

SYMPOSIUM: PATENTS ON TAX STRATEGIES PROTECTING INNOVATION OR INHIBITING ADVICE?

I.	OPENING REMARKS	225
II.	INTRODUCTION BY DEAN RAYMOND NIMMER	226
III.	PRESENTATION BY CHARLES F. WIELAND, III.....	228
IV.	PRESENTATION BY E. DANIEL LEIGHTMAN	249
V.	QUESTION AND ANSWER PERIOD.....	263

I. OPENING REMARKS

My name is Chris Marchand and I am the Editor-in-Chief of the Houston Business and Tax Law Journal. I want to take this opportunity to thank everyone for coming to our first annual Symposium. I think everyone in the room probably knows what the topic our speakers will be discussing today is, with the possible exception of the students from the Business School and the Tax Classes that are here. Our topic for tonight is the patentability of tax strategies.

Before I introduce Dean Nimmer, I would like to take the opportunity to thank everyone who made this possible, beginning with the organizations that provided us with very generous financial support, including the IPIL, which is the University of Houston Law Center's Intellectual Property and Information Law Institute, the Activities Funding Board or the AFB from the main campus, and the tax fund.

In terms of people, I cannot thank enough all the professors who have made this possible, including Professor Ira Shepard who wasn't able to be here this evening. I would also like to thank Professors Christine Agnew, William Streng, Greg Vetter, Paul Janicke, and Craig Joyce. Without all of your help, all of the e-mails and phone calls bouncing topic ideas around, there is just no way that this could have happened. Lastly, I would like to thank some of the journal members, particularly Ivy Grey, Charles Salmon, and Kacie Bevers, who have all gone out of their way to absolutely dedicate themselves to making this symposium happen.

226 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

In terms of the speakers, I am proud and honored to be able to thank them for being here. Charles Wiland, Dan Leightman and, of course, the moderator for this evening, Dean Raymond Nimmer, who I cannot say enough about. He is the co-director of the IPIL, and he has written more treatises, books, and articles than I can even name, including an article that we are proud to have been able to publish in the *Houston Business and Tax Law Journal*.¹

Without further ado, I will hand the mike over to Dean Nimmer.

* * *

II. INTRODUCTION BY DEAN RAYMOND NIMMER

This is a real pleasure and I actually think it is quite remarkable. This is a great turnout for a topic that branches across two significantly different areas of law. It is the kind of reaching out past normal boundaries that I hope the Law Center can continue doing, and the *Business and Tax Law Journal* has done a great job in innovating and making it happen. The truth is, you can thank the people on the faculty – and I think Christine Agnew and Ira Shepard and a few others deserve those thanks—but the real thanks should go to the two people who have managed to put this together – and they are both sitting right there.

I just really think it is a special evening. It is actually an evening in which I am going to enjoy being a moderator because I do not have to contribute anything whatsoever since we have two of the leading people on this topic. It is actually a topic that in my mind comes sort of in the natural flow from what years ago used to be the debate in the patent area about whether software could be patented or not.² That debate is either dead or has at least been totally reshaped in the last 15-20 years.³ Once it got

1. Raymond T. Nimmer & Lori Brennan, *Modernizing Secured Financing Law for International Information Financing: A Conceptual Framework*, 6 HOUS. BUS. & TAX L.J. 1 (2005).

2. See generally Donald S. Chisum, *The Future of Software Protection*, 47 U. PITT. L. REV. 959 (1986); Pamela Samuelson, *Contu Revisited: The Case Against Copyright Protection for Computer Programs in Machine-Readable Form*, 1984 DUKE L.J. 663 (1984).

3. See Kristen Osenga, *Ants, Elephant Guns, and Statutory Subject Matter*, 39 ARIZ. ST. L.J. 1087, 1087-91 (2007) (detailing how both the courts and the patent office “are poised to reconsider the issue” of software patentability “in the near future.”); see generally John R. Allison, Abe Dunn & Ronald J. Mann, *Software Patents, Incumbents, and Entry*, 85 TEX. L. REV. 1579 (2007) (discussing how the “scope of software innovation has become even broader,” though the patenting of the innovations is not always “easy” or “available.”).

reshaped, this new set of issues arose – patenting business methods, patenting tax strategies and other legally relevant strategies.

I was at a conference in Japan speaking on a software-related topic. Judge Rader from the Court of Appeals for the Federal Circuit was also a speaker at the program. This was shortly after the court established that business method patents were available.⁴ Judge Rader began his speech on that topic, saying something along the lines of “This is the greatest thing ever in the United States because wherever patents have gone, wherever the idea of patenting things has gone, innovation was expanded and promoted,” and in the business method area I think he thought this surely was going to happen. I think he probably still feels that way, but there are clearly people—and we will hear about some of these views—who have questions. And it is a big current issue and one in which we have two of the nation’s leading experts here to talk to us about.

I am going to introduce both of these people and then just have them come up and do presentations in the range of 20-25 minutes and then we will be open for questions after that. Hopefully, we will keep to a time frame that fits the schedule here. But I think the more important thing is to have a good discussion and some good interaction among these figures.

The first will be Charles Wieland, who is a shareholder at the Buchanan, Ingersoll & Rooney law firm in Alexandria, Virginia. He has practiced in the area of intellectual property for a number of years. He deals with startups and other companies, as well as engages in patent drafting and a whole range of intellectual property activities. He is also the co-author of the article, *Tax Strategy Patents – Policy and Practical Considerations*.⁵ Mr. Wieland obviously will be approaching the issue from the standpoint of an intellectual property practitioner and, as I think we all discovered in the reception before this, the perspective of intellectual property law can be quite different from the perspective of tax law, although both areas are very complicated and fairly esoteric.

Our second speaker will be E. Daniel Leightman, who is a partner at Gardere Wynn here in Houston. He is in the tax

4. See *State St. Bank & Trust v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1373 (Fed. Cir. 1998) (finding that a computer program which uses an algorithm to calculate a final share price does produce “a useful, concrete and tangible result” and is thus patentable).

5. Charles F. Wieland III & Richard S. Marshall, *Tax Strategy Patents—Policy and Practical Considerations*, TAX MGMT COMP. PLANNING J., Vol. 35, No. 5 (May 4, 2007), available at http://www.hbtlj.org/content/HBTLJ_Symposium2007_E-Binder.pdf.

228 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII

planning group. He recently retired as the Vice President of Tax-Related Issues at Cooper Industries, one of the larger companies based here in Houston. He was previously Director of Taxes at Intel. He has a series of very prestigious involvements in a combination of tax and technology issues over his career, and he will obviously be approaching this from the standpoint of somebody with a tax background. I should also mention that Dan is an adjunct professor at the University of Houston Law Center and if we could figure out a way to have classes in Alexandria, I would like to make both of our speakers adjunct professors and keep their involvement at the University.

As I said, these are two of the leading people on this topic, and I am just going to introduce them – which I have just done, and then hand it over to Charles, let him start, and then sit and enjoy hearing their insight on what is a major policy issue in modern U.S. intellectual and tax law.

* * *


III. PRESENTATION BY CHARLES F. WIELAND, III

Thank you. It is very nice to be here. We have a very unique situation here. I, as a patent attorney, am going to try to talk you out of getting tax patents, and Dan, as a tax attorney, is going to try to talk you into them. So we are going to have a very interesting play. It is great that none of my marketing people are here because they would be wondering what I am doing.

Recent History

- ▶ **Decade of Business Method Patents**
 - Recognized need to protect Innovations around the Internet
 - State Street (Fed. Cir. 1998), often cited as starting the wave - arguably a tax strategy patent
 - SOGRATs™ (U.S. Patent No. 6,657,790) patent litigation started the current opposition to patenting tax strategies

MAKING A CASE FOR TEAMWORK.



History of Patenting Business Methods: State Street. *State Street* is now a decade old.⁶ *State Street* really was not the origin of business method patents. They were around for arguably a hundred years. You go back into the 1800s and pull a few patents and you can say they were, in some color, business method patents. But *State Street* was picked up by the *Wall Street Journal*.⁷ The financial district happens to be on Wall Street and we saw a huge flood of applications – 3,000 in 1999; more than 7,000 in the year following, and the numbers kept on growing.⁸

The U.S. Patent and Trademark Office (“PTO”) knew this was coming, but they were fairly unprepared for it.⁹ There are a number of reasons for that. The patent system was really designed to patent technology, not business methods.¹⁰ There were a lot of scientists and engineers working at the PTO, and by regulation they were required to be scientists and engineers.¹¹ They desperately looked around to hire anyone who had an MBA and they pulled in a few.¹² But what actually happened was that they pulled in some of the most problematic examiners in the examining corps because they did not have a home anywhere else

6. *State St. Bank & Trust v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1373 (Fed. Cir. 1998).

7. See Paul Barrett, *Courts Open Way for More Patents for Finance Firms*, WALL ST. J., July 27, 1998, at B5.

8. U.S. Patent and Trademark Office, Filing Trends in Class 705, <http://www.uspto.gov/web/menu/pbmethod/partnership.pps#682,6> (last visited Feb. 17, 2008).

9. See Lois Matelan, *The Continuing Controversy Over Business Methods Patents*, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 189, 199-200 (2007).

10. Cf. *Lab. Corp. of Am. Holdings v. Metabolite Lab., Inc.*, 548 U.S. 124 (2006), denying cert. (BREYER, J., dissenting) (citing *Diamond v. Diehr*, 450 U.S. 175 (1981); U.S. CONST., art. I, § 8, cl. 8) (asserting that overexpansion of patentable subject matter would impede scientific progress.).

11. See 37 C.F.R. § 10.7 (repealed 2004), repealed by 69 Fed. Reg. 35,428, at 35,452 (June 24, 2004). The current statute states the patent office “shall not be subject to any administratively or statutorily imposed limitation on positions or personnel.” 35 U.S.C. § 3(b)(3)(B) (2006); but see <http://www.uspto.gov/go/ac/ahrpa/ohr/jobs/qualifications.htm> (listing basic qualifications for patent examiners).

12. See ROBERT M. HUNT, FED. RESERVE BANK OF PHILA., BUSINESS METHOD PATENTS FOR U.S. FINANCIAL SERVICES 3 (Sept. 2007), <http://www.philadelphiafed.org/files/wps/2007/wp07-21.pdf> (last visited Feb. 17, 2008) (“In mid 2007, the patent office had 68 examiners dedicated to reviewing applications for financial patents. Of these, 32 have either their MBA or master’s degree in finance or economics.”); see also Wynn W. Coggins, Group Director, Business Methods Group, U.S. Patent & Trademark Office, *Update on Business Methods*, Presentation for the Business Methods Partnership Meeting (June 19, 2007), at slides 14-16, 30-31, available at <http://www.uspto.gov/web/menu/pbmethod>.

230 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

at the PTO. Now the PTO has around 5,500 examiners.¹³ It is a big place with a lot of different qualities of work.

So we start from *State Street* and we have this enormous weight of new applications. The PTO reacted by basically shutting down the patenting of business methods.¹⁴ The flow went from allowing about 45% of the applications down to as low as 11%.¹⁵ They did this procedurally by putting in something called a “second pair of eyes.”¹⁶ What that basically entailed was someone else going through the application and saying, “No.”¹⁷ You as the applicant weren’t allowed to talk to the person who said “no.” It’s kind of a Star Chamber,¹⁸ and it had a very strong effect on the patents that came out. The glorious thing is they are now up to about 20%.¹⁹ Their explanation is that the number of bad patent applications are going down so the PTO can start raising the allowance rate.²⁰ The funny thing is that the 11% that were allowed were not very good either. So, they have a significant manpower issue.

Then we get to the SOGRAT patent.²¹ I am not sure everybody knows about that. It is involved in a patent infringement suit filed in Connecticut.²² SOGRATs are non-qualified stock options dealing with grantor-retained annuity trusts.²³ Everyone was doing GRATs but there was some external factors that prevented them from making public plans

13. U. S. PATENT AND TRADEMARK OFFICE, PERFORMANCE AND ACCOUNTABILITY REPORT (2007), <http://www.uspto.gov/web/offices/com/annual/2007/2007annualreport.pdf> (last visited Feb. 28, 2008).

14. See George Elliott, *Basics of US Patents and Patent System*, 9 AAPS J. (2007), <http://www.aapsj.org/articles/aapsj0903/aapsj0903035/aapsj0903035.pdf>; HUNT, *supra* note 12, at 2.

