing taxable income.<sup>29</sup> Again, like patents focused on the tax strategy itself, this patent refers to computers, or any physical component, only as an aside.<sup>30</sup>

In reviewing these sample patents, it is evident that patent applicants tend to avoid a strictly tax strategy-focused approach when drafting patent descriptions and claims. It seems probable that patent drafters fear disallowance of claims that lack backing in at least *some* computer-related step in the method, as approved by *State Street Bank*. Indeed, under the recent *Bilski* decision, it would seem that the mere mention of a physical component may be an insufficient basis to rise to the level of patentability in method claims.<sup>31</sup>

---

24. Establishing and Managing Grantor Retained Annuity Trusts Funded by Nonqualified Stock Options, U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003).

25. *Id.* at Abstract.

26. *Id.* at col.7.

27. Nuclear Decommissioning Insurance Financial Product and Method, U.S. Patent No. 6,772,128 (filed Apr. 26, 2001) (issued Aug. 3, 2004).

28. *Id.* at Abstract.

29. *Id.* at col.5.

30. *See id.* at cols.19–20.

31. “[T]he involvement of the machine or transformation in the claimed process must not merely be insignificant extra-solution activity.” *In re Bilski*, 545 F.3d 943, 962 (Fed. Cir. 2008) (en banc) (citing *Parker v. Flook*, 437 U.S. 584, 590 (1978)). The machine-or-transformation test consolidated by the *Bilski* court will be discussed below in more detail. Suffice it say here that it is unclear after *Bilski* how integrated or specific a “machine” must be in a patent claim to rise to the level of patentability under 35 U.S.C. § 101.

*B. Utility, Novelty, and Nonobviousness*

Three statutory hurdles must be overcome for patent claims to be allowed: utility, novelty, and nonobviousness. The utility requirement for patentability is found in 35 U.S.C. § 101 and is implicit in § 112, ¶ 1.<sup>32</sup> To satisfy the utility requirement, a patent applicant must state a specific use for the invention.<sup>33</sup> The applicant is not required to show substantial proof of this use because the patent system seeks to have inventors disclose their inventions, and it is in the public interest to have even incomplete or partially functioning inventions disclosed so as to gain from the knowledge of the innovation.<sup>34</sup> A claim of utility must be credible<sup>35</sup>—“a person of ordinary skill in the art would immediately appreciate why the invention is useful based on the characteristics of the invention.”<sup>36</sup> Thus, in the arena of tax strategy patents, if the Internal Revenue Code were to be amended so as to render a given patented tax method obsolete or impossible, the relevant claims may be found invalid in litigation for failure to meet the utility requirement—when the established tax law upon which the method depended was changed, the method would cease to be useful and therefore may be found invalid under § 101.<sup>37</sup>

The requirement of novelty, outlined in § 102, “exclude[s] from consideration for patent protection knowledge that is already available to the public.”<sup>38</sup> If all limitations of a patent claim are wholly disclosed in a printed publication or patent before the applicant’s invention, or contained in a printed publication more than one year prior to the date of application, the patent claim is disallowed as anticipated by the prior publication.<sup>39</sup> Thus, if anything *in the world* is published that wholly teaches the claimed invention, the claim is unpatentable as being anticipated by this prior publication. This provision regarding printed publications in other countries is broadly construed by courts.<sup>40</sup> Indeed, most any published document, if wholly teaching the invention, will qualify as prior art<sup>41</sup> under the novelty requirement of § 102.<sup>42</sup> Part III of this Note

---

32. For the remainder of this Note, any reference to a “section” is referring to title 35 of the U.S. Code unless otherwise noted.

33. See *In re Brana*, 51 F.3d 1560, 1564–65 (Fed. Cir. 1995).

34. *Id.* at 1567.

35. *In re Cortright*, 165 F.3d 1353, 1356 (Fed. Cir. 1999).

36. U.S. PATENT & TRADEMARK OFFICE, MANUAL OF PATENT EXAMINING PROCEDURE, § 2107.02(II)(B) (2007).

37. It is unclear whether patent claims would be found invalid retroactively were the law to change in a manner that would eliminate the utility from claims.

38. *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 148 (1989).

39. 35 U.S.C. § 102 (2006).

40. See *In re Carlson*, 983 F.2d 1032, 1036–37 (Fed. Cir. 1993) (granting legal status of “patent” to a registered design in Germany).

41. Prior art is “[k]nowledge that is publicly known, used by others, or available on the date of invention to a person of ordinary skill in an art, including what would be obvious from that knowledge.” BLACK’S LAW DICTIONARY 119 (8th ed. 2004).

42. See *Carlson*, 983 F.2d at 1036 (finding a design registration obtained from the German government to constitute valid prior art in spite of being published in a non-English language).

addresses the concerns that there are inadequate sources of publications to constitute prior art for tax strategies and that patent examiners have inadequate experience or resources to locate relevant prior art.<sup>43</sup>

Finally, to complete the trifecta of the three basic hurdles to patentability, § 103 requires that a patent be nonobvious in light of the prior art in the field.<sup>44</sup> “Even if a particular combination of elements is ‘novel’ in the literal sense of the term, it will not qualify for federal patent protection if its contours are so traced by the existing technology . . . .”<sup>45</sup> Nonobviousness thus requires a factual inquiry into whether a patent claim, though not wholly disclosed by a single publication or other prior art in the field, would be obvious to one of ordinary skill in the art.<sup>46</sup> This inquiry tests whether an invention claim is rendered obvious at the time of the invention, by one piece of prior art (often a publication) in light of another piece of prior art (also generally a publication) to one of ordinary skill in the art.<sup>47</sup> Thus, nonobviousness presents a hurdle of comparing multiple relevant references from an objective perspective.

The hurdle of nonobviousness will allay many concerns regarding the allowance of improper patent claims covering tax strategies. Even when a particular strategy is not wholly taught in one written publication, if a tax practitioner—having the ordinary level of knowledge and experience of a professional tax practitioner—would find the strategy to be obvious, it will be denied patentability. Concerns about patent examiners lacking the knowledge or resources to recognize obvious developments in the field of tax are discussed in Part III below.<sup>48</sup>

### C. Eligible Subject Matter

Section 101 states that “any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof”<sup>49</sup> is eligible for patent protection. Accordingly, courts have held that this language “include[s] anything under the sun that is made by man.”<sup>50</sup> Thus, most any subject matter is presumptively eligible for patent protection, unless an exception has been explicitly carved out, either statutorily or judicially.<sup>51</sup> It is clear that tax strategies are not a “machine,

---

43. See *infra* Part III.C.5.

44. 35 U.S.C. § 103 (2006).

45. *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 150 (1989).

46. See *Graham v. John Deere Co.*, 383 U.S. 1, 18 (1966).

47. *KSR Int’l Co. v. Teleflex Inc.*, 550 U.S. 398, 417 (2007). For further discussion on what constitutes appropriate prior art, see *In re Clay*, 966 F.2d 656 (Fed. Cir. 1992).

48. See *infra* Part III.C.5.

49. 35 U.S.C. § 101 (2006).

50. *Diamond v. Diehr*, 450 U.S. 175, 182 (1981) (internal quotations omitted); *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980) (internal quotations omitted); H.R. REP. NO. 82-1923, pt. 2, at 6 (1952), as reprinted in 1952 U.S.C.C.A.N., 2394, 2399.

51. For example, the Supreme Court has held that “laws of nature, natural phenomena, and abstract ideas” are not patentable under § 101. *Diehr*, 450 U.S. at 185.

manufacture, or composition of matter.” Thus, they have generally been analyzed under the umbrella of “process[es].”<sup>52</sup>

There are very few direct statutory exceptions to this general rule of subject matter eligibility.<sup>53</sup> Instead, exceptions are generally codified in the form of limiting liability for infringement of certain patented subject matter.<sup>54</sup> In addition, in the relatively recent past, courts have found certain subject matter—which had previously been thought to be ineligible for patent protection—to constitute eligible subject matter under § 101.<sup>55</sup>

Recently, however, the patent eligibility of so-called business method inventions has been called into question by the Federal Circuit. In October 2008, the Federal Circuit held in *In re Bilski*<sup>56</sup>—which some commentators think is “one of the most significant [cases] ever to be decided by the Federal Circuit”<sup>57</sup>—that “[a] claimed process is surely patent-eligible under § 101 if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing.”<sup>58</sup> The primary concern here is the danger inherent in allowing a patent claim covering a “fundamental principle” that is not “limited to a particular use, a specific application.”<sup>59</sup> This test seems to require that a business method invention be more than merely a strategy or technique that can be maintained in the human mind; it must either be tied to some machine or transform matter to be patent-eligible.<sup>60</sup> The issue left open by *Bilski* is to *what extent* a process must be tied to a machine in order to

---

52. See, e.g., *In re Bilski*, 545 F.3d 943, 951 (Fed. Cir. 2008) (en banc). This is an important distinction because the subject matter at issue in *In re Nuijten* was analyzed as a *manufacture*, making the “process” analysis of *Bilski* important. 500 F.3d 1346, 1356–57 (Fed. Cir. 2007) (finding an electronic signal not patent eligible).

53. See, e.g., 42 U.S.C. § 2181(a) (2006) (excluding from patentability “any invention or discovery which is useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon”). It is evident that Congress views the creation of subject matter exceptions to be within its mandate, as is evidenced by proposed changes in subject matter eligibility for patent protection. Proposed S. Bill, 110th Cong. § 303, [http://levin.senate.gov/newsroom/supporting/2007/PSI\\_OffshoreTaxBill.021707.pdf](http://levin.senate.gov/newsroom/supporting/2007/PSI_OffshoreTaxBill.021707.pdf); Press Release, Carl Levin, United States Senator, Levin, Coleman, Obama Introduce Stop Tax Haven Abuse Act (Feb. 17, 2007), available at <http://levin.senate.gov/newsroom/release.cfm?id=269479>.

