Patenting Tax-Related Legal Advice: A step in the wrong direction

Yonatan Heisler
Patenting Tax-Related Legal Advice: A step in the wrong direction

Yonatan Heisler
Chicago Kent College of Law
April 24, 2007
I. Introduction

A. Abstract

The patenting of tax planning strategies has started to attract a great deal of attention recently as an issue that carries with it important and far-reaching social policy and tax implications. The issue, however, is not just of interest to tax practitioners; it has also attracted the attention of Congress. In July of 2006, the House Committee on Ways and Means\(^1\) held a hearing to discuss whether tax planning strategies ought to be granted patent protection. Those testifying before the committee included IRS Commissioner Mark Everson, and General Counsel of the United States Patent and Trademark Office (USPTO), James Toupin.

The catalyst for the recent controversy surrounding tax patents was the case of Wealth Transfer Group v. John. W Rowe. The case, which settled in March of 2007, centered on an individual’s right to use a patented tax plan involving a sophisticated tax savings scheme that implemented a trust funded with non-qualified stock options. The lawsuit was watched extremely closely by tax practitioners who feared that an adverse decision would have had broad, significant, and far-reaching consequences not only for tax attorneys and accountants, but for individual taxpayers as well. As the law currently stands, sophisticated tax savings plans are eligible for patent protection.

In this paper I will examine a number of reasons explaining why the patenting of tax ideas is, in the simplest of terms, a bad idea. In order to better understand the issues at hand, however, I will begin the paper by giving a rudimentary summary of the patent

\(^1\)The House Committee on Ways and Means is responsible for drafting tax legislation
system itself. From there I will proceed to explain the many reasons why the issuance of tax patents should be disallowed.

1. Brief Summary

To begin with, the three requirements for patentability (novelty, usefulness, and non-obviousness) cannot easily and accurately be applied to patents regarding tax planning strategies. Second, tax patents inevitably place an undue burden upon tax practitioners, and individual taxpayers might mistakenly confuse a tax patent as being the equivalent to an IRS stamp of approval. Moreover, the patenting of tax advice might also have serious and damaging repercussions that reverberate across other areas of law. After all, if one can patent tax advice, should one be able to patent any type of legal advice? Clearly, it’s a dangerous slippery slope. Tax patents also raise concerns that tax practitioners will limit themselves in the course of their counsel due to concerns that they might suggest a patented tax plan that would subsequently subject them to expensive patent infringement litigation. Ultimately, the most significant problem with tax related patents is that they allow patent holders to preclude others from using patented tax plans, effectively preventing other taxpayers from utilizing certain aspects of the tax code. As will be set forth in greater detail below, no individual or corporation should be able to hold what essentially amounts to a monopoly over Internal Revenue Code (IRC) sections. All taxpayers should have the right to pay taxes in any manner they choose as long as it’s compliant with IRC rules and regulations.
In short, the continued issuance of patents for tax planning ideas opens up a Pandora’s Box of tax and public policy problems. As a result, and for other reasons I will expound upon later, Congress would be well advised to issue a directive prohibiting the U.S Patent and Trademark Office from continuing to issue patents for tax and financial planning ideas.

B. The John Rowe Case

Again, the cause for the recent attention surrounding tax patents was the recently settled case of Wealth Transfer Group v. John W. Rowe. The basic facts of the case are laid out below.

In 2003, the USPTO granted a patent to a Florida company called the Wealth Transfer Group for a sophisticated tax planning strategy involving a trust funded with nonqualified stock options -- otherwise known as a grantor retained annuity trust (GRAT). Soon thereafter, on the advice of his lawyers and financial advisors, John Rowe implemented a similar type of strategy in order to save a significant amount of money he would have otherwise had to pay in gift taxes. The GRAT set up by Rowe operated in such a way that it would pay Rowe an annual income for a specified period of time, and upon his death, whatever would be leftover would go to his heirs. In setting up the GRAT, Rowe did not pay the Wealth Transfer Group a licensing fee for use of the tax savings plan.
Upon learning of Rowe’s tax plan\(^2\), the Wealth Transfer Group, in one of the first cases of its kind, sued John Rowe in U.S District Court for patent infringement. The lawsuit sought royalties, damages, and attorneys' fees. Until the case was settled in March 2007\(^3\), tax practitioners were fearful that a decision in favor of Wealth Transfer Group would have dire consequences for tax attorneys, accountants, and financial planners alike. So while tax professionals can temporarily breathe a sigh of relief, the issue remains unresolved and a continued point of contention.