15. Coggins, *supra* note 12, at slide 8.

16. See U.S. Patent & Trademark Office, Business Methods Patents Initiative; An Action Plan (2000), <http://www.uspto.gov/web/offices/com/sol/actionplan.html>; U.S. Patent & Trademark Office, Patent Quality Improvement: Expansion of the Second-Pair-of-Eyes Review, <http://www.uspto.gov/web/offices/com/strat21/action/q3p17a.htm> (last modified April 4, 2003); see Matelan, *supra* note 9, at 207-08.

17. See Matelan, *supra* note 9, at 207-08.

18. AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE, (4th ed. 2007) (originally a 15th- to 17th-century closed English court of state security matters, the term now refers to any “court or group that engages in secret, harsh, or arbitrary procedures”).

19. See Coggins, *supra* note 12, at slide 18.

20. *Id.* at slide 9.

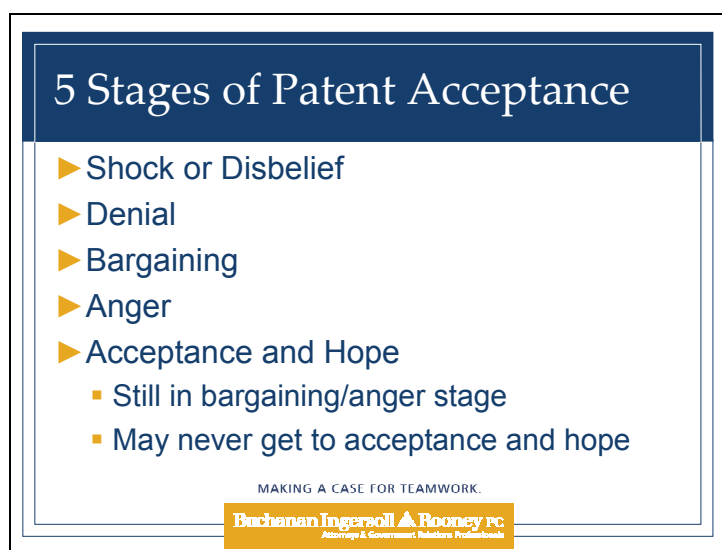
21. Establishing and Managing Grantor Retained Annuity Trusts Funded by Nonqualified Stock Options (SOGRAT), U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003).

22. *Wealth Transfer Group LLC v. Rowe*, No. 3:06-CV-00024-AWT (D. Conn. filed Jan. 6, 2006); see Evelyn McDowell, *Tax Strategy Patents: Truth and Consequences*, 78 CPA J. 46, 47 (Feb. 1, 2008) (discussing the case).

23. See ‘790 Patent.

for their clients, but this guy got a patent on a type of GRAT. The question is, was it valid?²⁴ We will talk about what validity means in a minute.

It really got the attention of the tax community. There were people working on this problem before, but when that suit was filed it hit a nerve, and the tax community woke up.²⁵ Unfortunately, that litigation has ended—and it ended in a most unfortunate way—with a private settlement without a trial on the merits,²⁶ so we never did get to hear a determination of the validity of the patent.



I have been through the process of introducing patents to with a number of communities and it is always the same: (1) Shock: “You can patent that?” (2) Denial: “You cannot patent that.” (3) Bargaining: “Hey, are you sure you have to patent that?” (4) Anger: “Now that you have patented it, what do we do?” Finally, (5) acceptance and hope. Acceptance and hope is something you may never reach. Acceptance and hope is when you start looking at the patent system and saying, “How do I use this to my advantage?” Dan is a leader in this, and we are going

24. See *Wealth Transfer Group LLC*, No. 3:06-CV-00024-AWT; see McDowell, *supra* note 22, at 47.

25. See, e.g., McDowell, *supra* note 22, at 47; William A. Drennan, *The Patented Loophole: How Should Congress Respond to This Judicial Invention?*, 59 FLA. L. REV. 229 (2007).

26. See Consent Final Judgment Regarding Settlement Decree, *Wealth Transfer Group LLC*, No. 3:06-CV-00024-AWT; see also McDowell, *supra* note 22, at 46.

232 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII

to explain why you would want a patent system overlaying the tax system. There is actually a pretty good argument for it.

Patentability

- ▶ **New and Useful 35 USC 101**
- ▶ **Statutory Subject Matter 35 USC 101 - process, machine, manufacture, or composition of matter**
(excludes abstract thoughts, mathematical algorithms and natural phenomena)

MAKING A CASE FOR TEAMWORK.

Buchanan Ingersoll & Rooney PC
Attorneys & Government Relations Professionals

Now, I know this is not an IP 101 course, but I have to go through this to frame the issues, and I am going to move through it fairly quickly. We have four cornerstones or foundation statutes – 101, 102, 103, and 112.²⁷

*New and Useful.*²⁸ Section 101 has these two criteria – new and useful.²⁹ Useful is a major aspect here. Is a patent on a tax strategy useful if the IRS says it is not valid? Did you save any money? If the end result is a reduction in tax savings, deferral, or whatever the effect is, it would seem to be useful. But, if the IRS says, “No,” does the patent have any utility? That is one of the major questions.

Now, the IRS has said, “We are not in the business of granting patents,”³⁰ and they are right. The PTO has said, “We are not in the tax business,”³¹ and they are right. But the PTO has dodged what they view as their responsibility here. It turned out utility is an odd creature at the PTO. They do not care if the

27. See 35 U.S.C. §§ 101, 102, 103, 112 (2000).

28. See *id.* § 101.

29. *Id.* (“Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefore, subject to the conditions and requirements of this title.”).

30. See *Patenting Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 109th Cong. 77 (July 13, 2006) (statement of Mark Everson, IRS Comm’r).

31. See *id.*

actual patented subject matter goes to something illegal like contraband or drugs³²—the water bong,³³ for instance, that I am sure no one in this room would recognize or would have ever been to a party where one was. Then there's the [Juicy Whip] case³⁴ which was this vat of grey glob that they put colors around. You ordered this wonderful looking drink based on this display and it came out as this grey glob.³⁵ It was a state law fraud claim. The one I like best—I love this patent—it is a combined umbrella and lightening rod.³⁶ What a great idea! Two utilities in one! But that was determined to be useful.³⁷ “Usefulness” in the patent world is a very odd creature.

That is one of the questions. The other is that there are statutory categories of patentable subject matter.³⁸ This is being affected by the pending legislation we are going to talk about in a minute.³⁹ But this has not changed for 200 years.⁴⁰ Up to now, they changed one word in the statute, but that was to modernize the terminology.⁴¹ This is our cornerstone – I said foundation before. This is our cornerstone.

“Anything made by man under the sun” is the quote that you often see.⁴² It excludes abstract thoughts.⁴³ That is a major aspect here because when you think about the practice of law, it is all mental steps. How you integrate various legal concepts together and come out with a result is a mental process. So, we are going to talk about that.

32. See, e.g., *In re Watson*, 517 F.2d 465, 476 (C.C.P.A. 1975).

33. U.S. Patent No. 4,253,475 (filed Oct. 12, 1977) (issued March 3, 1981).

34. *Juicy Whip, Inc. v. Orange Bang, Inc.*, 382 F.3d 1367 (Fed. Cir. 2004).

35. *Id.* at 1370.

36. U.S. Patent No. 5,798,482 (filed Jan. 23, 1997).

37. See *id.*

38. See 35 U.S.C. §§ 101, 103 (2000).

39. See *infra* note 85 and text accompanying.

40. See 35 U.S.C. § 103.

41. *Id.*

42. *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980) (citing S. Rep. No. 1979, at 5, reprinted in 1952 U.S.C.C.A.N. 2394, 2399 (1952) and H.R. Rep. No. 1923, at 6 (“The Senate Report repeats in substance the House Report.”) as evidence of congressional intent that statutory subject matter include “anything under the sun that is made by man.”).

43. *Chakrabarty*, 447 U.S. at 309 (citing numerous cases to qualify its broad holding, stating that “[t]he laws of nature, physical phenomena, and abstract ideas have been held not patentable”).


Patentability

▶ **New/Novel 35 USC 102**

- Public nature of disclosure
- PTO has to establish that patentee does have right to a patent

▶ **Non-Obvious/Inventive Step 35 USC 103**

- Standard does not require flash of genius

MAKING A CASE FOR TEAMWORK.


New/Novel.⁴⁴ An invention has to be novel and non-obvious.⁴⁵ These statutes go together – §§ 102 and 103. If someone did it before or if it is an obvious variation of what has gone on before, the invention is not patentable.⁴⁶ One thing, I should have started this explanation of the four sections by saying is that at the PTO can use these four sections to determine whether or not you should get a patent.⁴⁷ The standard at the PTO is a preponderance of the evidence.⁴⁸ They create what is called a *prima facie* case of un-patentability and then you have to rebut it.⁴⁹ It can go up through appeal, etc.⁵⁰

44. 35 U.S.C. § 102 (2000) (A person is not entitled to a patent if “the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by applicant.”).

45. 35 U.S.C. § 103 (stating that even if an invention passes the tests of § 102, it still may fail patentability if “the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.”).

46. 35 U.S.C. §§ 102, 103.

47. See MANUAL OF PATENT EXAMINING PROCEDURE § 706.02 (2007), available at <http://www.uspto.gov/web/offices/pac/mpep> (discussing rejection of patent applications under 35 U.S.C. §§ 102(a)-(b) and 103); *id.* § 706.03(a) (discussing rejection of patent applications on 35 U.S.C. § 101 grounds); *id.* § 706.03 (c)-(d) (discussing rejection of patent applications on 35 U.S.C. § 112 grounds).

48. See 37 C.F.R. § 1.56(b) (2000) (stating, in the context of a discussion of required disclosures to the patent office, that: “A *prima facie* case of unpatentability is established when the information compels a conclusion that a claim is unpatentable under the *preponderance of the evidence, burden of proof standard*, giving each term in the claim its broadest reasonable construction consistent with the specification, and before any consideration is given to evidence which may be submitted in an attempt to establish a contrary conclusion of patentability.” (emphasis added)).

49. See *id.*

The standard of proof is relatively low, but they do have the burden of proof.⁵¹ You get a patent unless they prove that you should not get a patent.⁵² In court, it is different. There it is, a validity challenge and the patent has already issued.⁵³ The patent carries with it a presumption of validity.⁵⁴ That is a huge advantage for the patentee because it has to be overturned through clear and convincing evidence⁵⁵ – a very high standard to meet. Oddly enough, there is a procedure to drag patents back to the PTO to access that lower standard⁵⁶ – it is not used often because it is a very weak process and favors the patentee.

*New and non-obvious.*⁵⁷ For criticism, in the SOGRAT patent, GRATs are defined in the statute,⁵⁸ non-qualified stock options are defined in the statute⁵⁹ – all the inventor did was put them together.⁶⁰ How can that be patentable?

50. 35 U.S.C. § 134 (2000) (detailing the patent appeals procedures).

51. See 37 C.F.R. § 1.56(b).

52. See *id.*

53. 35 U.S.C. § 282 (2000) (recognizing invalidity of a patent as a defense to an infringement suit.). See *Ultradent Prod., Inc. v. Life-Like Cosmetics, Inc.*, 127 F. Supp. 3d 1065, 1066 (D.C. Cir. 1997), for an example of an infringement suit in which the validity of the patent at issue was used as a defense.

54. 35 U.S.C. § 282 (In part: “A patent shall be presumed valid. Each claim of a patent . . . shall be presumed valid independently of the validity of other claims; dependent or multiple dependent claims shall be presumed valid even though dependent upon an invalid claim.”).

55. *Apotex USA, Inc. v. Merck & Co., Inc.*, 254 F.3d 1031, 1036 (Fed. Cir. 2001) (stating that “in order to overcome the presumption of validity, the party challenging a patent must prove facts supporting a determination of invalidity by clear and convincing evidence.”).