54. See, e.g., 35 U.S.C. § 287(c)(1) (2006) (limiting available damages for “medical practitioner’s performance of a medical activity that constitutes an infringement”).

55. See, e.g., *Diamond v. Chakrabarty*, 447 U.S. 303, 309–10 (1980) (finding “a product of human ingenuity” to be patentable subject matter where a new, living bacterium was scientifically created by respondent); *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1375 (Fed. Cir. 1998) (finding “the judicially-created, so-called ‘business method’ exception” to be “ill-conceived” and laying it to rest).

56. 545 F.3d 943 (Fed. Cir. 2008) (en banc), cert. granted, 2009 WL 221232 (U.S. June 1, 2009) (No. 08-964).

57. Posting of Jennifer Forsyth to Law Blog—WSJ, [http://blogs.wsj.com/law/2008/10/30/court-reverses-position-on-business-methods-patents-in-bilski-case/?mod=googlenews\\_wsj](http://blogs.wsj.com/law/2008/10/30/court-reverses-position-on-business-methods-patents-in-bilski-case/?mod=googlenews_wsj) (Oct. 30, 2008, 14:21 EST).

58. *Bilski*, 545 F.3d at 954.

59. *Id.* at 957.

60. Still, one commentator has asked, “Is a biological ‘DNA nanocomputer’ a machine? If so, why is a human mind that comprehends a business method not also a ‘machine?’” Posting of David Opperbeck to Concurring Opinions, *Bilski and the Drivers of Patent Law*, [http://www.concurringopinions.com/archives/2008/11/bilski\\_and\\_the.html](http://www.concurringopinions.com/archives/2008/11/bilski_and_the.html) (Nov. 5, 2008, 16:18 EST).



gain patent-eligibility.<sup>61</sup> In any case, the court specifically declined to categorically “adopt a broad exclusion over software or any other such category of subject matter beyond the exclusion of claims drawn to fundamental principles . . . .”<sup>62</sup> Thus, while the test enunciated by the *Bilski* court may seem limiting at first glance, there is serious question as to how far it extends in curtailing the patentability of business methods under the threshold question of subject matter eligibility under § 101.

#### D. “Best Mode” Requirement

Under the first paragraph of § 112, a patent specification must “set forth the best mode contemplated by the inventor of carrying out his invention.”<sup>63</sup> In setting forth this best mode, an inventor need not explain every technical detail of the underlying field, because this disclosure requirement is “directed to those skilled in the art.”<sup>64</sup> The inventor needs to “disclose the *best* mode of carrying out the invention,” however, not merely *a* mode.<sup>65</sup> It is not difficult for a valid patent specification to satisfy the enablement requirement.<sup>66</sup> But merely enabling use of an invention does not allow the inventor to withhold any information that the inventor might deem *useful* in practicing the invention.<sup>67</sup> Indeed, most cases in which a best mode violation has been found address “situations where an inventor fail[s] to disclose non-claimed elements that [are] nevertheless necessary to practice the best mode of carrying out the claimed invention.”<sup>68</sup> In the context of tax strategy patents, this requirement compels patent applicants to disclose all methods they consider useful for practicing the tax strategy, thus yielding to the public knowledge the full range of benefits available from the strategy.

---

61. Commentators have effectively thrown their hands in the air in this regard. It seems necessary to have the court consider a fact pattern where the issue is whether the invention is sufficiently tied to a machine to get a clear answer on this point. *See id.*; Posting of Dennis Crouch to Patently-O, <http://www.patentlyo.com/patent/2008/10/in-re-bilski.html> (Oct. 30, 2008, 11:56 CDT).

62. *Bilski*, 545 F.3d at 960 n.23.

63. 35 U.S.C. § 112 para. 1 (2006).

64. *Chemcast Corp. v. Arco Indus. Corp.*, 913 F.2d 923, 926–27 (Fed. Cir. 1990) (citations omitted).

65. *Id.* at 928.

66. “The specification shall contain a written description of the invention, and of the manner and process of making and using it, in such full, clear, concise, and exact terms as to enable any person skilled in the art . . . to make and use the same . . . .” 35 U.S.C. § 112 para. 1.

67. *See id.*

68. *Chemcast Corp.*, 913 F.2d at 928–30 (finding patent covering dual durometer grommet invalid for failure to disclose the ideal material hardness and supplier/trade name the inventor contemplated); *see also* *Dana Corp. v. IPC Ltd. P’ship*, 860 F.2d 415, 420 (Fed. Cir. 1988) (finding failure to disclose unclaimed fluoride treatment of surface of claimed valve seals that was necessary for satisfactory performance of claimed seal to be violation of the best mode requirement); *Spectra-Physics, Inc. v. Coherent, Inc.*, 827 F.2d 1524, 1536–37 (Fed. Cir. 1987) (finding failure to disclose specific braze cycle constituting preferred means of attaching heat web to alumina tube to be violation of the best mode requirement).

### *E. Policy Concerns Underlying the Patent System*

The primary policy forming the foundation of the United States patent system is the constitutionally backed purpose of promoting innovation and progress.<sup>69</sup> In analyzing how patents promote innovation and progress, “the courts have emphasized two mechanisms”:<sup>70</sup> first, the prospect of obtaining a monopoly right to exclude others from use, manufacture, or import of a valuable innovation for a limited time provides a strong incentive to invest time and money in innovation research;<sup>71</sup> and second, the patent system requires disclosure, thereby increasing the store of public knowledge.<sup>72</sup>

#### *1. The Incentive to Invent*

The free riding theory effectively summarizes the incentive to invent.<sup>73</sup> The concern here is that, absent the patent system and its protections to patentees, “too few inventions will be made.”<sup>74</sup>

If successful inventions are quickly imitated by free riders, competition will drive prices down to a point where the inventor receives no return on the original investment in research and development. As a result, the original inventor may be unable to appropriate enough of the social value of the invention to justify the initial research and development expenditures. The high risk involved in research compounds the likelihood of underinvestment in invention. Thus inventions with potentially great social benefits might never come about, or at least might be significantly delayed, unless private returns to invention were increased above their free market levels. Patents serve to bring the private benefits of inventions in line with their social value by allowing inventors to use their monopoly positions to extract a price that more closely approaches the value that users receive from inventions.<sup>75</sup>

In spite of the reliance on this policy as a theory underlying the patent system, arguments have been made for its lack of necessity. One argument against the free riding rationale is that the head start into the market caused by being the first to inception of the innovation may provide sufficient incentive to research and develop.<sup>76</sup> A second argument

---

69. The Constitution reserves to Congress the power to enact laws “[t]o promote the Progress of Science and useful Arts[.]” U.S. CONST. art. I, § 8, cl. 8.

70. Rebecca S. Eisenberg, *Patents and the Progress of Science: Exclusive Rights and Experimental Use*, 56 U. CHI. L. REV. 1017, 1024 (1989).

71. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480 (1974) (citing *Universal Oil Co. v. Globe Co.*, 322 U.S. 471, 484 (1944)).

72. *Id.* at 481 (citing *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 187 (1933)).

73. See generally John S. McGee, *Patent Exploitation: Some Economic and Legal Problems*, 9 J.L. & ECON. 135 (1966).

74. Eisenberg, *supra* note 70, at 1024.

75. *Id.* at 1025–26 (citations omitted).

76. *Id.* at 1026. Professor Eisenberg also suggests that “the need to keep up with the technological progress of market rivals might stimulate invention without further incentives.” *Id.* at 1026–27.

relates to economic activity: working to beat competitors to a potentially patentable solution may result in too many resources being diverted from fields where no patent protection is available to fields where higher monopoly profits are likely to be available, in spite of the potential social value in the former fields.<sup>77</sup> Nonetheless, the free riding concern remains a strong underlying justification for the current state of the patent system.

## 2. *Disclosure Requirement*

At least somewhat associated with the incentive-to-invent policy is the theory that public disclosure of innovations—thereby allowing for further development of ideas—also undergirds the patent system as a primary policy. As the adage says, like “dwarfs standing on the shoulders of giants.”<sup>78</sup> The premise behind this theory is “that in the absence of patent protection inventors would keep their inventions secret in order to prevent competitors from exploiting them.”<sup>79</sup> This secrecy would keep information from the public and would cause innovation to stagnate.<sup>80</sup> Clearly, if the public does not have access to new innovations and inventions, it is incapable of building on these ideas and thereby further advancing innovation. In the realm of tax strategy patents, if tax innovations are kept secret for the exclusive use of the few, potentially useful and creative ideas will be withheld from the public. This would result in decreased innovation by other practitioners because they would be deprived of the opportunity to further develop potentially creative, money-saving innovations built on the back of the secret strategy.

Though public disclosure of knowledge for the purpose of promoting development is an admitted policy underlying the patent system,<sup>81</sup> there is a question as to whether granting patent rights actually promotes disclosure of knowledge that would not otherwise be disclosed.<sup>82</sup> Often, keeping a development secret is not practical, as it may be reverse engineered by competitors.<sup>83</sup> Those inventions that actually *can* be kept secret may be more valuable to their inventors as trade secrets than the limited monopoly right to exclude granted by the patent system.<sup>84</sup> Also,

---

77. *Id.* at 1027.

78. *Nanos gigantum humeris insidentes*. See THE OXFORD DICTIONARY OF QUOTATIONS 41 (3d ed. 1979).