**II. The Patent System**

**A. Constitutional Roots**

The roots of the patent system can be traced back to Article 1, Section 8, Clause 8 of the United States Constitution which states that Congress has the power to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”

One of the ways Congress exercised its duty to promote the “progress of science” was through the enactment of the Patent Act of 1952, which as the backbone of the patent system, lays out the requirements for patentability. The patent system, over time, has proven to be extremely flexible and adept at responding and adjusting to a number of advances in a variety of fields. In doing so, it has been a primary factor and catalyst for the development, and proliferation of a number of inventions and processes that have

---

\(^2\) Rowe is a board member for Wealth Transfer Group and was required to report the details of the transaction

\(^3\) As part of the settlement agreement, both parties agreed to resolve their differences without any admission of liability by either party
helped the United States pioneer new industries and become a world leader in technological, mechanical, and chemical innovation.

B. Statutory Background

Section 101 of the 1952 U.S Patent Act (codified in title 35 of the U.S. Code) provides that:

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

Put simply, patents are awarded for processes and products. Patents, however, are not granted for abstract ideas, but rather for the implementation of ideas. For example, one cannot patent the idea of changing the channel on a television set without having to move from a couch. Clearly, though, a remote control that implements that idea would be patentable.

In order to receive a patent, an item must first meet three requirements; it must be

1. **new (novel)**
2. **useful**
3. **non-obvious**

Since the enactment of the U.S Patent Act, patents have been issued for a broad range of products and processes as the Supreme Court has interpreted 35 U.S.C §101 broadly to include “anything under the sun that is made by man.” Once a patent is issued, a patent owner has an exclusive right to use (assuming that the item or process is legal) the patented item for a period of 20 years starting from the date of the original

---

4 35 U.S.C. §101
patent application. Accordingly, a patent owner may sue anyone that uses portions of his patent, either in part or in full, without permission. A patent holder, however, can always choose to license out the patent and has the right to seek injunctive relief from anyone who uses said patent without permission. It should be noted that all patents have a presumption of validity, and once issued, the Patent Office does not have significant recourse to revoke or nullify it. Moreover, once Congress deems a subject matter to be patent worthy, the USPTO does not have the authority to disagree or assert otherwise. The USPTO, in other words, is not in the business of making policy decisions.

C. Statutory Requirements for Patentability

1. Novelty
   The novelty requirement under 35 U.S.C. §102 demands that an item be new in the sense that is has not previously been discussed, disclosed, or explained in any medium that would have made it readily accessible to the public. The array of materials that encompass previously disseminated public disclosures, as it pertains to a newly patented item, is referred to as prior art. When reviewing an item for patent approval, patent examiners review all of the relevant prior art to ensure that the item is indeed novel and has not previously been made or discussed in a public medium. Typically, only a minimal level of publicity is required to bar an item from meeting the novelty requirement.

2. Useful

---

6 35 U.S.C. §154
7 35 U.S.C. §281
The useful requirement is as straightforward as the name implies. A new invention must have some sort of utility, and this requirement is usually met easily.⁸

3. Obvious

Lastly, an item seeking a patent must be non-obvious.⁹ This means that an invention or process will not be granted a patent if its composition, though new, would be thought of as obvious to “one of ordinary skill in the art.”¹⁰ In making this determination, a patent examiner will review the relevant prior art and determine whether the item seeking patent protection is such a significant improvement over the prior art that its composition would not be obvious to one skilled in the relevant field. Put simply, an item seeing patent protection cannot be an obvious derivative of something already in existence. Thus, though an invention may in fact be new, it may nevertheless be considered obvious.

D. History of Patenting Tax Planning Strategies

Granting patents for tax strategies is a relatively new development that began in 1998 when a Federal Circuit court established in State Street Bank & Trust Co. v. Signature Financial Group, Inc., 149 F.3d 1368 that business methods, of which tax strategies are a subset, are patentable so long as it “produces a useful, concrete, and tangible result.”¹¹ In State Street Bank, the Court upheld a patent that involved a type of mutual fund asset pooling system developed by the Signature Financial Group.

---

⁸ See Juicy Whip, Inc. v. Orange Bang, Inc., 185 F.3d 1364, 1366 (Fed. Cir. 1999)
⁹ 35 U.S.C. §103
¹⁰ 35 U.S.C. §103 (a)
¹¹ State Street Bank citing In re Alappat, 33 F.3d, 1554 (Fed. Cir. 1994)
A business method patent is a type of process patent that seeks to protect a particular and unique way of implementing a business strategy. Process patents generally cover a series of steps that when done in a specified order and manner, produce a sought-after product and/or result. A process patent must be detailed enough to explain the necessary steps required to bring about the desired end product, yet it cannot be so broad as to only embody the idea of how to do something. In other words, abstract ideas are not patentable.\[^{12}\] For example, one cannot patent the idea of a chemical that helps to remove stains from clothing, but the process that one would undertake in order to produce such a chemical would be patentable. Since the 1998 decision, and according to the U.S. Patent Office, patents have been issued for over 40 tax planning strategies, while an additional 61 are currently pending review.