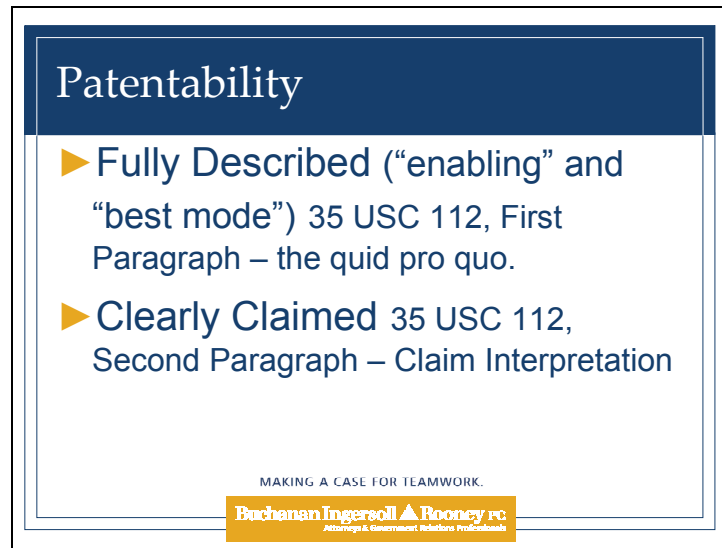
56. See 35 U.S.C. §§ 311-18 (providing for procedure by which a newly-issued patent may be challenged by third parties, and, if the challenger demonstrates a “substantial new question of patentability,” the patent will undergo *inter partes* reexamination by the PTO); MANUAL OF PATENT EXAMINING PROCEDURE § 2601 (2007), available at <http://www.uspto.gov/web/offices/pac/mpep> (outlining the procedure for an *inter partes* reexamination in the U.S. Patent and Trademark Office and describing the proceeding as “a desirable alternative to litigation in the Federal courts”).

57. 35 U.S.C. § 103(a) (Supp. III 2003).

58. I.R.C. § 2702(b) (2000). A GRAT is a trust in which the grantor retains rights to pre-determined annual income that must meet the qualifications of Treas. Reg. § 25.2702-3(b), (d) (as amended in 2005).

59. Treas. Reg. § 1.83-7 (as amended in 2004) (defining a non-qualified stock option as an incentive based option not meeting the requirements of § 421); see also I.R.C. § 421 (2000).

60. U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003).



*Fully described.*⁶¹ This is the quid pro quo of the patent system. This is the part that people are not getting in the tax community—at least not that I have heard. You are required to fully disclose your invention—all the details, no holding back—including your best way of carrying it out.⁶² This is so people can look at the patent and design around the inventor.⁶³ They can be educated by what you did and do something different. Or they can look at the background information and what you have done, and can come up with a new invention. Patents spark further innovation. This is the cornerstone. But the description has to be “enabling.”⁶⁴ You have to enable one skilled in the art of making these new inventions and you must disclose the best mode, the best way you know of carrying it out.⁶⁵ This is the part that is not focused on. We will talk about that when we start talking about the legislation.

61. 35 U.S.C. § 112 (Supp. III 2003) (“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 which it pertains, . . . to make and use the same, and shall set forth the best mode contemplated by the inventor of carrying out his invention.”).

62. *Id.*

63. *See State Indus., Inc. v. A.O. Smith Corp.*, 751 F.2d 1226, 1236 (Fed. Cir. 1985).


64. 35 U.S.C. § 112, para. 1.

65. *Id.*

Changes to Patent Law During Debate on Tax Strategy Patents

- ▶ Injunctions require greater showing. **eBay Inc. v. MercExchange, L.L.C.**, 126 S. Ct. 1837 (2006) (four traditional factors have to be weighed, rather than a near-automatic injunction.)
- ▶ Raised Standard for “Obviousness”. **KSR v. Teleflex**, 550 U.S. ___, 127 S. Ct. 1727, (2007)
- ▶ Licensee has standing to challenge patent. **MedImmune, Inc. V. Genentech, Inc.** (No. 05-608) 127 S. Ct. 764, 427 F.3d 958 (2007)

MAKING A CASE FOR TEAMWORK.



Since I wrote the article that is in your materials with Richard Marshall,⁶⁶ who by the way is a tax attorney both here in Houston and in D.C., a number of changes have occurred. *MercExchange* is actually in the materials. We used to think that if you had a patent you had an automatic injunction against an infringer.⁶⁷ You just went to the court and said, they are infringing, and absent some showing of why the court should not do it, the injunction would issue.⁶⁸ That was the club that the patent represented – you could stop someone. Did everyone hear about the Blackberry case?⁶⁹ The patentee used that club to extract more than \$612 million.⁷⁰ That club is basically gone – what the court did was go from the almost automatic granting of injunctions to the traditional four factors restricting the issuance of injunctions.⁷¹ In tax strategies, those four factors probably

66. Charles F. Weiland III & Richard S. Marshall, *Tax Strategy Patents — Policy and Practical Considerations*, 35 TAX MGM'T COMP. PLANNING J. 123 (May 4, 2007), available at http://www.hbtjl.org/content/HBTLJ_Symposium2007_E-Binder.pdf.

67. *e-Bay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 390-93 (2006) (rejecting the “reasonable apprehension” test in favor of the traditional four factors which are: (1) irreparable harm, (2) inadequate legal remedies, (3) balance of hardships, (4) public interest would not be disserved); see also *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282, 1293 (Fed. Cir. 2005) (“It is a bedrock principal of patent law that the claims of a patent define the invention to which the patentee is entitled the right to exclude.” (quoting *Phillips v. AWH Corp.*, 415 F.3d 1303, 1312 (Fed. Cir. 2005) (en banc))).

68. See *NTP, Inc.*, 261 F. Supp. 2d 423, 426 (E.D. Va. 2002).

69. *NTP, Inc.*, 418 F.3d.

70. See Press Release, Research in Motion, Ltd. (Mar. 3, 2006), available at http://www.rim.com/news/press/2006/pr-03_03_2006-01.shtml.

71. *MercExchange*, 547 U.S. at 390-95.

238 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

would never occur because “there is a remedy in law” in the foreseeable situations, which is one of the factors.

KSR is a Supreme Court decision that raised the standard of obviousness.⁷² The standard fell a little low and then the Supreme Court pumped it back up. It means that to get a patent you have to make a greater showing;⁷³ this is actually something new and worthy of a patent.

MedImmune—that was about a licensee’s right to challenge a patent.⁷⁴ Now, this is an interesting thought: you have licensed the patent so you have no “case or controversy” to contest the validity of the patent. You are paying royalties, right? Where is your standing? Well, in *MedImmune* the Court said that there was standing if you wanted to challenge the patent, if it was a huge economic burden to you not to be able to challenge it.⁷⁵ Prior to this discussion, you would not have to breach the agreement and then challenge it in court, which would potentially expose you to treble damages.⁷⁶ So the Supreme Court said, “no way, you get standing as a licensee.”⁷⁷ You can have your cake and eat it, too: you can license a patent, get rid of the infringement issue for now. A couple of years later you get to go back and challenge the patent but continue to pay the royalty. After the patent is defeated, I would consider paying the licensee until that is jeopardizing to her business.

Declaratory judgment jurisdiction was fairly difficult to obtain, particularly against what we call patent trolls or patent speculators. Patent speculators would send out a letter. This letter would suggest that there was an infringement and you would send it to say 500 companies. Each of those 500 companies, to jump to the next point, would be under a non-affirmative duty to investigate that patent. They would each spend about \$30,000 investigating the claim: 500 companies x \$30,000 = 15,000,000. The guy is patentee’s expense – 500

72. *KSR Int’l. Co. v. Teleflex, Inc.*, 127 S. Ct. 1727, 1739-42 (2007) (holding that the Federal Circuit erred in rigidly applying the narrow teaching/suggestion/motivation standard for obviousness under 35 U.S.C. § 103, for precluding application of “obvious to try” considerations, and for too rigidly constricting the use of hindsight, in conflict with the broader obviousness evaluation established in *Graham v. John Deere Co. of Kansas*, 383 U.S. 1 (1966)).

73. *Id.*

74. *MedImmune, Inc. v. Genentech, Inc.*, 127 S. Ct. 764, 770-77 (2007) (permitting licensee to challenge the validity/unenforceability of the patent without breaching the patent license because there was sufficient adverse legal interest to establish Art. III “case or controversy” with regard to the patent’s validity, enforceability or scope).

75. *Id.* at 770 n.6, 771-73.

76. *Id.* at 773 (citing *Altwater v. Freeman*, 319 U.S. 359 (1943)).

77. *Id.* at 777.

stamps. It did not seem fair. So they changed that by basically saying that you are under no duty to investigate patents.⁷⁸ That goes to the point that you often hear as a tax practitioner: “Do you have to investigate every patent or patent application?” The answer is, unless you are really, really reckless, you are not going to get stuck with treble damages.⁷⁹ You are not going to have to pay a penalty. Under statute, the minimum damages are really a royalty which, by the way, is calculated as a willing licensor and a willing licensee getting together and agreeing to a license prior to the litigation.⁸⁰ That creates a situation where you are no worse off not looking for patents. You just have to have a credible argument as to why you thought it was appropriate and thought you did not have a problem with any particular patent need to investigate.⁸¹

Pending Legislation

- ▶ **H.R. 1908, Sec. 10**
 - A patent *may not* be obtained for a tax planning method.
- ▶ **S. 1145**
 - Currently being discussed in halls of Senate
 - Concerns about both the language and the approach of H.R. 1908

MAKING A CASE FOR TEAMWORK.

Buchanan Ingersoll & Rooney PC
 Attorneys & Government Relations Professionals

78. *SanDisk Corp. v. ST Microelectronics, Inc.*, 480 F.3d 1372, 1381-83 (Fed. Cir. 2007) (dramatically lowering the threshold for declaratory judgment such that repeated indications during license negotiations that ST would not sue did not prevent SanDisk from suing for a Declaratory Judgment of Non-Infringement when ST's actions indicated that suit could be brought).

79. 35 U.S.C. § 284 (2000) (permitting the court, at its discretion, to assess treble damages for patent violations); *see also In re Seagate Tech., LLC*, 497 F.3d 1360, 1370-71 (Fed. Cir. 2007) (“[T]o establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.”). This eliminates the “affirmative duty of care” standard of *Underwater Devices*. *Id.* at 1371.

80. *See Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers, Inc.*, 446 F.2d 295 (2d. Cir. 1971).

81. *See In re Seagate Tech.*, 497 F.3d at 1370-71.

240 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

We have the courts hammering the patent system. We have pending legislation that is also going to be hammering the patent system if it passes – and it probably will. H.R. 1908 has a provision in it that says you cannot obtain a tax strategy patent – a patent on a tax planning method.⁸² The Senate version doesn't have this yet,⁸³ but they're working on it. It is very controversial in the patent community.⁸⁴ I have to share with you some of the other things the bill is attempting to do. This bill is actually a very global change. It is the biggest act since 1952 in the patent community. It changes ours to a first to invent system⁸⁵ – I guess you do not need to know that. Apportionment of damages would be changed⁸⁶ – again lowering the value of patents.⁸⁷ However, prior user rights might be expanded.⁸⁸ Post-grant opposition – now here is a major change. It used to be that you would have this very stark choice. You could go back to the PTO on this asking for a patent to be reexamined. But, this process greatly favors the patentee.⁸⁹ Or, you could go to court and spend a million dollars or more on litigation costs. That was not a very good choice. So post-grant opposition to a PTO proceeding will probably cost around \$100,000 – maybe even more – but this is a lot lower in cost compared to going to court but it is, in part, very much like litigation.⁹⁰

I will have to skip the rest because they are peripheral provisions. The patent forum shopping provisions I love because it is due to the Eastern District of Texas—that is why they threw that in—because the Eastern District has attracted a lot of patent litigation led by patent trolls. Inequitable conduct is all but gone and the best mode requirement is also gone if this

82. Patent Reform Act of 2007, H.R. 1908, 110th Cong. § 10(b)(2) (2007) (“A patent may not be obtained for a tax planning method. . . . [T]he term ‘tax planning method’ means a plan, strategy, technique, or scheme that is designed to reduce, minimize, or defer, or has, when implemented, the effect of reducing, minimizing, or deferring, a taxpayer’s tax liability, but does not include the use of tax preparation software or other tools used solely to perform or model mathematical calculations or prepare tax or information returns.”).

83. Patent Reform Act of 2007, S. 1145, 110th Cong. (2007).

84. See, e.g., *A Section White Paper: Agenda for 21st Century Patent Reform*, 2007 A.B.A. Sec. I.P.L. 1-6, available at <http://www.abanet.org/intelprop/home/PatentReformWP.pdf> [hereinafter A.B.A. I.P.L., *Agenda for Patent Reform*].

85. H.R. 1908 § 3 (amending 35 U.S.C. § 100(h) to give patent applications with the earliest file date priority over later filed applications).

86. *Id.* § 5 (amending 35 U.S.C. § 284(a)).

87. See *supra* notes 80-84 and accompanying text.

88. See A.B.A. I.P.L., *Agenda for Patent Reform*, *supra* note 84, at 51-53.

89. *Id.* at 33-35.