79. Eisenberg, *supra* note 70, at 1028.

80. Martin J. Adelman, *Property Rights Theory and Patent-Antitrust: The Role of Compulsory Licensing*, 52 N.Y.U. L. REV. 977, 983–84 (1977).

81. If developments were not made known to the public, there would be little purpose behind granting patents and the corresponding monopoly rights.

82. Eisenberg, *supra* note 70, at 1028–29.

83. See *Paulik v. Rizkalla*, 760 F.2d 1270, 1276 (Fed. Cir. 1985) (“[T]he obligation to disclose is not the principal reason for a patent system; indeed, it is a rare invention that cannot be deciphered more readily from its commercial embodiment than from the printed patent.”).

84. See Eisenberg, *supra* note 70, at 1029; Peter C. Quittmeyer, *Understanding the Intellectual Property License 2003: Software Licensing*, 763 P.L.I.-PAT. 903, 935–36 (2003).

there is doubt as to whether, in spite of the requirement to disclose “the best mode contemplated by the inventor of carrying out his invention,”<sup>85</sup> “patent disclosures in fact convey enough information to be useful to the public.”<sup>86</sup> Indeed, if the inventor has not contemplated a best mode at the time of the application filing, it need not be included.<sup>87</sup> Furthermore, even if a best mode is included, there is no requirement that the application explicitly identify the best mode; it may very well be buried amongst many different suggested embodiments of the invention.<sup>88</sup>

In spite of the arguments against disclosure being a valid policy underlying the patent system, it would be difficult for inventors to license their inventions to others without the protection against free riding provided by the patent system. For example, it would likely be difficult for an inventor of a novel manufacturing method to license the newly patented method to another manufacturer without first showing how the new method will reduce costs for the potential licensee. Of course, by disclosing this method (absent the protections of the patent system), the potential licensee would lose any incentive to license and would merely duplicate the novel invention independently. By avoiding these economically unreasonable scenarios, the disclosure policy has at least some validity.

#### F. *Rights Conferred by a Patent*

Once a patent has been obtained, it confers upon its owner “the right to exclude others from making, using, offering for sale, or selling the invention throughout the United States.”<sup>89</sup> In addition, § 271 proscribes any importing of a patented invention and any inducement (direct or indirect) of patent infringement.<sup>90</sup> Also, in the case of a challenge to the patent’s validity, issuance gives the patent a presumption of validity that must be overcome by the opponent.<sup>91</sup> In exchange for these rights, the patentee is required to fully disclose the best mode known of practicing the invention.<sup>92</sup> Thus, by obtaining a patent on an invention, the patentee is required to abandon any trade secret protection pertaining to

---

85. 35 U.S.C. § 112 (2006); *see also supra* Part II.D.

86. Eisenberg, *supra* note 70, at 1029 (citations omitted); *see also Paulik*, 760 F.2d at 1276.

87. *See Chemcast Corp. v. Arco Indus. Corp.*, 913 F.2d 923, 927–28 (Fed. Cir. 1990) (establishing that the first step in a best mode analysis is “*whether*, at the time the inventor filed his patent application, *he knew* of a mode of practicing his claimed invention that he considered to be better than any other” (emphasis added)).

88. *See id.* at 927–29.

89. 35 U.S.C. § 154(a)(1) (2006).

90. *Id.* § 271.

91. *Id.* § 282.

92. *Id.* § 112; *see also supra* Part II.D.

the patented subject matter and dedicate to the public the full benefit of the knowledge of the innovation.<sup>93</sup>

### III. ANALYSIS

To understand how tax strategy patents satisfy the legal framework and policy rationales underlying the patent system, this Part analyzes the application of constitutional and statutory requirements to tax strategy patents. This analysis is followed by a consideration of the policy implications of allowing these patents. Finally, this Part concludes with an analysis of the practical impact of tax strategy patents in the world of tax practice. Throughout this Part, concerns with and arguments against tax strategy patents are considered and responses provided. Ultimately, this Part demonstrates the acceptability of tax strategy patents through the lenses of legal requirements, policy concerns, and practical applications.

#### A. *The Constitutional and Statutory Legality of Tax Strategy Patents*

Tax strategy patents fulfill the statutory requirements laid out in title 35<sup>94</sup> and fall under the constitutionally established umbrella of patentability.<sup>95</sup> Issues of utility, novelty, and nonobviousness will be unique to each patent application;<sup>96</sup> thus, debate regarding tax strategy patents' legality, as a general matter, revolves around the patents' constitutionality<sup>97</sup> and whether they satisfy the subject matter eligibility requirements of § 101.<sup>98</sup>

#### 1. *The Constitutionality of Tax Strategy Patents*

In 1787, the Constitutional Convention adopted the text proposed by Charles Pinkney for Article I, Section 8, Clause 8,<sup>99</sup> providing the constitutional basis for what has become the U.S. copyright and patent law systems.<sup>100</sup> This clause grants Congress power “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discove-

---

93. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 485 (1974). This is an important point: typically tax strategies are likely to be kept secret, and this disclosure commits to the public an otherwise nonpublic innovation. See *infra* Part III.B.3.

94. See *supra* Part II.B–C.

95. See *infra* Part III.A.1.

96. See *supra* Part II.B.

97. See, e.g., Schwartz, *supra* note 4.

98. See generally Banner, *supra* note 8.

99. Mr. Pinkney's proposed version of Article 1, Section 8, Clause 8 contained language allowing Congress “[t]o grant patents for useful inventions,” and had separate language allowing Congress “[t]o secure to Authors exclusive rights for a certain time.” The version proposed by James Madison had no clause referring to patents, but contained only a copyright clause (expressly using the word “copyrights,” which does not now appear in the adopted version of that section). 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, 324–25 (Max Farrand ed., 1966).

100. U.S. CONST. art. I, § 8, cl. 8.

ries.”<sup>101</sup> Though the founders chose the word “discoveries” rather than “inventions,”<sup>102</sup> courts have held that an idea itself is not patentable; the idea must be implemented in some concrete form to be patent-worthy.<sup>103</sup> Courts have also held that patent applications covering “laws of nature” are not patentable subject matter.<sup>104</sup> Though courts have referenced the application of the “laws of nature” in making an invention patentable,<sup>105</sup> contrary to assertions made by some commentators,<sup>106</sup> this does not mean that only the application of a pure law of nature to a physical medium is eligible for patenting. When the “laws of nature” doctrine was introduced, the Court merely held that discovery of an existing law of nature is not available for patent.<sup>107</sup> Indeed, if a strict requirement were to be adopted that application of the “laws of nature” were necessary to constitute patentable subject matter, the approval of business method patents in 1998 would be highly suspect.<sup>108</sup> Finally, a patent may not be obtained on a mathematical algorithm or a scientific truth.<sup>109</sup> Allowing a patent on such fundamental principles would preclude potentially wide ranges of innovations and could cripple entire economic fields.<sup>110</sup>

Tax strategy patents fall well within this broad constitutional umbrella of patentability. A new implementation of a tax strategy by a practitioner constitutes a “useful art” worthy of protection as a “discovery.”<sup>111</sup> Though it may seem that in order to gain patent protection an invention must qualify as “Progress of Science,”<sup>112</sup> this clause was not directed to patentable inventions but was intended to provide protection to authors for what has become copyright protection.<sup>113</sup> The Constitutional Convention, therefore, did not intend to limit patent protection to some narrow scientific or industrial niche as some countries do,<sup>114</sup> but intended

101. *Id.*

102. The language most closely resembling that which was eventually adopted proposed the word “inventions” rather than “discoveries.” See 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, *supra* note 99, at 325.

103. *Clark Thread Co. v. Willimantic Linen Co.*, 140 U.S. 481, 489 (1891); *Rubber-Tip Pencil Co. v. Howard*, 87 U.S. (20 Wall.) 498, 507 (1874).

104. *Funk Bros. Seed Co. v. Kalo Inoculant Co.*, 333 U.S. 127, 130 (1948).

105. *Id.*

106. See Schwartz, *supra* note 4, at 356–57.

107. *Funk Bros.*, 333 U.S. at 130–31 (“If there is to be invention from [the discovery of a bacteria], it must come from the application of the law of nature to a new and useful end.”).

108. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1375 (Fed. Cir. 1998) (asserting that business methods should not have their own rules, but instead should be “subject to the same legal requirements for patentability as applied to any other process or method”).

109. *Mackay Radio & Tel. Co. v. Radio Corp. of Am.*, 306 U.S. 86, 94 (1939).

110. See *Diamond v. Diehr*, 450 U.S. 175, 187 (1981).

111. See U.S. CONST. art. I, § 8, cl. 8.

112. *Id.*

113. See Kevin A. Goldman, Comment, *Limited Times: Rethinking the Bounds of Copyright Protection*, 154 U. PA. L. REV. 705, 709 (2006).

114. For example, the European Patent Convention determined in 1973 (revised as recently as November 29, 2000) that patentable subject matter under the convention explicitly excludes “schemes, rules and methods for performing mental acts, playing games or doing business, and programs for computers.” European Patent Convention, art. 52, Oct. 5, 1973, 13 I.L.M. 268, available at <http://www.epo.org/patents/law/legal-texts/html/epc/2000/e/ar52.html>.

a broad scope of protection to innovators.<sup>115</sup> This principle is further evidenced by the Convention's failure to adopt the exact language proposed by Charles Pinckney, which would have only allowed patents for "useful inventions" rather than the more expansive scope of "discoveries" as actually adopted.<sup>116</sup> Within this broad framework, authority lies with Congress to establish the scope of patentable subject matter and any limitations to be placed on patentability requirements and patentable subject matter.<sup>117</sup> Because tax strategy patents do not fall outside the broad language employed in the clause, any restriction on their patentability must be imposed by Congress.