### III. Problems with Tax Patents

The patenting of tax advice brings with it a unique set of problems. As will be set forth below, the unique nature of the tax system makes it particularly difficult to apply the standards of novelty and non-obviousness. Furthermore, there are considerable issues relating as to whether the USPTO is even sufficiently staffed to examine tax-related patents in the first place. Also problematic is the fact that tax patents have the potential to cause significant taxpayer confusion, have detrimental side effects on other areas of law, and hinder the ability of tax practitioners to fully serve and represent their clients. Of utmost importance, however, is the fact that tax patents restrict the ability of taxpayers to utilize the tax law to their advantage, essentially fencing off aspects of the tax code for the benefit of a few, and to the detriment of everyone else.

\[^{12}\] Diamond v. Diehr, 450 U.S. 175, 185 (1981)
E. Patent requirements in connection with tax planning strategies

1. What’s Novel?

As noted above, one of the requirements of the patent system is that something be novel, meaning that it’s new to the extent that it has not previously been disclosed to the public. And again, the array of materials that encompass previously disseminated public disclosures, as it pertains to a newly patented item, is referred to as prior art. With this in mind, the confidential nature of tax returns makes it seemingly impossible for the USPTO to realistically examine whether or not a particular tax plan has been implemented before. Furthermore, it is often common for particular tax planning strategies to be disseminated via publications and closed seminars that are not generally accessible to the public or the USPTO. Thus, in the case of tax patents, all of the relevant prior art would be practically inaccessible to patent examiners. Also of concern is the fact that certain tax savings plans, while commonly used, are not always reduced to writing. Some strategies may be so basic and widely employed that they only appear as numbers on a taxpayers return. As such, there is a significant risk that patents may be granted for tax strategies that are well known and widely employed and, thus, not novel at all.

In the Rowe case, for example, the strategy of implementing a trust funded with stock options was not uncommon, according to Dennis I. Belcher, a trusts and estates lawyer who testified before the House Committee on Ways and Means in July of 2006. According to Belcher, the GRAT patent was “widely discussed in practitioner circles many years before the patent was applied for, but was not implemented due to non-tax law restrictions in effect at that time. When these restrictions were relaxed, the technique
became practicable - but it was not new or non-obvious to gift tax practitioners.” Simply put, in the course of reviewing a tax plan for patent approval, the USPTO seems ill-equipped to accurately determine if a similar plan has been implemented before due to the fact that much of the prior art would be inaccessible to patent examiners.

2. What’s Obvious?

Another requirement for patentability is that the invention or process at issue not be obvious. This requirement differs from the novel requirement to the extent that while an invention may in fact be new, its composition, or the way it’s put together may nonetheless be obvious to a skilled artisan in the field. The obvious requirement poses special problems when applied to tax patents. First, tax advice and tax strategies are often uniquely applied to a specific set of factual circumstances and it may therefore be difficult to determine whether or not a tax practitioner, when given the same set of circumstances as another practitioner, would be able to independently come up with a similar tax savings strategy. In other words, because tax plans are generally devised in response to the unique financial situations of clients, it seems impracticable that the USPTO would be able to fairly determine whether or not another practitioner would find a patented tax plan obvious. Compounding the problem is the simple fact that patent examiners are not tax attorneys, and they most likely lack the requisite skill and tax knowledge to make such determinations in the first place.

3. Is the USPTO qualified to evaluate tax patents?

Even putting aside the impracticality of determining whether or not a tax patent meets the necessary patent requirements, a more general concern centers on the ability of
the USPTO to evaluate tax patents in the first place. As mentioned above, the Patent Office lacks a sufficient body of prior art with regard to tax patents as compared to other areas that involve more traditional types of patentable subject matter. While the Patent Office is adequately staffed with various types of engineers and scientists who are able to use their expertise and training to make informed decisions during the patent review process, it is not similarly staffed with tax specialists or practitioners. Accordingly, the Patent Office is not nearly as well equipped to make accurate patent determinations over tax planning strategies as it is in other fields. Furthermore, because the tax code is constantly changing, it is highly improbable that USPTO employees would be able keep up to date with the latest changes in the IRC. The tax code is complex and its arcane nature can be confusing to even the most seasoned of tax practitioners. Put simply, the USPTO is not equipped with the personnel to effectively review the patentability of complex tax saving schemes.

F. Tax Patents give an unfair advantage to the Patent holder

A significant problem with tax related patents is that they give patent holders an unfair advantage over competing firms and individual taxpayers. In essence, tax patents allow a small few to take advantage of IRC provisions at the expense of other taxpayers.