90. H.R. 1908 § 6(f) (amending Part III of 35 U.S.C. to add Chapter 32, entitled Post-Grant Review Procedures).

legislation goes through.⁹¹ So they are changing the very basic fundamentals of our system in Congress.

Unintended Scope of H.R. 1908, Sec. 10

► Language raises many issues - difficult to understand “tax planning method” - a plan, strategy, technique, or scheme

- *that is designed to reduce, minimize, or defer, or*
- *has, when implemented, the effect of reducing, minimizing, or deferring, a taxpayer’s tax liability,*
- *but does not include the use of tax preparation software or other tools used solely to perform or model mathematical calculations or prepare tax or information returns*

MAKING A CASE FOR TEAMWORK.

Buchanan Ingersoll & Rooney PC
Attorneys & Government Relations Professionals

The language of proposed statute H.R. 1908 is very strange to a patent attorney. I do not know who came up with it. Actually I did see it in a Texas bar review so I am thinking Texas had something to do with it, perhaps Ellen Aprill and Dennis Drapkin, an attorney at Jones Day – they are both tax attorneys. H.R. 1908 says that a tax planning method is not going to be patentable anymore,⁹² if they are designed to reduce, minimize, or defer taxes.⁹³ Design, is that a subjective standard? If that is the standard – did you have that intent? What does that mean? A patent attorney and a patent litigator would have a field day with that. “[H]as, when implemented, the effect of reducing [or] minimizing [taxes].”⁹⁴ That is probably half of the business method patents. Nearly all business methods have a tax aspect. They have to. So, when you say, “when implemented it has the effect,” you can see a litigator saying, “Here is one way to do it and here is their way of doing it.” The patentee’s way reduces taxes, hence the patent is invalid. This usually has the potential to end business method patents. You may be on the side that says that ending business method patents generally is not a bad idea, but, it is what it is.

91. *Id.* § 13.


92. *See id.* § 10(a)(2).

93. *See id.* § 10(2)(A).

94. *Id.*

What is a Tax Planning Method?

- ▶ State Street – Would it be patentable under H.R. 1908, Sec. 10?
- ▶ SOGRATs – Sec. 101 compliance not argued before settlement
- ▶ Tax Advice - Not Patentable Subject Matter - *In re Comiskey* (Fed. Cir., No. 2006-1286, 9/20/07)
 - Integrated with Technology – Only if “non-obvious” result

MAKING A CASE FOR TEAMWORK.


The *State Street* patent probably would not be patentable under the pending legislation.⁹⁵ The validity of the SOGRAT patent was never determined by a court,⁹⁶ but there are some really interesting arguments out there as to why it was invalid. It is too bad it was not validated. This is the one slide that I really want to get across to you. According to *In re Comiskey*,⁹⁷ which is a decision from the Federal Circuit, tax advice is not patentable.⁹⁸ The case is not squarely on point, but what it says is, if an invention involves only mental processes, it is too abstract to be patented.⁹⁹ So the argument that is put forth by those opposing the patenting of tax patents is that you cannot deny the public access to the law. *Comiskey* says that is right; you cannot get a patent on giving tax advice – it is too abstract.¹⁰⁰ So what happens is you go back to that legislation—and you can see better that the legislation itself is in fact very protectionist and reaches far beyond the identified problem. You

95. The business method at issue in *State Street* “allow[ed] for consolidation of, inter alia, the costs of administering the fund combined with the tax advantages of a partnership.” *State St. Bank & Trust v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1371 (Fed. Cir. 1998). This stated tax advantage would run *State Street* afoul of the pending legislation. See H.R. 1908 § 10(b).

96. See *supra* text accompanying note 27.

97. See *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007), *petition for reh’g filed*, No. 2006-1286 (Fed. Cir. Oct. 4, 2007).

98. *Id.* at 1379; cf. *In re Chatfield*, 545 F.2d 152, 157 (C.C.P.A. 1976) (listing inventions that are not patentable, including those involving “purely mental steps.”).

99. *Comiskey*, 499 F.3d at 1379.

100. See *id.*

might ask yourself, is tax advice patentable? It might be. As a tax attorney talking to my client, none of her advice is patentable. But if she puts it into a software program, is it patentable then? *Comiskey* has the answer there, too. If there is something really clever about that software program, maybe. If it is just a spreadsheet or program merely doing computations, then no, it is not patentable.¹⁰¹

Unintended effect of H.R. 1908, Sec. 10

► **Concern about Precedent**

- 42 U.S.C. 2181 **"No patent** shall hereafter be granted for any invention or discovery which is **useful solely** in the utilization of special nuclear material or atomic energy **in an atomic weapon.**"
- 35 U.S.C. 287(c)(2) - Under this statute, patent holders are **deprived of all remedies**, both monetary and injunctive, against licensed medical practitioners or related health care facilities with respect to the performance of a **"medical activity"** that constitutes an infringement of the patent, but **does not include** the use of a **patented machine, patented matter, or a valid biotechnology patent.**

MAKING A CASE FOR TEAMWORK.

Buchanan Ingersoll & Rooney PC
Accounting & Government Relations Professionals

We in the IP community are very concerned about this proposed legislation. Why? Because you do not step on a slippery slope with an approach that makes certain parts of the economy immune from patents, you step off a cliff. If the tax community gets away with this, you will see every single community, every single industry, going to Congress and saying, "Protect my industry." How do I know that? Part of the Senate bill includes a ban on the enforcement of check imaging patents.¹⁰² Check imaging is a very traditional area for patenting. The banks want a ban on the enforcement of those patents. It did not take long for people to think Congress might be a way to avoid the costs of using other peoples inventions. We currently have two exceptions: you cannot get a patent on an atomic weapon.¹⁰³ I do not think we have any questions about why that would be. Then

101. See *id.* at 1379-80.

102. See Patent Reform Act of 2007, S. 1145, 110th Cong. § 14(a) (2007).

103. "No patent shall hereafter be granted for any invention or discovery which is useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon." 42 U.S.C. § 181(a) (2000).

244 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII

there is the Physicians Immunity Act.¹⁰⁴ Back in the 1990s, a lot of physicians were getting patents on their medical procedures.¹⁰⁵ This upset other physicians, so they carved out a very narrow exception, saying you cannot sue doctors following a patented medical procedure,¹⁰⁶ so even if they are using a device, or if they are using a drug, or if they are using a biotechnology, you can sue them,¹⁰⁷ but you cannot sue them for simply following a procedure.¹⁰⁸ Those are the only two exceptions we have ever accepted and the opposition to the H.R. 1908 is probably more about starting a bad precedent.¹⁰⁹ There are approximately 101 pending applications;¹¹⁰ there are sixty patents on tax strategies.¹¹¹ If you look at them carefully, I would say you could probably thin that down to just a handful. It is not a major dent in the 180,000 or so patents that are granted each year.¹¹² The patent community does not really care if these few patents are eliminated. It is the precedent that they are mostly concerned about, and *Comiskey* basically took care of the major objection to patenting legal strategies, which is denying people access to the law.¹¹³ That really should not be able to

104. See 35 U.S.C. § 287(c)(1) (2000).

105. See, e.g., *Pallin v. Singer*, 1995 WL608365, at *1 (D.Vt. 1995).

106. See *id.*; see also Steve Dirksen, *A Reconsideration of the Physicians' Immunity Statute*, 2001 DUKE L. & TECH. REV. 27, ¶ 2 (2001), <http://www.law.duke.edu/journals/dltr/articles/2001dltr0027.html>.

107. The statute defines "the term 'medical activity' [to mean] the performance of a medical or surgical procedure on a body, but [excluding] (i) the use of a patented machine, manufacture, or composition of matter in violation of such patent, (ii) the practice of a patented use of a composition of matter in violation of such patent, or (iii) the practice of a process in violation of a biotechnology patent." 35 U.S.C. § 287(c)(2)(A) (2000).

108. *Id.*

109. See Ellen P. Aprill, *Responding to Tax Strategy Patents*, 2007 PROC. U.S. CAL. GOULD SCH. L. 2007 TAX INST.—MAJOR TAX PLAN. (forthcoming 2007) (manuscript at 13), available at http://www.abanet.org/tax/patents/articles/070811_abataxrelatedinventions.pdf ("To limit patent protection in a particular area . . . is to undermine the patent system as a whole and represents a dangerous precedent that would hurt our progress as a nation.").

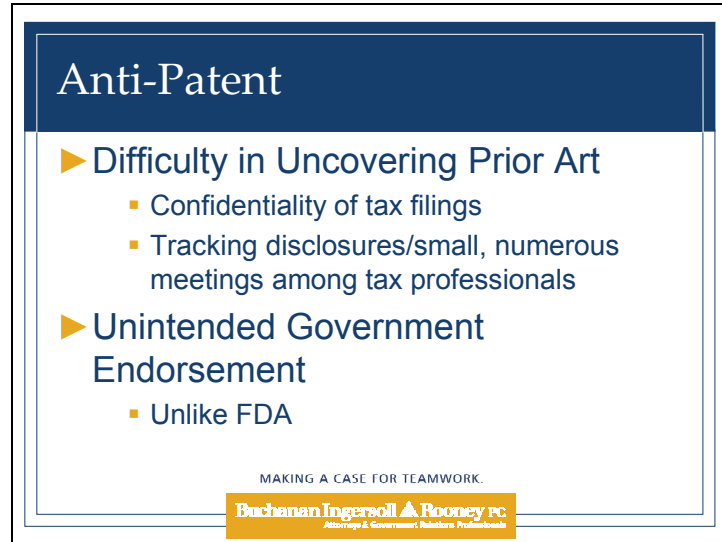
110. The U.S. Patent & Trademark Office classifies tax strategies under Classification 705/36T. See Class Schedule for Class 705, <http://www.uspto.gov/go/classification/uspc705/sched705.htm#C705S03600T> (displaying 107 published applications as of Feb. 21, 2008); see also U.S. Published Application Patent Full-Text and Image Database, www.uspto.gov (follow "Patents: Patent Search" hyperlink; then search "Advanced Search" for "CCL/(705/36T)") (listing 63 issued 705/36T patents as of Feb. 21, 2008).

111. Searching for issued patents under the 705/36T Classification yielded 63 patents as of Feb. 21, 2008. See U.S. Patent Full-Text and Image Database, <http://patft.uspto.gov/netathtml/PTO/search-bool.html>.

112. See 2007 U.S. PAT. & TRADEMARK OFF. PERFORMANCE & ACCOUNTABILITY REP. 113 (2007), available at <http://www.uspto.gov/web/offices/com/annual/2007/2007annualreport.pdf>.

113. See *supra* text accompanying notes 99-103.

happen. Bad patents do issue, but in theory, mental processes are not patentable.



Difficulty in Uncovering Prior Art. Confidentiality of tax filings – that is where the power exists, right? You have all these small meetings and you talk. Word of mouth is how you disseminate information in the tax community. That is really difficult for someone challenging a patent to track down, get it declared as prior art, and invalidate the patent.¹¹⁴

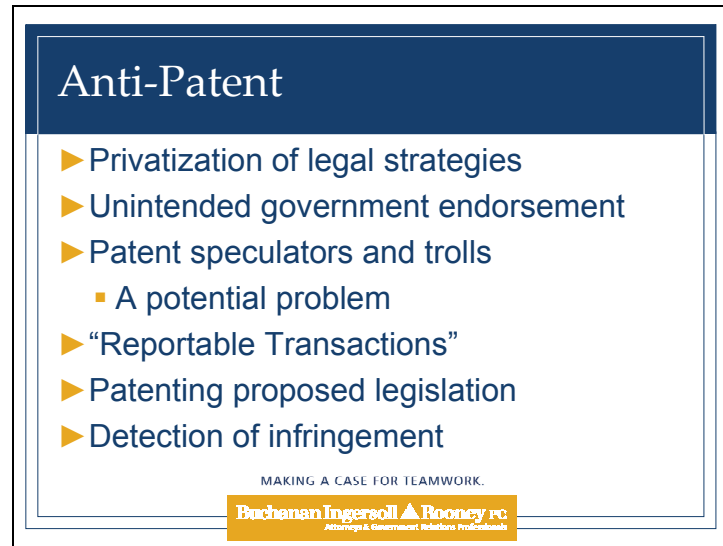
Unintended Government Endorsement. The other anti-patent comment is the unintended government endorsement.¹¹⁵ None of us in here remember patented medicines, but that was the same issue. Before the FDA, people would run around patenting medicines.¹¹⁶ The medicines could kill you. So they developed the FDA and the reason you do not hear people talking

114. Unless the prior art is published or itself patented, a challenger cannot use it to challenge a patent because 35 U.S.C. § 301 limits prior art citations to “prior art consisting of patents or printed publications.” 35 U.S.C. § 301 (2000).