## 2. *The Subject Matter Eligibility of Tax Strategy Patents*

As a result of the broad constitutional language employed<sup>118</sup> and the resulting broad statutory language chosen by Congress,<sup>119</sup> patents covering tax strategies fall within the subject matter eligibility bounds established by statute and case law. Courts have broadly construed the language chosen by Congress to allow patents on "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof."<sup>120</sup> In construing this language, courts have repeatedly held that "anything under the sun that is made by man" is eligible for patent protection.<sup>121</sup>

The broad scope of subject matter eligibility has been made manifest by the emergence of business method and software patents.<sup>122</sup> Prior to the *State Street Bank* decision, software was largely protected under copyright law,<sup>123</sup> and business method patent applications were often submitted under the guise of separate subject matter.<sup>124</sup> Indeed, there has been argument that patent protection should be recognized on non-physical, useful results of valuable innovations.<sup>125</sup> The Federal Circuit

115. See *Ex parte* Lundgren, 76 U.S.P.Q.2d (BNA) 1385, 1387 (Bd. Pat. App. & Int. 2005), No. 2003-2088, 2004 WL 3561262, at \*4 (rejecting the "technological arts" requirement for patentability).

116. See *supra* notes 99, 102.

117. Indeed, Congress has chosen to enact very few exceptions to the broad scope of subject matter eligibility established by courts. See *infra* Part III.A.2.

118. U.S. CONST. art. I, § 8, cl. 8; see *supra* Part III.A.1.

119. 35 U.S.C. § 101 (2006).

120. *Id.*

121. See, e.g., *Diamond v. Diehr*, 450 U.S. 175, 182 (1981); *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980); H.R. REP. NO. 82-1923, pt. 2, at 6 (1952), as reprinted in 1952 U.S.C.C.A.N. 2394, 2399; see also *supra* Part II.C.

122. See, e.g., *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1375 (Fed. Cir. 1998).

123. See, e.g., *Johnson Controls, Inc. v. Phoenix Controls Sys., Inc.*, 886 F.2d 1173, 1175 (9th Cir. 1989); see also Robert P. Merges, *Software and Patent Scope: A Report from the Middle Innings*, 85 TEX. L. REV. 1627, 1634 (2007).

124. Thomas J. Scott, Jr. & Stephen T. Schreiner, *Planning for the Brave New World: Are Business Method Patents Going to be Second Class Citizens?*, INTELL. PROP. & TECH. L.J., June 2007, at 6, 6.

125. Richard S. Gruner, *Intangible Inventions: Patentable Subject Matter for an Information Age*, 35 LOY. L.A. L. REV. 355, 453 (2002). This Note does not go so far as to endorse this proposed expan-

made clear in its unanimous *State Street Bank* panel decision<sup>126</sup> that it interprets the “repetitive use of the expansive term ‘any’ in § 101 [to show] Congress’s intent not to place any restrictions on the subject matter for which a patent may be obtained beyond those specifically recited in § 101.”<sup>127</sup> In determining that business methods are patentable, the Federal Circuit focused on taking an abstract idea and implementing it in a “useful” way.<sup>128</sup> Hence, laws of nature, natural phenomena, and abstract ideas are unpatentable on their face.<sup>129</sup> It is the application of these laws, phenomena, and ideas that creates patentable subject matter.<sup>130</sup>

Tax strategy patents fall nicely within the “application of an abstract idea” test proclaimed in *State Street Bank*. A tax strategy takes existing ideas (tax laws) and generates a process whereby taxpayers minimize their tax responsibilities by effectively manipulating their practices to conform to the tax laws.<sup>131</sup> This is merely an embodiment of the Federal Circuit’s requirement that an abstract idea (a strategy for applying tax laws) be applied (by manipulating an actual personal or business situation) in an innovative fashion.

One may argue that a tax strategy patent lacks the physical results (the so-called physical transformation) generated by software or business method patents. Because tax strategy patents have fundamentally the same result as software or business method patents, however, they ultimately constitute patentable subject matter. In practice, a business method patent will direct a change of behavior or a process of a business, resulting in increased efficiency, decreased costs, increased profits, or any combination thereof.<sup>132</sup> Likewise, performing the invention claimed in a tax strategy patent will result in a change of behavior by a company seeking to reap the benefits of a tax law, or it will result in application of the tax laws in a certain way so as to generate money, which is ultimately the goal of obtaining a patent in any case.<sup>133</sup> Thus, tax strategy patents are nothing more than a subset of the business method patents articulated by the Federal Circuit in *State Street Bank*.

---

sion of the scope of eligible subject matter, but this example is merely used to demonstrate that no expansion of the current interpretation of § 101 is necessary to accommodate the emerging field of tax strategy patents.

126. *State St. Bank*, 149 F.3d at 1368.

127. *Id.* at 1373.

128. *Id.*

129. *See id.*; *see also supra* Part II.C.

130. *State St. Bank*, 149 F.3d at 1373. Of course, to actually be patentable the remainder of title 35 must also be satisfied.

131. *See, e.g.*, Establishing and Managing Grantor Retained Annuity Trusts Funded by Nonqualified Stock Options, U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003); *see also supra* Part II.A.

132. *See* H.R. REP. NO. 107-1332 (2001).

133. *See* Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 2163, 2171 (2007). Indeed, if patent owners and their licensees did not believe the invention would generate any profits for them, either through direct efficiencies or sales or through indirect results such as the right to exclude competitors, they would have no motivation to obtain patent rights in the first instance.



Furthermore, the Federal Circuit has more recently held that the notion of “physical transformation”—seemingly articulated in *State Street Bank*—“is not an invariable requirement, but merely one example of how [an abstract process] may bring about a useful application.”<sup>134</sup> The Federal Circuit observed that “when [a claimed invention] is performing a function which the patent laws were designed to protect (e.g., transforming or reducing an article to a different state or thing), then the claim satisfies the requirements of § 101.”<sup>135</sup> Indeed, the patent laws were designed to protect, among other things, precisely what tax strategy patents accomplish—conception of a novel process generating benefits for its implementer.<sup>136</sup>

In its most recent decision addressing patentable subject matter, the Federal Circuit supplanted the *State Street Bank* “useful, concrete and tangible result” inquiry with a consolidated “machine-or-transformation” test.<sup>137</sup> Though some commentators view this decision as substantially quashing business method patents,<sup>138</sup> others have observed that this new test merely reiterates the requirement of tying business method inventions to a particular application and machine.<sup>139</sup> Indeed, the *Bilski* court stated clearly that the “machine-or-transformation” test was not intended to be new subject matter eligibility doctrine, but merely to be a statement of Supreme Court precedent.<sup>140</sup> Thus, the material principles underlying subject matter eligibility of tax strategy patents have merely been clarified, paving a clear path for the Supreme Court to articulate a clear rule allowing such critical innovations.<sup>141</sup>

#### B. Tax Strategy Patents Align with the Patent System’s Policies and Purposes

Whenever considering a potential evolution of a legal system, it is useful to analyze the underlying policy concerns of the system to ensure that the new outgrowth is in line with these concerns. This is especially important in the context of patents because a patent grants a limited monopoly to its owner which may last for up to twenty years.<sup>142</sup> Given that the U.S. legal system generally avoids sanctioned monopolies,<sup>143</sup> it is important to ensure that any exception to this rule, or outgrowth of the es-

---

134. AT&T Corp. v. Excel Commc’ns, Inc., 172 F.3d 1352, 1358 (Fed. Cir. 1999).

135. *Id.* at 1359 (quoting *Diamond v. Diehr*, 450 U.S. 175, 192 (1981)).

136. *See infra* Part III.B.

137. *In re Bilski*, 545 F.3d 943, 959–60 (Fed. Cir. 2008) (en banc).

138. The *Bilski* Decision Is In: Buh-Bye [Most] Business Methods Patents—As text—updated, Groklaw, <http://www.groklaw.net/article.php?story=20081030150903555> (Oct. 30, 2008, 15:27 EDT).

139. Posting of David Stein to Patently-O, <http://www.patentlyo.com/patent/2008/11/bilski-adding-o.html> (Nov. 3, 2008, 12:12 EST).

140. *Bilski*, 545 F.3d at 960.

141. *See id.* at 956 (“[W]e recognize that the Supreme Court may ultimately decide to alter or perhaps even set aside this test to accommodate emerging technologies.”).

142. 35 U.S.C. § 154(a)(2) (2006).

143. *See* 15 U.S.C. § 2 (2006).

tablished scope of this rule, is well-considered. It is equally important to note, however, that considering an evolution of the patent system in this context is merely a consideration of whether the evolution *should* be allowed, not whether it *can* be allowed given the established scope of the law. Indeed, if a particular application does not conflict with existing statutory or case law, a decision to limit that application must come as either a matter of equity or because the application would clearly be inherently detrimental to the public interest.<sup>144</sup>

### 1. *Burden of Proof Lies in Showing Exception to Patent Laws*

Because the patent laws regarding eligible subject matter are very broadly construed,<sup>145</sup> any new class of patents is presumptively valid inasmuch as it does not violate the three basic eligibility hurdles laid out in case law.<sup>146</sup> The Supreme Court has been clear when interpreting patent laws that courts “should not read into the patent laws limitations and conditions which the legislature has not expressed.”<sup>147</sup> By implication, then, if Congress has not expressly excluded a method or some other category of patents,<sup>148</sup> the burden lies with the party challenging the subject matter to show that it lies outside the statutorily or constitutionally defined realm of eligible patent subject matter. For example, courts have been clear in eliminating three classes of applications from patent eligibility: laws of nature, natural phenomena, and abstract ideas.<sup>149</sup> Without an explicit statutory exception, the USPTO and courts have found all other subject matter presumptively valid.<sup>150</sup> Indeed, if an exception to the broad interpretation of the subject matter laws exists, it has traditionally been carved out by Congress.<sup>151</sup>

### 2. *Allowing Tax Strategy Patents Will Further Incentivize Innovation*

One primary purpose behind the patent system is to encourage innovation through a system of incentives in the form of a monopoly on the patented invention.<sup>152</sup> It may be argued that tax practitioners are already strongly motivated to find creative tax strategies because their clients are paying for these services. But by providing a stronger economic incentive—i.e., the right to exclude others from the use of the

---

144. For discussion on whether tax strategy patents can be allowed, see *supra* Part III.A.2.

145. See *supra* Part III.A.2.

146. See *supra* Part II.B.

147. *Diamond v. Chakrabarty*, 447 U.S. 303, 308 (1980) (quoting *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 199 (1933)).