The competition between law and accounting firms is a healthy part of the everyday business routine to the extent that it benefits the client. Typically, a client will choose the services of the firm or practitioner that he/she feels can provide the most advantageous tax result. In offering their services, law and accounting firms are on a level playing field, and though each might claim that they are better equipped to obtain a
favorable tax result, each firm is free to give it a shot within the confines of the law. In
the ordinary course of a business environment, one law firm, for example, might find that
it has particular success and expertise in employing a certain type of tax savings scheme
and might create a small niche for itself in the marketplace. This, however, does not
impede other firms from entering into the market and offering the same type of service.
Indeed, this type of competition ensures that firms continue to work hard in order to
provide clients with the best service and tax results possible. The availability of tax
patents, however, reduces this healthy competition into a game where whoever crosses
the patent finish line first is put into a unique position of power that should not exist
within the realm of the tax code. The holder of a tax patent, for example, might choose
not to license out a particular tax strategy, thereby stifling competition from competing
firms as tax planners would be prohibited from employing the unlicensed tax strategy.
Tax patents would effectively allow private individuals to attain ownership rights over
aspects of the tax code. This runs counter to all notions of fairness, and goes against the
public policy driven nature of the tax code. The tax code is in the public domain and the
ability to structure financial transactions in a manner consistent with IRC rules and
regulations is a right that should be freely available to all taxpayers. It should go without
saying that no individual or corporation should be allowed to own any portion of the
code, nor hold it hostage for a royalty fee.

Admittedly, the ability to attain a competitive advantage via the patent system is
not unique to tax patents and is applicable to a broad range of patentable subject matter.
For example, a company with a patent over a new technology holds a competitive
advantage over other rival companies. Why then, should the ownership rights associated
with tax patents differ from the ownership rights associated with all other types of
patents? The answer to this lies in the fact that tax patents are inherently and uniquely different from all other types of patents.

G. Why Tax Patents differ from other types of patents

It is important to remember that patent protection does not grant a patent holder the right to use, but rather the right to preclude others from using the patented item. This should come as no surprise as this is precisely what the patent system is about; granting patent holders a degree of autonomy and control over their patent. But because of the uniqueness of the tax system, normal adages about the patent system must be re-evaluated. The tax code is an entirely different beast, unique unto itself, and it should, therefore, be looked at and analyzed from that perspective. As will be set forth below, tax patents differ significantly from all other types of patents, and the root of this difference goes to the underlying purpose of the patent system itself.

1. The Patent System is about Innovation

At its core, the patent system is about innovation. It is an incentive system that encourages individuals to experiment, take risks, and discover. The patent system embodies the idea that if one devotes the time, the energy, and the resources into developing a new, useful, and non-obvious product, a patent will be granted so that the patent holder can benefit from all of his/her hard work. Would a computing company, for example, devote years of hard work into coming up with a new technology that they couldn’t patent, only to see it copied and implemented on a grand scale by a number of other companies? Would companies spend millions and millions of dollars on research and development costs if their latest products were simply going to be ripped off by
competitors? Of course not. Thus, the patent system operates to reward innovation by granting patent holders an exclusive license to profit from their hard work for a specified period of time.

Proponents of tax patents often point out that if patents are granted for extremely useful and important products such as HIV medications, then they should surely be granted for something as seemingly mundane as a tax plan. On the surface, this seems to be a valid point, and admittedly, the idea that a company can preclude others from manufacturing an HIV drug seems revolting. However, it is important to remember that if patents were not granted for new drugs and medications, the innovation and research that produces those drugs would dwindle. After all, what incentive would a company have to spend millions of dollars producing a drug that, in the end, would simply be copied? Coming up with new technologies, medicines, and inventions is an expensive process, and the majority of companies are able to innovate precisely because they realize that they will be able to recoup their costs in the form of a patent. Though seemingly counter intuitive, the patent system is the very reason why a number of medicines and products are discovered and manufactured in the first place. The patent system is one avenue by which Congress has chosen to “promote the Progress of Science and useful Arts”. Put simply, if patents were not granted for new products and technologies, innovation would be stifled.

2. Tax Patents do not promote Innovation

The tax system, however, does not operate under the same umbrella that encompasses all other types of patents. If patents were not granted for tax planning
schemes no discernable or negative consequences would result. The opportunity to use the IRC to lower one’s tax liability is motivation in and of itself for the individual taxpayer to tinker with the IRC. Tax practitioners also do not need the benefits of a patent system as an impetus to innovate within the realm of the tax code. A practitioner, for example, must represent his client to the best of his ability within the confines of the law, and that alone should serve as motivation for the practitioner. If a lawyer, for example, is already serving his client to the best of his ability, and indeed that is what lawyers are already paid to do, then the absence of tax patents should have no impact whatsoever. Clearly, there is nothing to be gained in the form of innovation from allowing individuals to patent tax strategies. Indeed, some might even joke that using the word “innovation” in the same sentence as the IRC is an oxy moron. The fact that tax patents don’t promote innovation does not, by itself, justify why tax patents should be disallowed. However, when looking at the broader issue of tax patents, it is a factor that should nonetheless be taken into consideration, if only to serve as a reminder that tax patents do not further the underlying purpose of the patent system.