115. See Letter from Jeffrey R. Hoops, Chair, American Institute of Certified Public Accountants Tax Executive Committee, to Patrick J. Leahy and Arlen Specter, Senate Committee on the Judiciary; John Conyers, Jr., Lamar S. Smith, Howard L. Berman, and Howard Coble, House Committee on the Judiciary; Max Baucus and Charles Grassley, Senate Committee on Finance; Charles B. Rangel and Jim McCrery, House Committee on Ways and Means (Feb. 28, 2007), <http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm> (“Taxpayers may be misled into believing that a patented tax strategy bears the approval of other government agencies, such as the IRS, and therefore is a valid and viable technique under tax law.”).

116. See Thomas V. DiBacco, *The Medicine Makers; Ash of Sponge May Be Long Gone, but Pharmacists Today Have Other Drugs to Help the Sick*, WASH. POST, Aug. 22, 1995, at Z15.

about patented medicines anymore is because it would not be on the market if it did not go through the FDA. They do not use the patents to endorse the idea that their medicines are good. But as to tax strategies, this is a very serious concern.



Privatization of legal strategies I think I covered.

Patent speculators and trolls. This is a really good area for those guys. Patent speculators are people who invest in patents in order to exploit them.¹¹⁷ Patent troll is a pejorative term for a really bad one.¹¹⁸ They get a patent and then go around the industry and they say, “You know, we could get an injunction against you or we could seek damages, but if you settle today it is going to be for \$80,000, about equal to your transaction costs in dealing with us.” Most people sign up.¹¹⁹ It is trolling, but not like the lowly creatures under the bridge. It is trolling, like in fishing – you are trolling the market to see what licensees might have a problem. And there is a real potential problem here because if there is a tax strategy out there that covers a recurring strategy, you can see how trolls can go after a lot of

117. See JOHN R. THOMAS & WENDY H. SCHACHT, CONGRESSIONAL RESEARCH SERVICE, PATENT REFORM IN THE 110TH CONGRESS: INNOVATION ISSUES 9 (2007) available at http://assets.opencrs.com/rpts/RL33996_20070507.pdf.

118. See *id.*

119. See Nicholas Varchaver, *The Patent King*, FORTUNE, May 14, 2001, at 202 (describing one successful patent speculator, Jerome Lemelson, who held 558 patents and received approximately \$1.5 billion in licensing fees in 2001). Varchaver suggests that expensive litigation costs motivate companies to settle even though they may not believe Lemelson’s patents are valid. See *id.*

different corporations for a small amount of money and fit that mold.

*Reportable Transactions.*¹²⁰ I have asked every tax attorney I can why they are concerned about patenting being a circumvention of “reportable transactions”. Does everyone know what a reportable transaction is? A reportable transaction was basically born – and I am sure that Dan will address this – but my understanding is that, when you have these strategies under an NDA – a non-disclosure agreement – you basically go up to someone and say, “Hey, have I got a tax strategy for you, but you cant tell anyone.” Because it is under an NDA, the tax community could not examine it very well. So the shenanigans were prevalent and the IRS said to you, “Hey, if you paid money and you are under a confidentiality agreement, we want to know about it. We are going to give the tax return special scrutiny.”¹²¹ People were concerned that patenting these things would circumvent that scrutiny because of the dependence on patents instead of trade secrets.¹²² But patents are in the public domain, so if you want to see what the tax strategy is doing, just look at the patent and if you do not agree that it is legal, you can always question it publically. Wouldn’t patenting answer the concern better than “reportable transactions”? That is the idea.¹²³

Patenting Proposed Legislation – Really cool concept. Let’s say you are a lobbyist. You go to Washington and say, “Guess what? I have this great tax incentive. Let’s get it into the law.” Senators and Congressmen say, “absolutely”. In the meantime, you get a patent application on file at the PTO. If they pass the law, you literally have a monopoly on the implementation of that law. It is a very clever thing to do. I think there are probably some antitrust issues as well as some other issues hiding, but apparently someone is running around and saying that is exactly what they have done. They got a patent back in the 1990s and it is just coming into law now. I have not been able to track that story down. It is just a rumor.

Detection of Infringement. Returns are all confidential, so how are you going to know if someone is using your innovative tax strategy?

120. See I.R.C. § 6011(g) (2000); Treas. Reg. § 1.6011-4 (2007).

121. Making Tax Patents a Reportable Transaction, 72 Fed. Reg. 54615-01 (proposed Sept. 26, 2007) (to be codified at Treas. Reg. § 1.6011-4).


122. See William A. Drennan, *The Patented Loophole: How Should Congress Respond to this Judicial Invention?*, 59 FLA. L. REV. 229, 278-279 (2007).

123. *Id.*

Pro-Patent

- ▶ Promotes dissemination of information
- ▶ Promotes innovation
- ▶ Investment vehicle
- ▶ Reduces motives for utilizing trade secrets
- ▶ Offensive and defensive filings
- ▶ “Chilling” effect on competitors

MAKING A CASE FOR TEAMWORK.



Remember that point I made about how you have all these small word-of-mouth ways to convey the information in the tax community? That is not a very effective way to communicate tax strategy. They should be public. They should be published frequently. I cannot think of a community more desperately in need of a patent system than the tax community, if only to create a better way to disseminate tax strategies and information. But when you talk to tax practitioners, they say that we have generally learned about these procedures in these small venues. What that creates is a situation where people are reinventing the same strategy over and over. Patents represent a vehicle that people are going to be willing to invest in if you have patent protection. Patents reduce motives for utilizing trade secrets or that guy with the NDA and the chilling effect.¹²⁴ If you are a major player and are making some sort of tax play, you could use this to disadvantage your competitors. They may not know just how strong your patent is so they will steer clear and remain far beyond what the patent would actually require.

124. *See id.*

Conclusions

- ▶ Recent changes in patent law mitigate perceived problems
- ▶ Pending legislation raises significant concerns beyond concerns of tax community
- ▶ Tax community has not looked to potential advantages of patenting
- ▶ Definitional issues will continue

MAKING A CASE FOR TEAMWORK.

BuchananIngersoll & Rooney PC
Attorneys & Government Relations Professionals

These are my conclusions: I would say that the advantage of getting tax strategy patents is very much diminished – since their impact will be very much diminished. That legislation stands a very good chance of getting through at this point. A tidal wave of patent attorneys coming into the issue this week. Apparently there is a lot of activity, so this might actually stop that particular bill from going through.

It is now Dan's turn.

* * *

IV. PRESENTATION BY E. DANIEL LEIGHTMAN

I want to first give full disclosure about my interest in patenting tax strategies – I have a personal interest because I have an application pending for a business methods patent. I never thought of it as a tax strategy patent. I thought of it as a business methods patent. It does have tax consequences because everything has tax consequences, as Charles pointed out. It would clearly be swept up in this broad legislation that has been proposed because anything that defers, minimizes, or reduces someone's tax is a tax strategy patent. Anybody here drive a Prius? That is that hybrid car you get a tax credit for if you drive it.¹²⁵ So the patent for the Prius would be considered a patent on a tax strategy since it reduces someone's income tax because you get a tax credit if you buy that car – so I think that legislation

125. I.R.C § 30B (West 2007).

250 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII

might be a bit broad. Anyway, my patent is for nonqualified deferred compensation.¹²⁶ It is designed to protect employees from the business risk or the credit risk of their employer. It is really not a tax strategy patent.

Tax patents have suddenly become a very hot topic¹²⁷ and I wonder if it just came out of the blue. Some of the tax patents Charles mentioned earlier are extremely offensive. The SOGRAT patent is just outrageous. I will talk about my view on offensive patents later. But everyone is sounding off against tax patents. The AICPA is on record.¹²⁸ The American Bar Association (“ABA”) Section on Taxation I think is on record against tax patents, or they are prevented from issuing their views because the Section on Intellectual Property section is already on record for – there are bylaws of the ABA that prevent the one section of the ABA from being publicly against views of another section of the ABA.¹²⁹ The Texas State Bar is against tax patents.¹³⁰ There have been multiple articles. I have seen none in favor of tax strategy patents. The legislation is pending, and, yesterday, Eric Solomon, the Assistant Secretary of Treasury for Tax Policy was quoted as saying that the administration has grave concerns about tax strategy patents.¹³¹ I wish the Administration had grave concerns about the potential bankruptcy of Social Security, or possibly the war in Iraq, but they have grave concerns about this handful of tax strategy patents. It is certainly a current topic.

126. A nonqualified deferred-compensation plan is “[a]n unfunded compensation arrangement . . . that defers compensation and [taxation] to a later date. It is termed nonqualified because it does not qualify for favorable tax treatment under [I.R.C.] § 401(a). The plan avoids the restrictions on qualified plans, [especially] the limits on contributions and benefits and rules against discrimination in favor of highly compensated employees.” BLACK’S LAW DICTIONARY 565 (8th ed. 2004).

127. See generally Drennan, *supra* note 124, at 1-2.

128. Jeffrey R. Hoops, *AICPA Urges Congress to Address Tax Strategy Patents*, AICPA, Feb. 28 2007, <http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm>.

129. Alison Bennett & David B. Brandolph, *Tax Patents: Debate Over Tax Strategy Patents Intensifies; Prospects for Legislation, Guidance Unclear*, TAX MGMT WKLY. REP. (BNA) (Sept. 3, 2007).

130. Alison Bennett, *Treasury, White House Discussing Patents, Tax Legislative Counsel Says*, DAILY TAX HEADLINES (BNA), (Jan. 22, 2008) <http://www.bnasoftware.com/knowledgecenter/dtr/article.aspx?id=1060>.

131. See Solomon Says Rules Not Enough to Fix Tax Patent Problem: Other Issues Discussed, DAILY REPORT FOR EXECUTIVES (BNA), (Oct. 15, 2007).

This was in the *Wall Street Journal* last week.¹³² It is a guy who says, “I invented the Swiss army knife, but forgot to patent it.” So he has a Swiss army-like device to beg for money because he is destitute. Somebody made a lot of money on the Swiss army knife. If you talk about fairness – and that is what I have heard: “It’s just not fair to get a tax patent.” That kind of takes me back to grade school. I remember people saying that all the time: “It’s just not fair.” Well, I suspect someone like this fellow does not think it is fair that he did the work and somebody else received the benefit. We can talk about fairness a little more as we go on.



I want to put this up for a minute because I think there are two ways to look at the issue of whether tax strategies should be patented. Now, from my experience of showing this slide, I know that different people in this room will see that picture differently. It could either be seen as an old hag or it could be seen as an attractive young lady. Now, Dean Nimmer pointed out that I am an adjunct professor so that entitles me to ask questions. So, I will make this simple: Who sees the old lady? Okay, who sees the young lady? Okay. I am glad more people see the young lady than the old lady because the young lady is the patentability of tax strategies. This all depends on how you look at it. This also demonstrates innovation because you can see that everybody sees

132. Harley Schwadron, *Invented the Swiss Army Knife but Forgot to Patent It*, THE SCHWADRON GALLERY, <http://www.schwadroncartoons.com/SCHWADRON/GALLERY>. HTML (last visited March 7, 2008); Editorial Cartoon, WALL STREET JOURNAL, Oct. 3, 2007.

252 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII

things one way until an innovator comes along and sees it a different way and points it out. One innovator in the history of science was Charles Darwin.¹³³ Another was Galileo.¹³⁴ More recently, while everybody else saw a pile of sand, Jack Kilby of Texas Instruments and Bob Noyce of Intel saw a computer chip.¹³⁵ Once you see it, you will always see it that way again. That is innovation.

Now my point in favor of patenting any intellectual property is that is what the United States' property law is all about – protecting intellectual property.¹³⁶ I am amazed that all these attorneys and accountants are against protecting intellectual property because that is all we do all day every day – develop proprietary tax strategies and proprietary tax advice. People pay us for that. We are entitled to be paid for that. Would you ask us to give it away for free? What was that quote? “It’s just not fair.” Why pick on tax strategies?