148. For example, atomic weapons are explicitly excluded from patent protection under 42 U.S.C. § 2181(a).

149. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1373 (Fed. Cir. 1998); see also *supra* Part III.A.2.

150. See, e.g., *Chakrabarty*, 447 U.S. at 308.

151. *Id.* at 315, 318.

152. See *supra* Part II.E.1.

strategies and thereby allowing the collection of licensing fees from other tax practitioners—the system may further incentivize truly novel and ground-breaking tax strategies and other legal methods. For example, very few would likely argue that engineers at Intel would lack the motivation to continue full-steam development if patent protection for innovative processors were to be eliminated.<sup>153</sup> If Intel were to cease development of new processors, it would quickly lose its market share to competitors who would continue to meet the market's demand for improved technology and quality in processors. The patent system continues to incentivize engineering developments, however, because it further enhances and encourages the development of original ideas and novel products through the right to exclude competitors from the use or manufacture of the products. Likewise, tax practitioners will feel motivated to develop not only innovative strategies, but also strategies so novel that they qualify for patent protection. This will in turn spur more disclosure, and the tax system will evolve accordingly.

### 3. *Closing Tax Loopholes*

As a requirement of patent protection, the patent applicant must disclose the “best mode contemplated by the inventor of carrying out his invention.”<sup>154</sup> Thus, in order to obtain a patent, an applicant for a tax strategy covering a potential tax loophole<sup>155</sup> is obligated to fully disclose the loophole and the best mode contemplated by the applicant to practice the tax strategy.<sup>156</sup> This requirement has two implications.

First, exposure of a true loophole will allow Congress to amend the tax laws to close the loophole. This may be argued by some to be a negative point as it eliminates potential areas of financial savings for applicable companies or individuals, or may make the patent essentially worthless. As a matter of legislative policy, however, it is a positive point because the tightening of the tax laws should result in more robust, predictable laws, allowing taxpayers to more efficiently utilize the tax system. If loopholes in the tax system result in an unintended quantity of income being withheld from the federal government, higher tax rates in other areas of the tax system will result in order to meet governmental

---

153. It may be argued that a weakness in this analogy is that Intel engineers receive very little (if any) personal incentive to develop patent-worthy innovations (i.e., the engineers receive very little financial reward for developing patent-worthy technologies). Yet, many ground-breaking tax strategies are likely developed by tax practitioners employed by major law firms or corporations (as these are the entities with enough financial strength to demand these innovations). As such, these practitioners will have comparable personal (i.e., financial) incentive to develop patent-worthy strategies, as their employing firm or corporation will likely own any resulting patent rights.

154. 35 U.S.C. § 112 (2006); *see also supra* Part II.D.

155. Of course, not all tax strategy patents need to cover loopholes in the tax system; many may merely disclose methods of how to best take advantage of tax provisions.

156. *See supra* Part II.D.

income needs.<sup>157</sup> Also, if legislative action renders a patent obsolete, this likely indicates that the patented invention runs contrary to public policy concerns, and therefore nothing would be lost in rendering it moot.

Second, out of fear of potential congressional action resulting from thorough patent disclosures, potential patent applicants may currently have a disincentive for filing tax strategy patents. Of course, if these tax strategists simply choose not to file for patents on their tax innovations, nothing is gained or lost by allowing others to file for tax strategy patents. This is precisely the logic underlying the patent system: if innovators choose not to file for a patent on an invention but instead maintain the innovation as a trade secret, they lose the ability to exclude others from making, selling, or importing the invention.<sup>158</sup> In addition, if another inventor later develops the same innovation and obtains a patent thereon, a “conflict arises as to which party has a greater right to have the invention protected” in the event the prior inventor later seeks protection of that invention.<sup>159</sup> Therefore, if a tax practitioner develops a novel tax strategy and chooses not to obtain patent protection or otherwise publicly disclose it, the practitioner runs the risk (which is apparently acceptable) that another practitioner may develop the same innovation and gain the right to exclude others (potentially including the original inventor, depending on the circumstances).<sup>160</sup>

### C. *Practical Consequences of Allowing Tax Strategy Patents*

Patents on tax strategies satisfy the constitutional requirements,<sup>161</sup> statutory subject matter requirements,<sup>162</sup> and policy concerns underlying the patent system.<sup>163</sup> Therefore, considering the practical consequences of allowing these patents, or conversely, the negative consequences of disallowing the patents, provides a pragmatic perspective on this issue.

#### 1. *Transferable Utility Is Lost by Disallowing Tax Strategy Patents*

In defining the types of subject matter that courts should allow, one commentator has suggested that transferable utility should be the “touchstone” of these tests.<sup>164</sup> “Transferable utility” is defined here as

---

157. See, e.g., Edward Yorio, *The President's Tax Proposals: A Major Step in the Right Direction*, 53 *FORDHAM L. REV.* 1255, 1277 (1985).

158. Philip L. Burke, *The 'Non-Informing Public Use' Concept and Its Application to Patent-Trade Secret Conflicts*, 63 *J. PAT. OFF. SOC'Y* 459, 469–70 (1981).

159. *Id.* at 469; see also Keith M. Kupferschmid, *Prior User Rights: The Inventor's Lottery Ticket*, 21 *AIPLA Q.J.* 213, 219–20 n.17 (1993).

160. For a discussion of prior user rights, providing an additional defense to the senior inventor, see also *infra* Part III.C.3.

161. See *supra* Part III.A.1.

162. See *supra* Part III.A.2.

163. See *supra* Part III.B.

164. 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, 428 (2007).

the benefit that may be gained by the public in having a particular invention or innovation disclosed and made available for public consumption.<sup>165</sup> This is because

[w]here transferable utility of benefit to substantial numbers of persons in the public is present in a particular type of advance, society will generally gain through access to more instances of such advances and it is desirable for the patent system to encourage new and nonobvious types of advances with these characteristics.<sup>166</sup>

It may be argued that in the tax arena (like many other areas of the law) there is a healthy, vibrant academic journal system whereby innovations are made public and receive comments from other scholars.<sup>167</sup> True as this may be, most contributing authors to these journals (and other publications) are likely to be academics, not practitioners. This effectively closes off a very significant portion of the tax community that may not contribute its knowledge and experience. Though academics no doubt have very worthwhile insights into the tax system, there is little substitute for experience with actual application of tax strategies to problems encountered in practice. While it is probable that practitioners read and keep up to speed on developments published in their field of practice, it is not a logical extension to contend that they also take the time to publish their work and thoughts.

In addition, many practitioners who develop new strategies may not publish those strategies, even if they are interested in academic discussion. This may be because they hold their strategies as trade secrets. By disclosing every innovative strategy in journals or publications, these practitioners would effectively feed the business of competing professionals and damage their own bottom line. The innovative practitioners' ingenuity sets them apart from their competition and incentivizes clients to retain them as counsel. This is contrary to the pressures on academics whose ability to publish their innovations is the source of their livelihood. This line of reasoning is one of the primary policies underlying the patent system.<sup>168</sup> If there are incentives in place not to disclose innovations, the patent system steps in to encourage more disclosure. While there likely is already a good amount of innovation in the legal field,<sup>169</sup> the patent system is in place, at least partially, to encourage inventors to push their innovations into the public domain.<sup>170</sup> With the ability to monopolize the strategy and generate revenue for a period of years through licensing,

---

165. *Id.*

166. *Id.*

167. *See Melone, supra* note 9, at 478.

168. *See supra* Part II.E.2.

169. *See supra* note 167 and accompanying text. Legal practitioners develop ideas and innovative strategies by necessity. Clients demand attorneys who will develop innovative solutions to practical problems. Hence, many law firms' websites declare the innovative solutions they provide. The issue here is not whether innovation exists, but whether that innovation is finding its way into the hands of society.

170. *See supra* Part II.E.2.

practitioners will be motivated to patent their innovations and contribute to the store of public knowledge, rather than keeping valuable methods private.

One further argument strengthening this point is that § 112 requires inventors to disclose what they feel to be the best mode of practicing their invention.<sup>171</sup> This requires an inventor of a legal strategy to disclose as much useful information as necessary relating to the strategy to enable one of ordinary skill in the art to *most effectively* practice the strategy.<sup>172</sup> This requirement will encourage full disclosure of valuable innovations to the public, and, if the best mode of practicing the innovation is withheld by the inventor, the information will be committed to the public because the patent may be deemed to be invalid as a violation of § 112.<sup>173</sup>

## 2. *Allowing These Patents Will Not Result in Tax Clutter*

There may be concern that allowing patents on tax strategies will result in a cluttering of the practice of tax law because a patent search will be required every time tax advice is given.<sup>174</sup> While this argument bears some merit—certainly a check will have to be performed before new advice can be given to clients—practically this should not be a major concern. Active tax practitioners are, and should be, well-apprieved of developments in the tax field. For the same reasons they should already be reading trade journals and staying educated in recent tax law developments, practitioners should be aware of new tax strategy patents that may be licensed for use in counseling their clients.