H. Tax Patents impede the ability for some to pay taxes

The most significant reason why tax related patents should not be granted is that they restrict taxpayers from fully maximizing their tax position in accordance with IRS rules and regulations, thereby making compliance with the law more difficult.

1. The obligation to pay taxes is universal

The most significant difference between tax patents and all other types of patents is the simple fact that everyone has to pay taxes. In contrast, no one is ever obligated to
use a patented product. As the old joke goes, there are only two things in life you can count on: death and taxes. This off-color joke pokes fun at the well known precept that tax laws are unique to the extent that they require universal participation and compliance from all U.S. citizens and residents. The following example will help illustrates why the universal obligation to pay taxes creates problems with respect to tax patents.

2. How tax patents hinder the ability for some to pay taxes

Suppose an individual develops and patents a new technology. Shortly thereafter, along comes another individual who wishes to use that technology in a product of his own. That individual is left with two choices. He can choose to either enter the market and license the technology, or upon conducting a cost benefit analysis, conclude that the potential benefit isn’t worth the cost of the license. A taxpayer, in contrast, has no such choice. A taxpayer cannot opt out of the tax system in the way that an individual or company can opt out of a product market. Taxes are mandatory, and it goes without saying that the need to use a certain technology pales in comparison to the need to pay one’s taxes.

By granting patent holders the ability to preclude others from implementing a patented tax plan, tax patents essentially grant ownership rights over the tax code to private individuals and corporations. It is not sound public policy to give individuals the right to preclude others from engaging in what would otherwise be a legitimate means of complying with the law. In an insightful article written on the topic for the Legal Times in October 2006, it was astutely stated that “When enacting the various provisions of the Internal Revenue Code, Congress surely never intended certain aspects of the tax law to be fenced off …” An illustrative example might be a tax patent on a new way to structure
a partnership under an IRC provision. Subsequent individuals who wish to form a partnership would accordingly be precluded by the USPTO from implementing a similarly structured partnership, even though it would presumably be allowable for IRS purposes. Tax patents allow patent holders to cordon off sections of the tax code, thus preventing taxpayers from fully minimizing their tax liabilities within the limits of the law; and because everyone is required to pay taxes, all taxpayers are potentially affected. The IRS is not oblivious to the effects that tax patents might have on tax compliance. In his testimony before Congress, commissioner Mark Everson stated that “granting patent protection to such strategies could limit the use of that particular tax strategy by other taxpayers and have a negative impact on their ability to comply with the tax law”.

Admittedly, a holder of a tax patent could license out a tax strategy for a fee, but there are no assurances or requirements that this would happen. Also, a patent holder could potentially make the licensing fee so high so that only wealthy individuals and corporations would be able to afford it. This goes against the public policy driven nature of the code as the IRC should be available to everyone, not merely accessible and open to the wealthy. Again, the issue of tax patents has created quite a stir among tax practitioners, and many professional organizations have publicly spoken out against them. In an open letter written to the head of the American Institute of Certified Public Accountants, the Virginia Society of CPA’s wrote:

“The Internal Revenue Code contains numerous sections that allow the taxpayer to structure transactions in manners that significantly reduce a tax liability. The Internal Revenue Code is a public domain set of laws, available to anyone. By granting tax advice patents, the taxpayer is forced to choose between paying a royalty fee and paying a higher tax bill than required by law. The taxpayer must
assume the responsibility of determining whether a tax advice patent exists or he or she will violate patent law and be subject to legal action.”

Indeed, the continued availability of tax patents raises the frightening possibility that the only people racing off to the patent office will be those seeking to profit by warding off sections of the tax code for monetary gain. Of course, others might race to patent tax plans as to make them publicly known and accessible, but it seems foolish to create a scenario where such a race has to take place in the first place. In short, the continued availability of tax patents will inevitably hamper the ability of taxpayers who wish to comply with their legal obligation to pay taxes. The scope of the U.S. taxing system is extremely broad and even the most basic of activities are influenced and affected by tax considerations. As such, tax patents will also increase the cost to taxpayers attempting to comply with their legal obligation to pay taxes. This point was concisely and eloquently expressed in an open letter written to members of the House Committee on Ways and Means by the tax section of the New York State Bar Association:

When an individual “enters into even the simplest transaction - for example, incorporating his sole proprietorship - he has no choice but to seek tax advice, if for no other reason than to report the transaction correctly on his tax return. The patenting of tax strategies would invariably increase the cost to taxpayers of complying with their tax obligations, a result we think is indefensible as a policy matter. For this reason, we believe that tax strategies and tax ideas should be generally available to all taxpayers. The tax law should be an open road, not a toll road.”