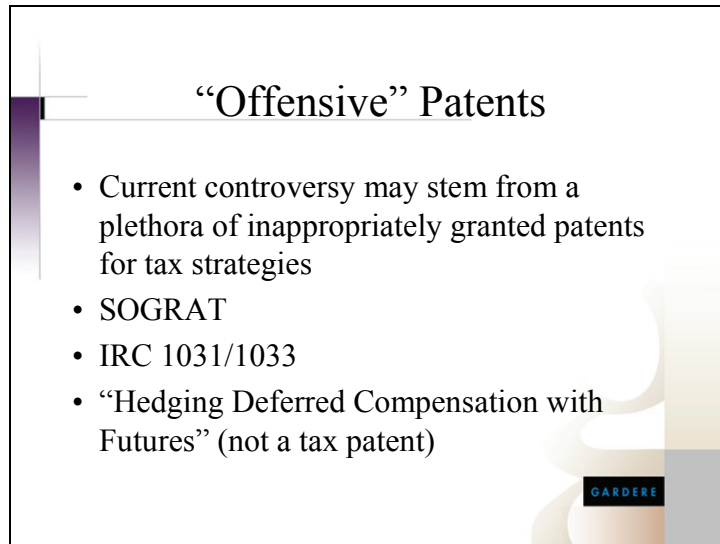
133. See, e.g., Ryan M.T. Iwasaka, Note, *Chakrabarty to Chimeras: The Growing Need for Evolutionary Biology in Patent Law*, 109 *YALE L.J.* 1505, 1511 (2000).

134. See W. Noel Keyes, *Our Continued Need for Coordination of the United States Constitution of the Eighteenth Century's Age of Enlightenment with the Twenty-First Century's Ages of Modern Science and Bioethics*, 27 *WHITTIER L. REV.* 951, 979 n.119 (2006).

135. See Nancy L. Kaszak, *Practicing Law in the Global Economy*, 22 *N. ILL. U. L. REV.* 1, 2 (2001).

136. See U.S. CONST. art. I, § 8, cl. 8 (stating that Congress is “[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 Discoveries.”).

Charles told you only area that the U.S. law does not allow people to patent¹³⁷ is atomic weapons, you cannot patent atomic weapons.¹³⁸ So if this legislation passes, you will not be able to patent tax strategies or atomic weapons.¹³⁹ So I guess we are in good company – a tax strategy is like an atomic weapon in the eyes of Congress. I think what Charles points out is a very good point: What will they want to not allow you to patent next?



There are some patents that are very offensive. The tax-free exchange patent is really troubling. It involves doing a like-kind exchange but you do not find the property in time, so you buy a piece of property that is going to be condemned. Then when it is condemned you get two years to reinvest the condemnation proceeds. You extend the forty-five day period to two years.¹⁴⁰ Clever idea. Should someone have been able to get a patent for that? I do not think so. That is mildly offensive. Hedging deferred compensation with a futures contract¹⁴¹ – it is just outrageous that the Patent and Trademark Office would allow that. The company owes an employee an amount of money based on the return on the S&P 500. This patent actually belongs to

137. See *supra* note 107 and accompanying text.

138. 42 U.S.C. § 181(a) (2000).

139. See *id.*; Patent Reform Act of 2007, H.R. 1908, 109th Cong. (2007).

140. See Combined 1031-1033 Exchange, U.S. Patent Application No. 20070174170 (filed Feb. 14, 2007) (published July 26, 2007).

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

254 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

Goldman Sachs,¹⁴² hedging that exposure with a future – that was supposed to be new, non-obvious, and useful? There is a \$20 billion futures market that exists for the purpose of hedging equity exposures.¹⁴³ It already existed and the PTO granted that patent.¹⁴⁴ I do not think that patent will stand up. Charles will tell you there is a presumption of validity because the patent has been granted.¹⁴⁵ I think that is a problem. By the way, this hedging with a future is not a tax patent – it is a business method patent.

This is the problem: We have a whole lot of patents that are offensive. We ought to learn this in law school: bad facts make bad law. Let us not allow bad patents to make bad law. I think that is what is happening right now. There is this short list of offensive patents that is leading to radical action on the part of tax practitioners.¹⁴⁶ That just reminds me of an old lawyer's joke: 99% of the lawyers are giving the other 1% of us a bad name!¹⁴⁷ I think the bad patents are going to give the few good patents a bad name. And I think we need to focus on that when deciding if this is really the appropriate legislation.

I personally think the problem is at the PTO because they are granting all these patents. I think the PTO is staffed for the 20th century. They have scientists and engineers.¹⁴⁸ They have 4,800 employees.¹⁴⁹ How many tax lawyers in the 4,800? One. A new hire, I bet? [Weiland: Well, he actually has an electrical engineering degree, too.] I do not think patent examiners are even permitted to call the IRS. They can go on the Internet to see if somebody else has a SOGRAT type structure out there, but typically the prior art has been confidential. They cannot call the IRS to see if it is a good patent or a bad patent.¹⁵⁰ One thing that

142. *Id.*

143. In June 2007, there was \$240 billion in OTC equity-linked future contracts outstanding. BANK OF INTERNATIONAL SETTLEMENTS, AMOUNT OUTSTANDING OF OTC EQUITY-LINKED & COMMODITY DERIVATIVES (June 2007), <http://www.bis.org/statistics/otcder/dt21c22a.pdf>.

144. U.S. Patent No. 6,766,303 (filed Oct. 15, 2001).

145. 35 U.S.C. § 282 (2000); see Gino Cheng, *Doubling up the Horses in Midstream: Enhancing U.S. Patent Dispute Resolution by the PTO's Adoption of the JPO's Hantei Request System*, 24 SANTA CLARA COMPUTER & HIGH TECH. L.J. 375, 405 (2008).

146. Alison L. McConnell, *Lawyers: No Patents for Tax Advice; Congress Considers Banning Practice*, BOND BUYER, Aug. 1, 2007, at 1.

147. WILLIAM L. PFEIFER JR. & G. RAY KOLB JR., *THE GREATEST LAWYER JOKES OF ALL TIME* (2007).

148. See Elliott, *supra* note 14.

149. See HUNT, *supra* note 12, at 3.

150. *Patenting Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 109th Cong. 77 (July 13, 2006) (statement of Mark Everson, IRS Comm'r).

Charles did not mention is that when a patent that is dealing with a tax strategy is filed, the applicant can request that the application not be published until the patent is actually granted.¹⁵¹ On my patent, I did not have an application published. I did not need to. The only time you have to publish it is if you are looking for international patent protection.¹⁵² If something is based on U.S. law only, you do not need international tax protection and you do not have to have it published. If it is published, if someone were to see your application, they may say that is prior art and they could write into the PTO and say do not grant that patent because there is prior art.¹⁵³ But if an application is not published, people will not be able to do that. So the PTO has blinders on. They cannot talk to anybody who knows anything about tax, and as a result, they are granting a lot of patents that should not be granted. Once again, bad patents make bad law.

Again, I think that is the heart of this problem – and this is my real premise: Tax innovators, like every other innovator, are entitled to protect their intellectual property. Now, before patents were in vogue prior to *State Street*, there were trade secrets.¹⁵⁴ You could have a confidentiality agreement – copyrights really were not too practical – and now, at least for the time being, there is a potential for a patent. We all protect our proprietary work. No one wants to spend 1,000 hours developing a tax strategy for a client, and then let the next person use it for free. It is just not going to happen and, again, if it did happen, it would not be fair.

What happens to trade secrets? Charles has already talked about the networking. I was going to mention three of the organizations that I participated in extensively when I was a corporate tax professional. Believe me, when tax people get together, even though it is at night and even though it is in a bar, they are not always talking about baseball. There is a lot of talk going around at professional meetings about tax ideas. CFOs of companies have their own network. CEOs of companies have their own network. Many times in my career, a CEO or a CFO has come back from a meeting with his peers and called me to tell me about some other company's doing that he heard about. He generally wants to know why we are not doing it, and I have

151. 35 U.S.C. § 122 (2000).

152. *Id.*

153. *Id.* § 102(a), (b).

154. *Morison v. Moat*, 68 Eng. Rep. 492, 501 (1851); RESTATEMENT (FIRST) OF TORTS § 757 (1939).

256 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

to make up a reason sometimes. Then there is the board of directors. It is the board of directors that led me to file a patent application on the business method that I had worked on, because if something goes to the board of directors, the directors all know about it. Almost every outside director is on at least two other boards. They may even be the CEO or CFO of some other company. So this stuff spreads like crazy: you come up with an idea, you present it to a company, it goes to their board, maybe you get a fee from the company you present it to, and then five other companies have it for free. A patent would step in and certainly help on that.

Then, this is almost embarrassing. Because a lot of times a company will implement a strategy that is brought to them from an outside advisor. They will go to their own advisor – their own law firm, their own accounting firm – and that firm will take that idea and present it to other clients. The idea again spreads without the innovator being protected or compensated. So, it is hard to protect these secrets absent patent protection.

Charles has made this point: Business and tax are so intertwined that you cannot stop one without the other. The Tax Code, in my mind, only needs Section 1 and Section 11, where you have the tax rates.¹⁵⁵ Even part of Section 1 is full of tax policy. The rest of the Code is either tax policy or economic policy. Congress uses the Tax Code to influence business conduct, to influence economic conduct, and to implement certain government conduct. The Research and Development (“R&D”) credit – it is in the Tax Code.¹⁵⁶ So, now you have an IRS CPA who must act like an engineer and figure out if some R&D is innovative enough to qualify for a credit – a tax credit. Japan, on the other hand, does not have a credit for R&D in their tax code.¹⁵⁷ They have a separate agency called the Ministry of Economy, Trade and Industry (“METI”).¹⁵⁸ So you go to METI, which has specialists in R&D and innovation, and METI gives you a grant.¹⁵⁹ It has nothing to do with the tax code. But our Tax Code is intertwined with business, so any business method is likely to have some tax consequences. Thus, this proposed legislation could be the end of business method patents.

155. I.R.C. §§ 1, 11 (2000).

156. *See id.* § 41.

157. GREGORY TASSEY, STRATEGIC PLANNING AND ECONOMIC ANALYSIS GROUP: NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY, COMPARISONS OF U.S. AND JAPANESE R&D POLICIES 3-5 (March 1998), <http://www.nist.gov/director/planning/r&dpolicies.pdf> (last visited Feb. 24, 2008).

158. *Id.*

159. *Id.*

Everyone has said that the *State Street* patent was really a tax strategy patent¹⁶⁰ – because it was really a series of related REITs or mutual funds – but it was a way to combine and treat them all as a single entity under Subchapter M of the Code.¹⁶¹ So, again, this proposed legislation is probably a lot more far-reaching than anyone is thinking at the moment.

**Stated Reasons to Oppose Patenting of
Tax Strategies and Methodologies**

- Taxpayers should not have to pay a royalty in order to meet their tax obligations
- Implied government seal of approval
- May promote abusive tax shelters
- No individual or firm should “own” or control a benefit conferred by the Internal Revenue Code
- Complicates tax practice
- Many “bad” patents issued
- Attorney/advisor has already been paid

GARDERE

These are the reasons that I have compiled as to why tax strategy patents should not be allowed. (1) Taxpayers should not have to pay a royalty to someone to meet their tax obligations. I am going to address these one by one. That one is a laugh. (2) An implied government seal of approval. I can see some validity in that, but there is a simple answer. (3) It may provide abusive tax shelters. Absolutely not. (4) No one should “own” or control a section of the Internal Revenue Code. I agree, but I don’t think that will happen. (5) They say it complicates the tax practice. I say it may simplify tax practice, and I will come to that. (6) There are a lot of “bad” patents and I think the courts need to address that. (7) Finally, if an attorney has developed the idea, the attorney has already been paid. So maybe the attorney who develops the idea, if he is paid by the client, is not entitled to a royalty. That is a serious argument, which has been promoted.

Taxpayers should not have to pay a royalty to someone to meet their tax obligations. You should not have to pay a royalty.