In addition, as a practical matter, there will not be many new tax strategy patents issued each year,<sup>175</sup> resulting in a relatively small amount of new information for tax practitioners to add to their educational repertoire.

Moreover, the statutory hurdles present in the patent system will help minimize the quantity of tax strategy patents issued. These hurdles serve the purpose of filtering patent applications that will not truly contribute to the field of tax strategies. The requirements of utility, novelty,

---

171. Paragraph 1 of § 112 requires the inventor to “set forth the best mode contemplated by the inventor of carrying out his invention.” 35 U.S.C. § 112 (2006); *see also supra* Part II.D.

172. *See Chemcast Corp. v. Arco Indus. Corp.*, 913 F.2d 923, 928 (Fed. Cir. 1990) (“A patent applicant must disclose the *best* mode of carrying out his claimed invention, not merely *a* mode of making and using what is claimed.”).

173. *See supra* note 68.

174. *See Melone, supra* note 9, at 465.

175. In the years following *State Street Bank*, there was an “explosion” of business method patents when an awareness was triggered that business methods constituted patentable subject matter. Steven M. Cohen, Case Comment, *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323 (*Fed. Cir.* 2005), 39 SUFFOLK U. L. REV. 879, 883 (2006). With the Supreme Court’s 2007 *KSR* decision, however, nonobviousness has become quite a difficult hurdle for patent applicants to overcome. *KSR Int’l Co. v. Teleflex Inc.*, 550 U.S. 398 (2007). Given the wide range of tax strategy information already in the public domain, it will be quite difficult for tax strategy patent applicants to overcome the hurdle of proving nonobviousness, thus limiting the quantity of new tax strategy patents that will be issued.

and nonobviousness ensure that only truly worthy inventions are granted patent protection.<sup>176</sup> While most inventions easily meet the utility requirement (as this requirement basically only requires a patent applicant to state a specific, useful purpose for their invention<sup>177</sup>), even this requirement could prove difficult to satisfy if the tax laws were to be changed to render the strategy moot or even illegal. Furthermore, the requirements of novelty and nonobviousness provide a valuable filter for “inventions” that should not qualify for patent protection. The requirement of novelty requires that no publication exists that wholly teaches the invention claim at hand.<sup>178</sup> Thus, if an alleged infringer of a tax strategy patent can merely show one publicly available, published instance anywhere in the country (or world) utilizing the strategy prior to the strategy’s conception by the patentee, this may be enough to avoid liability for infringement.

Nonobviousness is another relevant hurdle for tax strategy patents to overcome. This provision of the patent statutes<sup>179</sup> requires that a patent not be obvious to one of ordinary skill in the art considering one piece of prior art in light of another piece of prior art.<sup>180</sup> In the scenario of tax strategy patents, “one of ordinary skill in the art” would probably be defined as a professional tax practitioner. In addition, the prior art and the claims at issue must be considered on the whole, making an insignificant change from prior art unpatentable unless the change is truly unique.<sup>181</sup> In the realm of tax strategy patents, this means that if there is a well-known tax strategy, a simple customization of that strategy to a given set of circumstances or a minor adjustment of that strategy will likely be an unpatentable obvious variation, even though the adjustment may be, strictly speaking, novel under § 102.<sup>182</sup> Thus, the current patent laws will be effective at preventing system-encumbering “inventions” from slipping through the cracks. This effectiveness will be accented when the USPTO completes training of the relevant examiners so they are better trained to conduct prior art searches in the area of tax strategies.<sup>183</sup>

### 3. *Practitioners Already Using a Tax Strategy Have a Built-in Statutory Defense*

A valid concern arises when practitioners consider the prospect of having a tax strategy they are currently using potentially being patented

---

176. See *supra* Part II.B.

177. See *supra* Part II.B.

178. 35 U.S.C. § 102 (2006).

179. *Id.* § 103.

180. See *supra* Part II.B.

181. *Graham v. John Deere Co.*, 383 U.S. 1, 14–15 (1966).

182. See *supra* Part II.B.

183. See *infra* Part III.C.5.

by another party. This concern may arise when, as discussed above,<sup>184</sup> a party has developed a tax strategy that it has used for some time but has chosen to keep private as a trade secret. Thus, the novelty provision of § 102 would not apply because a publication describing the strategy has not been made publicly available.

Congress passed § 273 in the wake of the Federal Circuit's *State Street Bank* decision,<sup>185</sup> which first recognized business methods as patentable subject matter. The concern at that time, as is likely to arise now with regard to tax strategy patents, was that companies using certain business methods as trade secrets would have the right to continue those methods snatched from their grasp by parties quick to file patent applications.<sup>186</sup> Congress quickly reacted to this concern and passed § 273 in 1999, providing that

[i]t shall be a defense to an action for infringement . . . if [the alleged infringer] had, acting in good faith, actually reduced the subject matter to practice at least 1 year before the effective filing date of such patent, and commercially used the subject matter before the effective filing date of such patent.<sup>187</sup>

This defense has been referred to as "prior user's rights" in the field of patent law.<sup>188</sup> Thus, if a party obtained a patent for a tax strategy and attempted to enforce it against a practitioner, the alleged infringer need only show that the strategy was conceived and reduced to practice at least one year before the filing date of the patent and that it was commercially used prior to the patent's effective filing date.<sup>189</sup>

There is some argument as to whether the provisions of § 273 will apply to tax strategy patents.<sup>190</sup> Section 273 defines the word "method" as "a method of doing or conducting *business*."<sup>191</sup> If the tax strategy applies only to the affairs of individuals who have invested their wealth and are seeking to avoid tax payments on the resulting gains, it may be difficult for those individuals to classify their activities as "business" activities.<sup>192</sup> This concern, however, may easily be bypassed. For example, because most of the individuals taking advantage of these tax strategies will be sophisticated, affluent individuals,<sup>193</sup> they will likely have employed

---

184. See *supra* Part II.E.2.

185. *State St. Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998). See also *supra* Part III.A.2 for discussion of this case and the implications of its holding.

186. See Toshiko Takenaka, *The Best Patent Practice or Mere Compromise? A Review of the Current Draft of the Substantive Patent Law Treaty and a Proposal for a "First-to-Invent" Exception for Domestic Applicants*, 11 TEX. INTELL. PROP. L.J. 259, 269 (2003).

187. 35 U.S.C. § 273(b)(1) (2006).

188. See, e.g., Rebecca C.E. McFadyen, *The "First-to-File" Patent System: Why Adoption Is Not an Option!*, 14 RICH. J.L. & TECH. 3, 34 (2007).

189. 35 U.S.C. § 273.

190. See Richard S. Gruner, *When Worlds Collide: Tax Planning Method Patents Meet Tax Practice, Making Attorneys the Latest Patent Infringers*, 2008 U. ILL. J.L. TECH. & POL'Y 33, 91-92.

191. 35 U.S.C. § 273(a)(3) (emphasis added).

192. See Gruner, *supra* note 190, at 91.

193. See *id.*



tax planners and other business advisors. The employed professionals will recognize that forming a limited liability company will allow the individual to maintain his investments as a “business” activity while enjoying flow-through taxation and asset protection, thus taking advantage of the tax strategy and enjoying the “prior user rights” defense if a patent infringement suit were to be brought. The very fact that these individual taxpayers are employing such clever methods of tax avoidance as to be worthy of patent protection, albeit by another party, is strong evidence that they will be able to foresee the necessity of engaging the “prior user rights” defense and organize their affairs accordingly.

The argument has also been made that “the steps that businesses undertake to reduce their taxes may not be methods of ‘doing or conducting business’ because these tax-related activities are not aimed at enhancing traditional sources of business profits.”<sup>194</sup> Still, simply because a business is adopting an activity not inherently designed to increase revenues does not mean it is not “conducting business.” Reducing tax costs by implementing a tax planning method will result in increased profits to the business, thereby increasing available capital or equity for the business owners. Indeed, there should be little question that paying taxes is an activity that all businesses conduct. Therefore, the implementation of tax strategies is a business activity worthy of protection under § 273.

#### 4. *Impact on the Unsophisticated Subsection of Taxpayers*

A compelling argument has been made that tax strategy patents may have an adverse effect on a substantial portion of society: those who do not employ tax planning specialists nor have sufficient resources or motivation to keep apprised of tax strategy patent developments.<sup>195</sup> In response, Professor Richard Gruner has argued that the mere fact that a certain patented strategy is more attractive than other available options is not sufficient reason to exclude tax strategies from patentability.<sup>196</sup> This, in fact, is the purpose of the patent system—to grant inventors protection from free riders by granting a limited monopoly over their inventions.<sup>197</sup> Also, because the probable goal of any patent holder is to maximize his financial gain in his monopoly rights through exclusive use, sale, or licensing, it is in the best interests of a patent holder to license his patent to the general public at reasonable rates.<sup>198</sup>

Yet these arguments still leave one feeling dissatisfied. It simply does not feel right to allow a patent holder to control a method of such large potential value to so great a cross-section of society. Indeed, such a

---

194. *Id.* at 91–92.

195. JOINT COMM. ON TAXATION, 109TH CONG., BACKGROUND AND ISSUES RELATED TO THE PATENTING OF TAX ADVICE 25 (Comm. Print 2006).

196. *See* Gruner, *supra* note 190, at 66.

197. *Id.* at 39.