No other type of patent operates to fully restrict an individual’s ability to comply with the law. Tax patents do, and as such, they should not be granted
I. Implications for Other Legal Areas

A. Legal Advice should never be Patentable

Granting patents for tax and financial plans might also have serious implications for other areas of law. After all, if one can patent a tax planning idea, then why shouldn’t other types of legal advice be patentable? For example, if a unique and creative criminal defense strategy meets all of the patent requirements, should that be patentable as well? Clearly, this is an absurd, yet illustrative suggestion. The problem with tax patents, and all other patents relating to legal advice, is that no patent should restrict an individual’s right to do something he/she has a right to do. Suppose, again, the earlier mentioned example of an individual wishing to enter into a new product market. That individual can choose to pay a royalty fee for a license, or not enter the product market at all. That individual, however, does not have the right to use a particular patented technology. In contrast, all taxpayers have the right to organize their financial affairs in any manner that complies with the tax code, and as set forth above, tax-related patents will inevitably limit that right. Taxpayers should not be made to traverse obstacles as they attempt to pay their taxes. Very simply stated, patents that affect the ability of people to exercise their rights under the legal system are ill advised, make for horrible public policy, and should not be granted.

Proponents of tax patents, however, contend that the ability of taxpayers to comply with the law will not be hindered because any tax plan that is so overly broad as to affect a large number of taxpayers would most likely be obvious and hence would not be granted patent protection in the first place. Although seemingly logical, the mere fact
that litigation on this issue has already emerged proves otherwise. Moreover, even if a patent is properly issued, the tax code is constantly being updated and amended, and a change to the IRC might make a tax plan that was previously available only to a small few, available to the masses. In other words, a tax patent might not be overly broad or have a significant impact when granted, but subsequent changes to the tax code could change that and potentially preclude many taxpayers from using relevant IRC provisions.

J. A Patent does not equal IRS approval

Another problem with tax patents is that they lend an aura of legitimacy to tax plans that might not even be legal. People might mistakenly assume that a tax patent is the same thing as an IRS endorsement, when in reality, the IRS has nothing to do with the USPTO and a patent on a tax plan is no way, shape, or form the equivalent to an IRS stamp of approval.

The fear that tax patents might cause confusion among taxpayers is very real and was even addressed by IRS Commissioner Mark Everson at the Congressional Hearings held in July of 2006. Testifying before Congress, Everson stated:

“a patent may appear to legitimize an abusive tax patent, and that the public may be largely unaware about both the rights that a patent owner enjoys and the fact that a patent does not guarantee that the transaction has the desired tax consequences... A patent carries with it no assurance whatsoever that the patented process transaction or structure will pass IRS muster. We are concerned, however, that taxpayers may be confused about this... The grant of a patent for a tax strategy has absolutely no impact on IRS’ determination of the effectiveness or the legitimacy of the strategy under tax law.”
The fact that some individuals might mistakenly equate a tax patent with IRS approval is not a reason, in and of itself, to disallow tax patents. But given the massive scope of the United States taxing system, coupled with the enormous number of rules and regulations that fuel it, it seems unwise to make things unnecessarily more complex than they need to be. The tax code is already confusing enough without having to deal with the counter intuitive notion that a tax planning strategy, while worthy of a patent, is illegal at the same time.

K. Tax Patents place an Undue Burden on Tax Practitioners

Tax patents place an increased and unnecessary burden upon practitioners who in the course of advising their clients, must be concerned with using an already patented tax plan and subsequently exposing themselves to expensive patent litigation. This is troublesome because tax practitioners are not patent attorneys, and the focus of their work should be spent on helping their clients achieve favorable tax results, not scouring the patent office as to avoid patent infringement lawsuits. Ultimately, this affects individual taxpayers as the added cost of representation will be passed onto them.

Even more disturbing is the possibility that tax practitioners will feel pressured into limiting the scope of their counsel out for fear of implementing a patented tax strategy. In its open letter, the tax section of the New York Bar Association stated that the fear of infringing on a patented tax plan may

“interfere with the duties that tax practitioners owe to their clients, as well as the free exchange of ideas among tax practitioners and between tax practitioners”
and government officials, resulting in adverse effects on taxpayers and tax practitioners and ultimately on the development of sound tax policy.”

Patent litigation is expensive and laborious, and because one can never be sure that a patented tax plan is truly novel and non-obvious, the fear that one might inadvertently use a patented tax idea is a legitimate one.

**IV. Conclusion**

As people continuously look for ways to lower their tax liability, tax savings plans are becoming increasingly creative and sophisticated. It should therefore come as no surprise that patents for tax related planning strategies are becoming more and more popular. There are a number of reasons, however, why tax patents make for bad public policy and should be disallowed. The obligation to pay taxes is universal, and the taxing arm of the IRS reaches every individual and seeps into nearly every type of transaction. Even the most innocuous of decisions and transactions are affected and influenced by tax considerations. Simply put, the taxing mechanism of the United States is large and extensive, and its presence, ubiquitous. Accordingly, anything that significantly influences the manner in which that system operates, such as a tax patent, should be evaluated with extreme care and precision.