160. E.g., Robert King, *Only in America: Tax Patents and the New Sale of Indulgences*, 60 TAX LAW. 761, 765 (2007).

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

258 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

People pay for tax advice all the time. If they did not, none of you would be taking tax courses and none of you would be practicing law. We are going to get paid for our tax advice – and we may get paid a lot of money. Take Henry Camferdam in Indiana.¹⁶² He sold his business and made approximately \$50 million.¹⁶³ The tax on the \$50 million was \$13 million, leaving Henry Camferdam \$37 million and the rest of his life to spend it.¹⁶⁴ To me, figuring out how to spend \$37 million would be a pretty overwhelming problem. It is not enough to buy a baseball team, so I do not know what I would do with that money. But Henry Camferdam thought that \$37 million was not enough, so he bought a tax shelter from Ernst & Young, backed up by a tax opinion from Jenkins & Gilchrist.¹⁶⁵ He ended up paying \$7 million in fees in an attempt to save \$13 million in tax, and there was not any tax strategy patent involved.¹⁶⁶ There were just a lot of confidentiality agreements. Of course, it blew up on Henry Camferdam.¹⁶⁷ It also blew up on Jenkins & Gilchrist.¹⁶⁸ I am not sure how E&Y has come out on it. The point is that patents and royalties or not – people are going to pay significant money for valuable tax advice. I will take an extra 30 seconds to tell you I found Henry Camferdam's address, because he lived two streets behind a friend of mine in Indianapolis. Henry Camferdam sued Ernst & Young for \$1 billion because he had all this trouble with this tax shelter they put him in.¹⁶⁹ A \$1 billion lawsuit. I wrote Henry a letter and I told him I wished him well in his lawsuit. I said, "By the way, if you win the lawsuit, you will owe tax on \$1 billion, but attached is my business card and I have a really good idea to get you out of the tax." Now my wife brings in the mail, so I do not know this for sure, but I have never received an answer from Henry Camferdam. Nobody, patents or not, expects to

162. See Evan Halper, *Snared by Their Shelters*, L.A. TIMES, Jan. 10, 2005, at A1.

163. See *60 Minutes: Gimme Shelter; Tax Shelters and How Accounting Firms are Using Them to Their Benefit* (CBS television broadcast Oct. 19, 2003) (stating in response to the question, "And your cut [from selling your business] was \$50 million?" that he received "some part of \$50 million").

164. *Id.*

165. *Id.*

166. *Id.* ("What people like Henry Camferdam do understand is the bottom line: Ernst & Young told him he would save \$13 million in taxes, but he would end up paying \$7 million in fees.")

167. See *id.*

168. See Katie Fairbank and Terry Maxon, *How Jenkins Lost Its Way: As Law Firm Dissolves, Leaders Have No Doubt Tax Scheme to Blame*, DALLAS MORNING NEWS, Apr. 1, 2007, at 1A.

169. *Camferdam v. Ernst & Young Int'l, Inc.*, 2004 WL 307292 (S.D.N.Y. 2004).

receive valuable tax advice for nothing, and this legislation will not change that.

The Government's Seal of Approval. The IRS is forced to play catch-up. The IRS has no idea what is going on if a tax strategy is marketed under a confidentiality agreement. They find out about it three or four or five years later. Maybe they catch it on audit, maybe not. If patents are filed, I think, whether they are going to be published or not, the IRS should have access to all patent applications. The IRS can examine them immediately and can publish a notice. They can publish a notice in a matter of weeks. There was something in the early 1990s called "fast pay preferred."¹⁷⁰ Tremendous tax shelter. Bear Stearns developed it.¹⁷¹ It was presented to me and it had a forty-seven page opinion that was supposedly a "will" opinion by a major Wall Street law firm: You *will* get this tax benefit. Now, if you read to page forty-two, there was a footnote that implied you may not get the tax benefit. But, you know, a typical CEO would never read to page forty-two; he would never read past page two. He just sees a "will" opinion. There were ten or fifteen companies about to pull the trigger on this "fast pay preferred." The rumor is – and this was a Bear Stearns deal – I do not know for sure what happened, but the rumor is someone – a competitor of Bear Stearns – took the Bear Stearns offering materials, and leaked them to the IRS – the expression was "dropped them over the transom." The IRS saw it and a week later there was a notice saying that this is not going to work, and these are the twelve ways from Sunday we are going to attack it. So no one ever entered into that transaction.¹⁷² With early notice, the IRS can evaluate potential transactions. This will solve a compliance problem, not aggravate compliance problems. I think the real

170. See Robert D. Hershey, Jr., *Newly Popular Corporate Investment Banned as Tax Dodge*, N.Y. TIMES, Feb. 28, 1997, at D1.

171. See *id.*

172. *Id.* ("The Treasury official said that he and his colleagues had been working around the clock in recent days to plug the loophole that had given rise to the 'fast pay' practice. Until last month, Wall Street had used the deals in only a limited way, largely out of fear that they pushed the envelope of what was permissible and would be prohibited. Contrary to Wall Street's expectations, however, the Clinton Administration budget for the 1998 fiscal year failed to propose eliminating them, and the financing technique took off in the last few weeks. This appeared to be Washington's oversight but Wall Street, on the alert because of a similar but unrelated loophole closing last year, noticed it immediately. 'That's when it exploded,' a Treasury official said, suggesting that Wall Street and corporate officers figured they had been given the go-ahead for a practice widely seen as stretching tax law to its limit and perhaps beyond. 'People were looking at it and maybe having some suspicions before,' said Timothy McCormally, director of tax affairs at the Tax Executives Institute, a trade group of corporate tax officials. 'Now the nail is in the coffin.'").

concern should not be with patented tax strategies; the real concern should be with other strategies that are being marketed under confidentiality agreements and are not shared with the IRS and the public through the patent application process.

No individual should own a section of the tax code. I do not think any patent dealing solely with the Tax Code would meet the criteria of new,¹⁷³ useful,¹⁷⁴ and nonobvious.¹⁷⁵ Therefore, patents should not be granted.

Increased Complexity of Tax Practice

- Information readily available
- OS PTO website
www.uspto.gov
 Click on "Patents" and then search patents
 Advanced search ccl/705-36T
www.google.com
 Click on "Patents"
- Practitioners should be familiar with all developments (including patent activity) in their area of practice

Complicates Tax Practice. The tax practice would be a lot more complex. When you are advising the client you would have to worry about whether you are giving him advice that violates a patent. Well, there are a couple of web sites. Google has already added a tab for patents.¹⁷⁶ You click on Google, click on patents, click on advanced search, enter the number 705 and you get all the tax patents.¹⁷⁷ I think if you are a tax practitioner working in a field, you ought to be familiar with anything that is new anyway. You ought to be looking at that web site regardless. The PTO also has a search engine. You can get every tax patent

173. See 35 U.S.C. § 101 (2000); see also *id.* § 102.

174. See *id.* § 101.

175. See *id.* § 103.

176. See Google Patents, <http://www.google.com/patents>.

177. The current United States classification for tax patents is 705-36T. See U.S. Patent Classification 705/36T, http://www.uspto.gov/patft/class705_sub36t.html. From the Google Patents web page, a user can narrow the search to certain available tax patents by accessing the advanced search page and querying "705-36T" or access the larger group of 705 patents by querying "705" in the "U.S. Classification" box. See Google Advances Patent Search, http://www.google.com/advanced_patent_search.

off of www.uspto.gov. Once again, do an advanced search and there is the 705-36 class.¹⁷⁸ It will not complicate the practice of tax law. It might even simplify it.

"Bad" patents are issued. Again, Charles and I will debate this somewhat. I do not think the courts should enforce them. I think ultimately the bad patents will get forced out of the system. I think the PTO needs to improve and maybe the legislature ought to let it hire a few tax lawyers. I think that is the real solution.

Ethics Issue. I am not going to get into this ethics issue because I am getting close to running out of time, but I think when you charge a client for bad work, what you learn in the process as an attorney is your property. The client has the right to use that information for the specific transaction. There may be ways in an expensive project to share the costs if you come up with a proprietary product that you can sell to others. I just do not see that as a problem.¹⁷⁹

*IRC § 1031.*¹⁸⁰ Internal Revenue Code § 1031 has been fascinating, too. Section 1031 is the like-kind exchange.¹⁸¹ I have got a piece of property. I am going to sell it and make a big gain. I do not want to pay tax, so I ask my buyer if I can trade it because if I trade it for another property I can defer the tax.¹⁸² So, the technique used to be, Bill Streng here was going to buy a piece of property from me. I would tell him, "Bill, look, I am going to sell it to you but I really want that apartment building over there, so you go buy it and trade it to me." That was § 1031, which was an accepted tax practice. Somebody got a really bright idea in the mid-1970s, "I really do not want to pay tax, but I do not know what property I want yet and Bill really wants me to close on my deal with him." So, I tell Bill, "Put the money in escrow. Do not pay me and the escrow will hold it and in the next few months I will find a piece of property, and the escrow will buy it and deliver it to me." That was called a deferred

178. See Class Schedule for Class 705, <http://www.uspto.gov/go/classification/uspc705/sched705.htm#C705S03600T>.

179. Cf. *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals: Hearing Before the Perm. Subcomm. on Investigations of the S. Comm. on Gov't Affairs*, 108th Cong. 4 (2003) (statement of Senator Levin) (characterizing such activity as a "horde of tax advisers cooking up one complex scheme after another, so-called tax products, generally unsolicited by clients, and then using elaborate marketing schemes to peddle these products across the country"); see also Janet Novack and Laura Saunders, *The Hustling of X Rated Shelters*, FORBES (Dec. 14, 1998).

180. 26 U.S.C. § 1031 (2000).

181. See *id.*

182. See Treas. Reg. § 1.1031(a)-1 (as amended in 1991).

262 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII

exchange.¹⁸³ It was called a “Starker exchange” because the guy that figured this out was named Starker.¹⁸⁴ That became a fairly standard practice. Congress heard about it. It took them eight years, ten years, but they said, “Well, you better pick the property in 45 days and close in 180 days.” Then somebody got another really bright idea, “Gee, you could buy this property from a foreign subsidiary of the same company and you would never give up any property and still sell tax-free.” I have to tell you that was my idea. I implemented that transaction in 1985. I never told anybody about it except the tax advisors who worked with me. Five years later, Congress passed rules that stopped it.¹⁸⁵ I do not know how Congress found out about it, but it clearly leaked. Now, in the early 21st century, we have two patents – tenants-in-common¹⁸⁶ and this § 1033 patent.¹⁸⁷ These are now actually patented techniques in the like-kind exchange area.

I want to talk about Bob Dolgin. Bob Dolgin used to market various tax ideas,¹⁸⁸ and he had a couple of pretty good ones. One of them was prefunding the Voluntary Employees Benefit Association (“VEBA”),¹⁸⁹ that went around for a long time. Ultimately General Signal lost that in court in 1994.¹⁹⁰ The IRS found out about it and both Parker-Hannifin and General Signal litigated and lost.¹⁹¹ It was an interesting idea. It was an aggressive reading of the statute, and Bob marketed that through confidentiality agreements.

I am going to take an extra thirty seconds because this is entertaining. What Bob would do is when he called on a company, he said, “Now, I will not charge for this idea if it is something that you are doing already, so what you do is tell me all the ideas that you are working on.” When he came to me, I said,

Bob, I am not going to do that. What I am going to do is write down the ideas I am working – one per

183. James D. Bryce, *Deferred Exchanges: Nonrecognition Transactions after Starker*, 56 TUL. L. REV. 42, 87 (1981).

184. *Id.*; see *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979).

185. See, e.g., Robert L. Sommers, *Deferred Like-Kind Exchanges Under Section 1031(a)(3) After Starker*, 68 J. TAX’N 92, 92 (1988). See also I.R.C. § 1031(a)(3) (2005).

186. U.S. Patent No. 6,292,788 (filed Dec. 3, 1988) (issued Sep. 18, 2001).

187. Combined 1031-1033 Exchange, U.S. Patent Publication No. 2007/0174170 (filed Feb. 14, 2007) (published July 26, 2007).

188. See *Gen. Signal Corp. v. Comm’r*, 103 T.C. 216, 217 (1994).

189. *Id.* at 218.

190. *Id.* at 216.

191. See *id.*; *Parker-Hannifin Corp. v. Comm’r* 139 F.3d 1090, 1101 (6th Cir. 1998).

sheet of paper – and they are face down on the table. If you mention an idea that you are trying to sell me that I have already done, I am going to turn over the appropriate piece of paper. But I am not going to give you my ideas for free.

Bob agreed to that and, of course, you know what I did, right? I had twenty-seven pieces of paper on that table. Now, if you turned most of them over, they would have been blank on the other side. But it did intimidate Bob.

Bob then came up with a year-end 401(k) contribution technique accelerating the deduction for the six months of the following year.¹⁹² The IRS learned about it and came out with a revenue ruling about two years later.¹⁹³ But there was enough validity to Bob's second idea that the IRS said, we will let you get away with the past years if you change your accounting right now,¹⁹⁴ which I thought at least showed some validity to the idea. That was Revenue Ruling 90-105. By the way, I implemented that idea. He had a brilliant idea on how to anticipate the deduction for fringe benefits. I think it would be an idea you could patent today. I think it would be appropriate to patent and as far as I know, it still works. He thought of fringe benefits that you would never have thought of. That is innovation. How about rest periods? That is a benefit. That is a cost to the company. If you could identify your rest period costs, you were allowed to prefund a VEBA with the money for the rest periods and you could get a deduction for next year's expenses this year – a great idea. He has a whole list of these things. But there are ideas that could be patented.