198. *Id.* at 54.

result may leave one thinking “are you serious?”<sup>199</sup> Though the behavior of law being somewhat counterintuitive is not necessarily a sufficient reason to carve an exception,<sup>200</sup> it should be sufficient to at least cause careful consideration of the appropriate state of the law. Thus, this Note recommends congressional action to provide a narrow exception to the damages and remedies available to a patent holder in a patent infringement case where the alleged infringer is a nonbusiness entity in a lower tax bracket.<sup>201</sup>

5. *Short-Term Examination Deficiencies Are Compensated by Long-Term Efficiencies*

The patent system has consistently shown that when unprecedented classes of inventions are first allowed, the USPTO has a learning curve in developing the capacity to deal with these innovations.<sup>202</sup> In the long run, however, the USPTO makes the appropriate adjustments, and though there may be some patent applications that slip through the cracks in the beginning, those errors are corrected by the courts in litigation and ultimately prove to be a small subset of the new patent type.<sup>203</sup>

For example, regarding the first tax strategy patent issued, one commentator has observed, “PTO examiners are usually engineers, and they do not have the expertise in U.S. tax law that is necessary to evaluate [tax strategy patent] applications against the complex and confusing mass of data that constitutes ‘prior art.’”<sup>204</sup> Hence, criticism of the first grouping of tax strategy patents is likely to arise because the USPTO is still inexperienced in this field.<sup>205</sup> Given time to develop a system and to train examiners, however, the issuance of tax strategy patents will become more efficient.<sup>206</sup> Growing efficiencies in the USPTO’s processes occurred in the past when patents began to be filed for business methods and software.<sup>207</sup> For example, in the two years following the *State Street Bank* decision recognizing business methods as valid subject matter, the USPTO increased the number of examiners in the business method pa-

---

199. *Id.*

200. For example, the felony murder doctrine in criminal law is, at least initially, somewhat surprising to many first-year law students who cannot initially grasp how one involved in a felony is responsible for the homicide of any person connected to that felony, even if the individual in question had no direct part in the homicide.

201. *See infra* Part IV.B.

202. *See* Melone, *supra* note 9, at 458–59.

203. *See id.*

204. Gary C. Bubb, *Patented Tax Strategies—Are You Serious?*, MASS. LAWS. WKLY., Aug. 6, 2007, <http://www.lawyersweekly.com/reprints/riw9.htm>.

205. *Id.*

206. *See* Melone, *supra* note 9, at 458–59.

207. *See* John R. Allison & Emerson H. Tiller, *The Business Method Patent Myth*, 18 BERKELEY TECH. L.J. 987, 1025–26 (2003).

tent class<sup>208</sup> from twelve to thirty-eight, seventeen of whom held advanced degrees.<sup>209</sup> Inevitably, development demands evolution of examiner education, and the USPTO has historically stepped up to the plate.

Related to the concern regarding lack of examiner education and experience is the potential difficulty in conducting prior art searches for tax strategies.<sup>210</sup> But as one commentator observed, “[t]his is a challenge the USPTO has faced before, and is not unique to tax strategies, but is inherent in fields of rapidly developing technology.”<sup>211</sup> To combat the difficulty of prior art searching, the USPTO has put into place training programs available for examiners in the first month of their career at the USPTO and “as new systems are introduced.”<sup>212</sup> As part of this training, examiners are instructed on the use of commercial databases, which contain “non-patent literature” (NPL) such as “professional journals, magazines, and conference proceedings. Some commercial databases also offer abstracts of foreign documents.”<sup>213</sup> Since 1994, the USPTO has endeavored to make more commercial databases available and to train examiners more effectively in finding NPL.<sup>214</sup> This effort will continue and training programs will improve as the USPTO develops its understanding of the available prior art in the arena of tax strategies.

One obvious potential source of prior art is the tax returns filed by taxpayers with the Internal Revenue Service (IRS). Though tax returns are confidential by law,<sup>215</sup> this duty of confidentiality is only extended to taxpayers, not tax advisors.<sup>216</sup> Thus, Professor Max Oppenheimer has observed that “a tax return that discloses the tax strategy sought to be patented would create prior art available to defeat a subsequent patent application.”<sup>217</sup> With this wide base of prior art created every year in the form of tax returns filed with the IRS, if a claimed strategy has been used even once prior to the filing of a patent application, it will be denied under § 102’s novelty bar.<sup>218</sup> Partially for this reason, Professor Oppenheimer contends that a tax strategy patent has virtually no value.<sup>219</sup>

---

208. Class 705 covers business method patents under the heading of “Data Processing: Financial, Business Practice, Management, Or Cost/Price Determination.” U.S. Patent and Trademark Office, <http://www.uspto.gov/go/classification/uspc705/sched705.htm> (last visited July 23, 2009).

209. USPTO White Paper: Automated Financial or Management Data Processing Methods (Business Methods) 9, <http://www.uspto.gov/web/menu/busmethp/whitepaper.doc> (last visited July 23, 2009) [hereinafter USPTO White Paper].

210. Max Stul Oppenheimer, *Patents, Taxes, and the Nuclear Option: Do We Need a “Tax Strategy Patent” Ban Treaty?*, 2008 U. ILL. J.L. TECH. & POL’Y 1, 4.

211. *Id.*

212. USPTO White Paper, *supra* note 209, at 14.

213. *Id.*

214. *Id.* at 15.

215. 26 U.S.C. § 6103(a) (2006); *see also* Oppenheimer, *supra* note 210, at 22.

216. Oppenheimer, *supra* note 210, at 22.

217. *Id.*

218. *See* 35 U.S.C. § 102 (2006).

219. Oppenheimer, *supra* note 210, at 28. Others have opined that “it is not likely that truly novel and innovative tax strategies would be developed that have not already been discussed and vetted.”

## IV. RECOMMENDATION

Given the policy debates and growing concern in the legal community regarding tax strategy patents, as well as the apparent confusion surrounding the constitutionality and statutory legality of this class of patents, action is necessary by the Supreme Court to establish the validity of the subject matter and by Congress to draw the line of enforceability.

A. *The Supreme Court Should Grant Certiorari to Establish Subject Matter Validity*

The Supreme Court has recently taken an increased interest in patent law issues. Indeed, “[u]ntil quite recently, it was extremely rare for the Supreme Court to *accept* for review *any* patent case.”<sup>220</sup> There has not been anywhere near as much patent activity at the Supreme Court since 1965—over forty years ago.<sup>221</sup> It is possible that this surge in accepted patent cases is at least somewhat related to the constantly rising number of patents granted each year. Over the past twenty to thirty years, the USPTO has shown an increase in patent grants by about fifteen to twenty percent every three to four years.<sup>222</sup> Though it is well known that only a very small percentage of issued patents end up in litigation,<sup>223</sup> as the number of patents issued increases each year, the raw quantity of patent litigation is necessarily bound to have a corresponding increase, leading to more judicial decisions and a greater number of appeals.

Whatever the actual reason for the increase in patent appeals accepted by the Supreme Court, the issue of subject matter eligibility is one that the Court should engage. As discussed above, commentators have made heated arguments regarding the appropriate boundaries for eligible patent subject matter.<sup>224</sup> The arguments in this debate range from the argument that tax strategy patents are unconstitutional<sup>225</sup> to the argument that tax strategy patents fail to meet statutory demands.<sup>226</sup> Though the Supreme Court has accepted many patent law cases in recent years, it has not dealt with a difficult subject matter eligibility case since its 1980 *Diamond v. Chakrabarty*<sup>227</sup> decision.<sup>228</sup> Since the *Chakrabarty* decision, im-

---

Blake D. Rubin, *Creative Tax Planning for Real Estate Transactions: Analysis and Legislative Proposals Regarding Patents for Tax Strategies*, 23 A.L.I.-A.B.A. COURSE OF STUDY 367 (2007).

220. Harold C. Wegner, Top Ten Supreme Court Patent Cases 3, <http://patentlaw.typepad.com/patent/SupremeCourtMARCH9.pdf>.

221. *Id.*

222. U.S. Patent Statistics, [http://www.uspto.gov/go/taf/us\\_stat.pdf](http://www.uspto.gov/go/taf/us_stat.pdf).

223. Jean O. Lanjouw & Mark Schankerman, *Protecting Intellectual Property Rights: Are Small Firms Handicapped?*, 47 J.L. & ECON. 45, 47 (2004).

224. *See supra* Part III.A.2.

225. *See* Pollack, *supra* note 9; *supra* text accompanying note 9.

226. *See* Anish Parikh, Comment, *The Proliferation of Tax Strategy Patents: Has Patenting Gone Too Far?*, 7 J. MARSHALL REV. INTELL. PROP. L. 202, 216–17 (2007).

227. 447 U.S. 303 (1980).

portant and controversial cases, such as the *State Street Bank* and *Bilski* decisions discussed above, and issues, such as the instant tax strategy patent issue, have given rise to a need for the Supreme Court to address important constitutional and statutory boundaries.

Amidst the debate amongst commentators, various cases have arisen providing an opportunity for the Supreme Court to review the eligible subject matter issue. As discussed above, the Supreme Court recently dismissed a writ of certiorari as improvidently granted in the case of *Laboratory Corp. of America Holdings v. Metabolite Laboratories, Inc.*<sup>229</sup> Though the opportunity for review and determination of proper subject matter has passed in this case, another opportunity is looming in the not-too-distant future. The Federal Circuit has set the stage for a subject matter determination in *In re Bilski*<sup>230</sup>—denying patentability for claims of a method of managing hedge fund risk management. The Supreme Court has granted certiorari to *Bilski* and should take the opportunity to clearly reiterate the broad scope of eligible subject matter established by the Court in the past.<sup>231</sup> Indeed, the Supreme Court should reiterate the principle that “anything under the sun that is made by man”<sup>232</sup> is patentable subject matter for the purposes of title 35.