First and foremost, and as mentioned above, the most significant problem with tax patents is that they put up obstacles for individuals attempting to pay their taxes in a manner that would otherwise be in accordance with IRC rules and regulations. Tax patents give patent holders what essentially amounts to ownership over IRC code
sections, and this power, though typically part of the bundle of patent rights, should not exist within the realm of the tax code. An individual might patent a tax savings plan and decide not to license it out, thereby precluding others from using the IRC in a manner that should be available to them. Put simply, no individual or corporation should ever have to pay a licensing fee in order to use a particular tax plan. The tax code is in the public domain, and the ability to pay one’s taxes in a manner consistent with IRC rules and regulations should not be limited by tax patents. There are certain activities individuals have a right to do, and one of them is paying taxes in a manner compliant with IRC rules and regulations. Tax patents inevitably restrict this right, or at best, allow individuals to exercise it in exchange for a licensing fee. This is public policy gone awry, and is the principal reason why tax patents should be disallowed.

Broadly speaking, applying patent law to tax strategies is problematic and leads to a number of undesirable consequences. While a tax plan may technically meet the necessary patent requirements, the unique nature of the tax system makes it imperative to closely scrutinize the consequences of allowing such patents. As noted above, the three requirements for patent approval are novelty, usefulness, and non-obviousness.

With respect to the novelty requirement, the confidential nature of tax returns makes it unlikely that the USPTO will be able to accurately ascertain whether a tax plan is indeed novel or not. And with respect to the non-obvious requirement, because all of the relevant prior art exists either in the form of confidential tax returns or obscure tax publications, it seems wholly impossible that the USPTO would be able to accurately determine whether or not a new tax plan would be obvious to a skilled artisan in the field.
Compounding the problem is the simple fact that patent examiners are not tax attorneys, and their ability to evaluate the merits of complex and sophisticated tax plans might not be at an appropriate level -- often times, tax plans are even confusing to seasoned practitioners with years of experience. Simply stated, the USPTO would have problems establishing the originality and obviousness of tax strategies as it would not be able to access a sufficient pool of relevant prior art, thus making its determinations of novelty and non-obviousness tenuous at best.

Third, tax patents place an undue burden on tax practitioners who must thusly become concerned, and potentially preoccupied, with avoiding patent infringement lawsuits. In a paper prepared in anticipation of the July 2006 House Committee on Ways and Means hearing, the Joint Committee on Taxation expressed concern that:

“tax strategy patents might inappropriately burden tax practitioners and taxpayers with trying to determine whether structuring a transaction in a certain way or collecting data to report a transaction properly, has been patented or might be the subject of a pending application, before they can enter transactions, collect necessary data, or file tax returns.”

The cost associated with violating a patent is immense, and patent holders often seek the full range of remedies available; including royalties, damages, and lost profits from the alleged infringer. Of course, a patent infringer always has the right to challenge the validity of the patent itself, but this is an expensive and time consuming type of litigation. Moreover, all patents have a presumption of validity, and the alleged infringer carries the burden of proof. As such, tax practitioners will inevitably require tax practitioners to perform extra work and due diligence in the everyday counsel of their
clients. They will be pressured into expending extra time investigating the existence of patents covering a tax plan they wish to implement for their clients. That is not how a tax practitioner should spend his/her time. A tax practitioner should be concerned with attaining the best possible tax result for a client, not scouring the patent office. A tax practitioner might assume that a well known and widely employed tax strategy is not patented, but there is no guarantee to this because the IRS could very likely issue a patent for a tax plan that is neither novel nor non-obvious. Tax practitioners, therefore, might feel boxed in during the course of their representation, constantly fearing that they might be violating a patent, and it would be unfortunate if tax practitioners limited themselves during the course of representing a client out of fear that they might suggest a course of action that is subject to a patent.

Tax patents might also reduce the degree to which tax practitioners engage in frank discussion regarding tax law and strategy. Ideally, a free and open discussion regarding tax law should be actively encouraged. Tax patents, however, promote an atmosphere of secrecy among practitioners. This goes against all notions of rational public policy. An open and free flowing discussion is much more desirable, and as stated in the open letter written by the tax section of the New York Bar Association: “this exchange of ideas increases practitioners understanding of the law and enables them to better serve their clients. We also believe that such discussions enable groups such as our own to provide recommendations to legislators and tax administrators that ultimately facilitate good tax policy.”
Fourth, tax patents add a layer of confusion for individual taxpayers who might confuse a tax patent as being the same as an IRS endorsement. A patent on a tax plan, however, does not carry with it any semblance of an IRS endorsement, nor does it guarantee that a patented tax plan will protect a taxpayer from penalties should the IRS challenge it. One could, however, argue that tax patents are not unique in this regard. For example, patented drugs are not legally marketable until they are approved by the Food and Drug Administration (FDA). In light of this, should the IRS monitor the legality of patented tax plans? While seemingly a valid comparison, the IRS and the FDA function in completely different ways. While a patented drug will never see the light of day until it is granted FDA approval, the tax system does not operate this way. Aggressive tax savings plans, often based off of tenuous interpretations of the IRC, are typically used by taxpayers until the IRS explicitly rules otherwise. In other words, though the IRS oversees the viability of new type of tax savings schemes, its role as the “gatekeeper” is much more limited in scope when compared to the power of other governmental agencies such as the FDA.