This legislation is too broad. It is going to bring in the wrong stuff. I think that Congress really needs to reexamine the whole thing. It also needs to have a grandfather clause for applications that have already been filed.

* * *

V. QUESTION AND ANSWER PERIOD

Nimmer: It is always good to hear a self-serving end to a speech to preserve the grandfather.

Leightman: Let me mention that my contact information is at the end of the PowerPoint presentation.

192. See Rev. Rul. 90-105, 1990-2 C.B. 69.

193. See *id.*

194. *Id.*

264 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

- Nimmer: Exactly. I guess we have time for questions – about ten or fifteen minutes. And actually, Charles, I should ask, do you want to make any additional comments before we open it up for questions?
- Weiland: Just some things that were brought up, I need to say. First, the PTO is trying to hire tax attorneys.¹⁹⁵
- Leightman: That acknowledges that there is a problem.
- Wieland: Oh, it does. They freely acknowledge it.¹⁹⁶ It is not something that they're trying to hide. As for the IRS's play at the PTO, they could be issuing letter rulings based on the applications. They declined that offer before, but if you wanted to force the issue that would be a way to see which of these actual patents may have some validity. There are a couple of other things, but I think they are fairly minor.
- Nimmer: I have to admit that a lot of this discussion sounds so similar to the discussion of software patents from a number of years ago.
- Wieland: That is still controversial.
- Nimmer: Yes, that is still controversial. Any questions? I will have to repeat the question because everybody else cannot hear it. [Question] The question is, essentially, if you implemented one of the patented tax strategies and it turned out that it did not work, would there be an indemnity for the patent owner?
- Wieland: That is what Professor Longley focused on. He felt—I believe—that you cannot indemnify for malpractice, which is a fine statement. I think if you were in more of an informational role where you were just licensing a patent and not advising clients you might be able to throw into the contract an indemnification clause, but I do not really know if it would stick. If you are a CPA I imagine you have malpractice. I think that would be the problem. Your bad advice is still bad advice and it

195. See Coggins, *supra* note 12, at slide 30.

196. See *id.* at slides 14-16, 30, 32.

is still malpractice. At least in the profession of law, you cannot indemnify around malpractice.¹⁹⁷

Leightman: There is no validity just because the PTO granted the patent.¹⁹⁸ Charles pointed out earlier that you can patent something that is illegal, but it is still illegal.¹⁹⁹ You patent a hallucinogenic drug, but you are still going to jail for selling it even though the PTO granted the patent.

Nimmer: I would just add, from the licensing side, which is more my field, there are a fair number of cases out there and a lot of opinions that say in a normal patent license that is not more active – that is, you are not doing consulting – that there are not any warranties or indemnities.²⁰⁰ It is just – I will not sue you – that is the basic notion of the license. So that would also lend to what both of you were saying.

Wieland: It may go without saying in a law school setting, but a patent, like any property right, does not give you the right to practice it, it only gives you the right to exclude.²⁰¹ It is a very fundamental characteristic.

Nimmer: Any other questions? [Question] The question is, would you touch on why a copyright would not be sufficient for the tax strategy area? Dan?

Leightman: I think I would like to defer to the four or five copyright experts in the room, but to me the copyright is just the order of words on a page.²⁰² You could read a book that is copyrighted, take the plot, change the names of the characters, and write a similar book, and you would not violate the copyright as I understand it.²⁰³ Again, we have got a lot of experts in the room.

Nimmer: That is the right answer. It would not cover the things that you would want to be able to protect

197. *Channel Lumber Co. v. Porter Simon.*, 78 Cal. App. 4th 1222 (Cal. Ct. App. 2000).

198. *See, e.g.*, U.S. Patent No. 4,253,475 (filed Oct. 12, 1977) (issued Mar. 3, 1981) (patent for “water bong”).

199. *See In re Watson*, 517 F.2d 465,476 (C.C.P.A. 1975).

200. RAYMOND T. NIMMER AND JEFF C. DODD, *MODERN LICENSING LAW* § 8:1, 8:42 (2006 ed.).

201. 35 U.S.C. § 154 (a) (1) (2000).

202. 17 U.S.C. 101 (2006).

203. *Id.*

and would essentially leave me – as long as I was using different words or a different layout – the full right to use whatever ideas you had. It relates to the wrong piece. In the software area, it gets closer because you are getting a copyright on the code structure and often that is the most important implementation, but in this area it would not have any relevance, I think, to the main idea. Any other questions? Yes, sir. [Question] The question is, on what criteria should the PTO base the decision about granting or not granting a patent in this area? Either one of you.

Wieland: I think it is relatively clear for now. Actually, it is probably going to go up to the Supreme Court – *Comiskey*²⁰⁴ is probably going to go up to the Supreme Court. But the abstract nature of legal advice is probably not enough to get you over the 101 threshold.²⁰⁵ You implement that advice in a software package. For instance, I am going to use a specific example. TurboTax has the deduction finder. TurboTax, or Intuit actually, has seventeen patents and two published applications dealing with their software package.²⁰⁶ Because it is implemented in a machine, it is patentable.²⁰⁷ The reason you have not heard about royalty payments is because it is part of your license when you acquire your TurboTax.²⁰⁸ But it is the implementation of that legal advice perhaps in a computer or in a machine or something similar that would be patentable. I am sorry to go on here, but this is an important part. There is a lot of language out there about patents that are for the application of natural phenomena – you cannot patent natural phenomena, but you can patent their application.²⁰⁹ The same is true, I would say,

204. *In re Comiskey*, 499 F.3d 1365, 1376-77 (Fed. Cir. 2007).

205. *See id.*

206. *See* SEC INFO – INTUIT, INC., <http://www.secinfo.com/dr6nd.92az.htm> (detailing how “Intuit also has been granted seven patents and has eight patent applications pending with respect to methods of processing financial data and other processes used in certain of the Company’s products.”)

207. *See Comiskey*, 499 F.3d at 1376-77.

208. License Agreement for Tax Year 2007 TurboTax® Desktop Software and Services, available at <http://turbotax.intuit.com/corp/desktoplicense.jhtml>.

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

2008] *PATENTS ON TAX STRATEGIES* 267

in this arena, where you cannot patent tax law, but you can patent the application of tax law.

Nimmer: You could also patent the software that implements the strategy – or the software process.²¹⁰

Leightman: But the standard criteria are still there – new, useful, not consistent with the prior art . . .²¹¹

Wieland: . . . anticipation and obviousness.²¹²

Nimmer: Yes, sir. [Question] The question is, are there practical problems an injunctive or viable remedy when you have a large number of people in the public using it?

Leightman: For certain patents it will be impossible to detect infringement. If you had done a § 1031 transaction and selected a property you knew was going to be condemned, no one would ever know about that except the advisor who told you about it. On the other hand, the SOGRAT patent where someone took some stock options and put them into a grantor-retained annuity trust it happened to be the president or the chairman of Aetna Insurance Company. He had to file a Form 4²¹³ and he said that he transferred his stock. The patent holder was searching Form 4s looking for stock transfers. So that is a visible infringement of the patent. But short of something like that, it is going to be difficult to enforce a lot of patents. In terms of my own business method patent, I thought a lot about whether to patent it. Because I have an investment, not only of my time, but the filing fees are not insignificant, are they?

Wieland: They are cheap!

Leightman: (Well, he is from the East Coast.) By Texas standards it was a lot of money. I have a business method patent that would be used by only Fortune 1000 companies and would lead to 10-K disclosure,

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

211. 35 U.S.C. §§ 101, 102 (2000).

212. *Id.* § 103.

213. See U.S. Sec. and Exch. Comm'n, <http://www.sec.gov/about/forms/form4data.pdf> (requiring all directors, officers, and owners of more than 10% of a class of equity securities under Section 12 of the Securities Exchange Act of 1934 to file a statement of ownership regarding the security).

268 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

- so I will be able to detect any infringement. Normally it is going to be a big problem.
- Nimmer: Let me ask one question to follow up. Who would be the infringer? Would it be the client who files the return? Or would it be the attorney or CPA firm who gave the advice and implemented the return?
- Wieland: It depends on how the claim is written. But let's say that the infringement is the finished product, the numbers, the return itself. The client would probably be a direct infringer. Then the tax attorney could be a contributory infringer but it requires that he actually knew about the patent and that he actively used the infringement²¹⁴ – one of the reasons you do not want to go looking at every patent perhaps, but that probably will change because of the recent decisions.²¹⁵
- Nimmer: So that would change the enforcement issue depending on who you are suing.
- Question: Dan, I think we have all pretty much decided at this point that the SOGRAT patent is a bad patent. One of the statements that you made that I think was extremely accurate was that CPAs and attorneys alike spend a lot of time talking to one another about new law and existing law. We are going to Continuing Legal Education programs all the time, whether or not these things are brought up. When the SOGRAT patent came out, I basically did a verbal poll of several estate planning lawyers during a CLE program and I asked the question whether they had ever broached the issue of stock option grantor-retained annuity trusts and most of them came back and said "Yes, all the time." Yet a patent was issued on it.²¹⁶
- Leightman: Most of them probably did not know about the patent.

214. See 35 U.S.C. § 271(a)-(c).

215. See *e-Bay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 390-93 (2006); *KSR Int'l Co. v. Teleflex, Inc.*, 127 S. Ct. 1727, 1739-42 (2007); *SanDisk Corp. v. ST Microelectronics, Inc.*, 480 F.3d 1272, 1381-83 (Fed. Cir. 2007).

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

2008] *PATENTS ON TAX STRATEGIES* 269

Nimmer: Can you try to repeat? Because I do not think anyone else can hear it when you are talking in this direction.

Question: When we, as professionals, are talking among ourselves after work or in continuing education programs and so on, a lot of us take for granted that some of these novelties and innovations that we talk about in going over the new law or existing law, are something that we would need to think about going after patents. That was basically the result of a poll that I took of law firms in Houston and so the question that I have is how do you broach over the issue of novelty?

Leightman: Well you may decide in your own mind that there is no novelty. Going back to Charles' five stages of patents, you would be in the shock stage when someone tells you that there is this patent on the SOGRAT, as well you should be. You may decide to tell the client there is this patent, but you would get someone in the patent field to perhaps give you advice that the patent will not stand up, or you will be able to settle the claim for a small amount. Or if your client is not a reporting executive of a public company, you may decide to try the old audit lottery, I guess. Give Charles a shot at this.

Wieland: If you accept as a hypothetical that the discussion of SOGRATs was only ever oral, word of mouth, no one ever published it, wrote it down, or kept it in the public domain, it probably does not constitute "prior art." The reason for that is there has to be a degree of public retrievability.²¹⁷ There are a couple of cases in my article that try to bracket that issue a little bit.²¹⁸ But the patent system is about promoting the dissemination of information. The 10 people that you discussed that with over dinner one night do not represent the 70,000 tax practitioners in the United States. It is not a meaningful dissemination and so when I said that I cannot think of a community more desperately in need of a patent system, that is what I am talking

217. *See supra* note 5, at 136.

218. *See* *Invitrogen Corp. v. Biocrest Mfg., L.P.*, 424 F.3d 1374 (Fed. Cir. 2005); *see* *TP Labs., Inc. v. Professional Publishers, Inc.*, 724 F.2d 965 (Fed. Cir. 1984).

270 *HOUSTON BUSINESS AND TAX LAW JOURNAL* [Vol. VIII]

about. You do not really have a mechanism to convey that from the 10 people to the 70,000.

Nimmer: I think the follow-up from my perspective would be that you cannot assume that the world of tax strategies would be exactly the same if we allowed them to be patented. It would change the way in which that dialogue occurs. That I think is one of the intended effects of a patent system. Because I know for sure that the same issue you just raised was raised in the software area when those issues were being debated because the same kind of discussion was prevalent and may still be. But it is a choice. You either aim at a more patent controlled one or a more open discussion one. [Question] The question generally is, if patents are available in this area, why would not a valid business or professional strategy be to get a whole large number of smaller ones?

Wieland: I think they would. I think that is a very prevalent thing to do in other areas of patenting.

Nimmer: Unfortunately, we are out of time. I would like to thank our two speakers, Charles Weiland and Dan Leightman for their interesting presentations and an excellent discussion. Also, thank you to the Houston Business and Tax Law Journal for hosting this coming together of two very different areas of law. Finally, thank you to all of you for coming. Good night.