*B. Congress Should Pass Legislation Limiting the Enforcement of Tax Strategy Patents*

Once the Supreme Court has reestablished the broad scope of eligible subject matter encompassed by the Constitution, the corresponding statutory provisions, and judicial precedent, Congress should establish limits on the enforceability of tax strategy and other legal method patents. As discussed above, there are relevant policy concerns surrounding the use of tax law applications that mandate exemptions from liability for certain subsections of society in infringing tax strategy patents.<sup>233</sup>

---

228. The Supreme Court has dealt with subject matter eligibility since *Diamond v. Chakrabarty*, but the subsequent cases involved fairly straightforward subject matter, and the Court's decisions served more to reiterate previous holdings than to clarify any legal principles. See, e.g., *J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc.*, 534 U.S. 124, 145 (2001) (holding that newly developed plant breeds are patentable subject matter); *Diamond v. Diehr*, 450 U.S. 175, 192–93 (1981) (holding that a claim of a mathematical formula is patentable subject matter when being used in a structure or process designed to be protected by the patent laws).

229. 548 U.S. 124 (2006). This case involved a patent claiming “a process for helping to diagnose deficiencies of two vitamins.” *Id.* at 125. Certiorari was originally granted to determine whether the patent improperly seeks to “claim a monopoly over a basic scientific relationship” between homocysteine and vitamin deficiency. *Id.*

230. 545 F.3d 943, 949, 966 (Fed. Cir. 2008) (en banc), cert. granted, 2009 WL 221232 (U.S. June 1, 2009) (No. 08-964).

231. *Diehr*, 450 U.S. at 182; *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980). *Bilski* has addressed head-on the issue of business method patentability and qualified its opinion with a provision anticipating Supreme Court review of its announced “machine-or-transformation” test. *Bilski*, 545 F.3d at 956.

232. *Diehr*, 450 U.S. at 182; *Chakrabarty*, 447 U.S. at 309.

233. See *supra* Part III.B.

Congress has previously responded to concern about valuable and publicly necessary innovations being closed off from society.<sup>234</sup> A suit ending on March 28, 1996 involving infringement of a patent claiming a method of making a surgical incision directly in the eye in a manner that would allow the wound to be “substantially self-sealing,” spurred Congress into action that year.<sup>235</sup> On September 30, 1996, President Clinton signed into law an amendment to § 287 that limited the remedies available against infringers of patents covering certain medical activities:<sup>236</sup> “With respect to a medical practitioner’s performance of a medical activity that constitutes an infringement under . . . [title 35], the provisions [regarding remedies under title 35] shall not apply against the medical practitioner or against a related health care entity with respect to such medical activity.”<sup>237</sup> Though this language may seem to broadly exempt from liability basically any use of a patented medical activity by any medical “practitioner,” “medical activity,” “medical practitioner,” “related health care entity,” and other terms are carefully defined and strictly limited in the statute.<sup>238</sup> For example, “medical activity” is defined as “the performance of a medical or surgical procedure on a body,” but excludes “use of a patented machine, manufacture, or composition of matter in violation of a [patent], the practice of a patented use of a composition of matter in violation of [a patent], or the practice of a process in violation of a biotechnology patent.”<sup>239</sup> This being just one (of seven) of the limiting definitions in § 287(c)(2), Congress was able to carve out a fairly narrow exception to the general patent infringement laws.<sup>240</sup>

In drawing comparisons to the current tax strategy patent debate, it is useful to consider the legislative history behind the medical activity exception of § 287(c) in order to gain perspective into the process that may occur regarding tax strategy patents. When the amendment, entitled the “Medical Procedures Innovation and Affordability Act,” was first introduced in March 1995 by Congressman Ganske (a surgeon by profession), it contained much broader language than that which was passed the following year.<sup>241</sup> Indeed, it would have limited the scope of patentable subject matter (under § 101) by excluding “any invention or discovery of a

---

234. See, e.g., 35 U.S.C. § 287(c) (2006).

235. Gerald J. Mossinghoff, *Remedies Under Patents on Medical and Surgical Procedures*, 78 J. PAT. & TRADEMARK OFF. SOC’Y 789, 789 (1996).

236. See Pub. L. No. 104-208, § 616, 110 Stat. 3009, 3009–68 (codified as amended at 35 U.S.C. § 287(c)).

237. 35 U.S.C. § 287(c)(1).

238. See *id.* § 287(c)(2).

239. *Id.* § 287(c)(2)(A).

240. For statutory language providing for litigation proceedings in a patent infringement case, see § 271 (providing protection against making, using, selling, offering to sell a patented invention, inducing infringement, or importing a patented invention), § 281 (providing for civil action when a patent is infringed), § 283 (allowing courts to grant injunctions when a patent is infringed), § 284 (allowing for compensatory damages where calculable, and reasonable royalties otherwise when a patent is infringed), and § 285 (allowing for court-determined reasonable attorney fees to prevailing party in patent infringement case).

241. Mossinghoff, *supra* note 235, at 790.

technique, method, or process for performing a surgical or medical procedure, administering a surgical or medical therapy, or making a medical diagnosis” unless the invention was a “necessary component of a machine, manufacture, or composition of matter or improvement thereof which is itself patentable subject matter.”<sup>242</sup> Still because Congressman Ganske gave “sincere assurance[s]” that he had no intention of adversely affecting research-based pharmaceutical, biotechnology or diagnostic industries, it was determined early that the scope of the amendment would not center on subject matter eligibility under § 101 or what constitutes infringement under § 271,<sup>243</sup> but instead on remedies that would be available to patent owners under § 287.<sup>244</sup> Thus, in order to clearly minimize the impact on affected industries, as well as maintain the ability of innovators to obtain patent protection, the § 287 amendment drew a very clear line regarding its effective scope of exclusion. As a result, patents on medical techniques are obtainable and valid, but the patent owners may be somewhat limited in their ability to enforce the patents against and recover damages from an infringer.

Congress should again adopt this approach and limit the remedies available to holders of tax strategy patents. By carving out a narrow exception for available damages and remedies for infringement of tax strategy patent claims, Congress would effectively insulate a subsection of society from fear of expensive lawsuits or licensing fees. Like the enforcement of medical activity patents, it is impractical to allow enforcement of patents on novel tax strategies that could allow the patent holder to exclude a wide net of consuming individuals from utilizing these strategies. Though this is hardly an issue of saving lives through utilization of new medical techniques, for low-income households elimination of a potential money-saving device—particularly one they have already been using—can be detrimental to financial stability.

Representative Rick Boucher proposed an amendment to § 287 that would limit remedies available for the infringement of a patent covering a tax planning strategy, excluding certain software utilized for this purpose.<sup>245</sup> Its chances for becoming law were very slim, though, because “only one of the co-sponsors of the bill [was] a member of the House IP Subcommittee that must approve the bill.”<sup>246</sup> While it is unclear why other members of the House IP Subcommittee did not support the bill, it is possible that the bill was simply too broad—it limited remedies for in-

---

242. *Id.* (citation omitted).

243. See *supra* note 240 for discussion of the litigation process of protecting against infringement of a patent.

244. Mossinghoff, *supra* note 235, at 795.

245. H.R. 2365, 110th Cong. (1st Sess. 2007), [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:h2365ih.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h2365ih.txt.pdf).

246. Posting of Dennis Crouch to Patently-O, <http://www.patentlyo.com/patent/2008/06/tax-patent-legl.htm> (June 20, 2008, 8:35 CDT). The last major action of the bill was being referred to the House Subcommittee on Courts, the Internet, and Intellectual Property on June 4, 2007. Thomas, <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.02365>: (last visited Aug. 28, 2009).

fringement against basically *any* infringer, whether business or otherwise. Thus, in order to maintain the incentive for developing and patenting tax strategies, future amendments to § 287 should be more narrowly tailored to only apply the exemption from remedies to personal taxpayers.

Therefore, Congress should adopt an amendment to § 287 limiting enforcement of tax strategy patents comparable to the amendment adopted in 1996 for medical activity patents. The amendment should exclude the same enforcement mechanisms as § 287(c)(1) where the allegedly infringing defendant is a nonbusiness entity utilizing personal, nonbusiness tax laws. In addition, it may be useful to set a cap for yearly gross income of the alleged infringer in order to avoid unnecessarily insulating upper-income levels of society. By adopting this approach, Congress will maintain the policy concerns underlying the patent system<sup>247</sup> while preventing abuse of the patent system through a negative impact on the consuming public.

## V. CONCLUSION

With the growing concern over patentable subject matter, particularly in the emerging area of tax strategy patents, the Supreme Court is well-positioned to grant certiorari and establish the line for patentability. In accordance with such a ruling, Congress should act to ensure that proper public policy concerns are protected.

Tax strategy patents are merely the next evolutionary step in the life of the U.S. patent system.<sup>248</sup> These patents satisfy the Constitutional and statutory requirements established for patentable subject matter. In particular, they fall within the broad judicial umbrella established by the courts allowing “anything under the sun that is made by man” to be patentable.<sup>249</sup> As a practical matter, inasmuch as their enforceability is limited, allowing tax strategy patents that satisfy the general utility, novelty, and nonobvious standards will bolster innovation and satisfy the underlying policy concerns of the U.S. patent system.

---

247. See *supra* Part II.E.

248. Gruner, *supra* note 190 (observing that tax strategy patents are “new but not surprising, evolutionary rather than revolutionary”).

249. *Diamond v. Diehr*, 450 U.S. 175, 182 (1981); *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980).