Fifth, the granting of tax patents might have significant ramifications for other areas of law. If patents are granted for tax advice, then perhaps they might also be granted for other types of legal advice, such as defense strategies. The manner by which one complies with the law should not be hindered in any way by any patent.

Admittedly, many of the above arguments in opposition to tax patents can also be applied to other patentable subject matter. For example, technology patents put a burden upon companies who wish to develop a new product using patented processes. Why,
then, should tax patents be treated any differently? Again, the answer lies in the underlying purpose of the patent system, and also, in the fact that everyone is required to pay taxes. The underlying purpose of the patent system is to encourage and promote innovation. The patent system, in essence, fuels the research and discovery that is necessary for advances to be made in a variety of different fields. This fuel, so to speak, is unnecessary as applied to tax patents. The desire to lower ones tax liability is motivation in and of itself to innovate within the realm of the tax code. In short, the underlying purpose of the patent system simply does not mesh well with tax patents. Moreover, the universal obligation to pay taxes makes the impact of tax patents very real and substantial. A tax patent has the potential to affect an innumerable number of taxpayers, while most other patents, in contrast, only affect those who wish to enter into a particular product market. And though obvious, it is important to remember that no one can ever choose to opt out of the tax system.

V. Looking Forward

As described above, tax patents are problematic for a number of reasons, and lead to a number of undesirable consequences. The patent system, though well designed it may be, simply does not mesh well with tax patents. Though somewhat surprising, it should be noted that the controversy surrounding tax patents advice is not an issue the USPTO needs to resolve itself. James Toupin of the USPTO correctly stated that tax patents are not a USPTO problem, but rather something Congress is responsible for dealing with. Recall that the patent office is simply the vehicle by which Congress is exercising its constitutional power. As such, the USPTO is not, nor should it be, tasked
with making public policy decisions pertaining to the morality, efficacy, and social repercussions of patented items.

How this issue will be resolved is anyone’s guess, and whether Congress chooses to intervene and address the issue head-on remains to be seen. The issue was at a standstill for a long time as many awaited a decision in the John Rowe case. Since the parties decided to settle and no authoritative determination was issued by the court, the issue may potentially arise once more. Or, perhaps, the issue will fade into obscurity until a tax plan that encompasses a mainstream tax strategy, and thus affecting a large number of individual taxpayers, is granted a patent. For now, however, and in light of the John Rowe settlement, it seems that all interested parties are still taking a “wait and see” approach.

One thing is for certain, though. As long as the patent office continues to issue tax patents, there must be a concerted effort from both the USPTO and the IRS to establish and maintain a quality and efficient working relationship. Though there is still much work to be done, an impressive amount of cooperation has already begun. The USPTO, for example, has started to seek guidance from the IRS regarding tax issues commonly encountered during tax patent reviews. The IRS has also established a workshop to address a variety of tax issues of interest to the USPTO, and also to help the USPTO stay abreast of current developments in tax law. The IRS has also assisted the USPTO in developing the resources to properly determine what should constitute “prior art” for purposes of tax strategies and financial planning ideas. After the 1998 State Street Bank decision, a business methods category was created, and just recently in
March of 2006, a subcategory encompassing tax related patents was created facilitating the search for already patented tax and financial planning ideas. Thus far, the results of this increased cooperation between the USPTO and the IRS has begun to bear fruit. Mark Everson noted in his testimony before Congress in July of 2006 that the “cooperative efforts between the USPTO and the IRS have already resulted in significant strides in monitoring and reviewing tax strategy patents.”

Efforts have also been made to involve professional tax organizations in the patent process in order to help maintain the integrity and accuracy of the patent system. At the behest of the IRS, organizations such as the tax section of the American Bar Association and the American Institute of Certified Public Accountants have begun assisting the USPTO in determining appropriate frameworks for prior art, and also in improving training for both patent and IRS employees. At the same time, the USPTO is providing important background information to IRS employees to familiarize them with the patent process and rules. All in all, an open and free exchange of advice, training, and ideas has already begun and must continue to ensure the integrity of the patent system.

Looking forward, it would also be beneficial for the USPTO to hire experienced IRS personnel in much the same way that it employs experienced mechanical engineers, biologists, and scientists. So while it is promising that the USPTO is doing all it can to ensure that its patent examiners have all the necessary information needed to make informed decisions regarding tax patents, it should be remembered that the underlying problems and concerns associated with tax patents remain.