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PATENTING TAX STRATEGIES: THE CASE FOR EXCLUDING LEGAL METHODS FROM THE REALM OF PATENTABLE SUBJECT MATTER

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I. Introduction

In January 2006, a lawsuit was filed in the United States District Court for the District of Connecticut.[1] This lawsuit sounded an alarm for tax lawyers across the country; but the suit, which is still in the discovery phase of litigation, is not the type that one would expect to have the tax bar up in arms. Rather, the suit is ***492** a patent suit where the owner of a patent is suing an individual based on allegations of patent infringement.[2]

However, this is no ordinary patent suit. To start, suing an individual for patent infringement is certainly not an everyday occurrence.[3] Also unusual is the amount of commotion this lawsuit has created. It has pitted sections of the American Bar Association against each other,[4] generated a flurry of commentary,[5] and piqued Congressional interest to the point where the House Committee on Ways and Means found it necessary to hold a special hearing to discuss the very issue raised by the patent in this lawsuit.[6]

So what is the patent, and why has it sparked so much debate? The patent at issue is U.S. Patent No. 6,567,790 (the SOGRAT patent) that describes "[a]n estate planning method for minimizing transfer tax liability with respect to the transfer of the value of stock options from a holder of stock options to a family member of the holder."[7] More generally, it is a patented tax strategy that gives the owner of the patent the power to exclude others from using the same tax strategy.

In other words, a tax planner figured out a way to minimize the amount of money his client would have to pay in taxes to the government. That tax planner applied for a patent covering the method he developed, and the U.S. Patent and Trademark Office (USPTO) gave him a patent for that tax strategy. That tax planner, now a bona fide patent holder, has the government-granted authority to prohibit all persons in the country from minimizing their tax bills using the same ***493** technique. And in the event someone does use the technique without the patent holder's permission, the patent holder can bring that person into court and sue for patent infringement.

And herein lies the debate. On the one hand, the Supreme Court has said that patent-eligible subject matter includes "anything under the sun that is made by man."[8] On the other hand, the thought that one person can effectively claim a portion of the tax code as his own is troubling. Is there some underlying feature or policy of the tax system that makes it different than more traditional industries where patents have been used to spur innovation? If such a difference exists, is it enough to justify excluding tax strategies from the realm of patentable subject matter?

This paper explores these and other related questions, ultimately concluding that tax strategies in particular--and legal methods in general--should be excluded from the realm of patentable subject matter. Specifically, Section II explores the background of the controversy, highlighting the SOGRAT patent as well as the various issues raised in the testimony presented to the House Committee on Ways and Means. Section III argues that tax strategies specifically should not be patentable, while Section IV argues that the more general category of legal methods (which includes tax strategies) should not be patentable. Section V presents a number of ways in which Congress or the judiciary could solve the problem, and Section VI discusses some of the problems that may arise from the proposed solutions. Finally, Section VII completes the paper with a brief summary of the conclusions drawn in the other Sections.

II. The Current Debate

A. The SOGRAT Patent

It may not have started the debate,[9] but the lawsuit filed in January 2006 surely brought it to the forefront. And although the USPTO has issued only fifty-three patents relating to tax strategies,[10] a brief look at the patent involved in the lawsuit helps to explain why this has become such a big deal to tax planners across the country.

***494** To begin, a SOGRAT is a type of grantor retained annuity trust (better known as a GRAT), which is a congressionally approved estate-freezing technique that has been around since 1990.[11] At a basic, possibly over-simplified level, a GRAT works as follows: First, the grantor transfers assets to a trust. Then, the trust makes periodic payments (at least yearly) back to the grantor based on a formula established in the Tax Code.[12] These payments are made for the term specified at the trust's creation.[13] Finally, when the trust terminates the assets remaining in the trust are distributed to the beneficiaries of the trust.[14] The end benefit of the GRAT is that any appreciation of the trust assets escapes taxation.[15] What makes a SOGRAT different from a run-of-the-mill GRAT is that the trust is funded with non-qualified stock options.[16]

The SOGRAT patent specification contains a concrete example of a SOGRAT in action,[17] and this example highlights why the ability to patent tax strategies has generated so much concern. First, the grantor funds the SOGRAT with stock options and cash worth approximately $2.2 million.[18] Had this been an outright gift to the beneficiaries, the grantor would have been responsible for approximately $1.32 million in gift taxes.[19] However, because the grantor structured the transaction using a SOGRAT rather than giving the gift outright to the beneficiaries, the grantor need only pay gift taxes on approximately

$93,000--a total tax of only $56,000.[20] Thus, using a SOGRAT resulted in tax savings of approximately $1,264,000 for this transaction!

As the preceding example shows, this is a truly powerful tax-saving strategy. In granting the SOGRAT patent, however, the government has effectively given the patent holder exclusive use of this technique for twenty years. Thus, any tax planner or individual who creates or uses a SOGRAT without the patent holder's permission runs the risk of being sued for patent infringement. Given the possibility of such huge tax savings through the use of a SOGRAT, it is no wonder ***495** tax planners across the country "are aghast" at the thought of being excluded from using this technique.[21]

B. Hearing Before the House Committee on Ways and Means

Whether it was the lawsuit in particular or whether there was some behind-the-scenes lobbying going on (it was likely a mixture of both), Congress caught wind of the ongoing debate between tax professionals and patent lawyers. On July 27, 2006, Congressman Dave Camp (R-MI), Chairman, Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, announced that the subcommittee would hold a hearing "on issues relating to the patenting of tax advice."[22]

Testimony given at this hearing came from a variety of different viewpoints and included remarks from: James Toupin, General Counsel for the USPTO; The Honorable Mark Everson, Commissioner of the I.R.S.; Professor Richard S. Gruner, Whittier Law School; Professor Ellen Aprill, Loyola Law School; and Dennis I. Belcher, a partner specializing in estate planning at the firm of McGuireWoods LLP.[23] In addition, Stephen T. Schreiner, a patent attorney with Hunton & Williams LLP, submitted a statement for the record.[24]

The main thrust of the testimony focused on three issues. First, every testifying individual addressed the issue of whether the USPTO has the resources to effectively evaluate and issue tax strategy patents.[25] Second, some of those testifying discussed the danger that the public may misconceive a patent as the government's endorsement of a particular strategy even though a patented tax strategy could turn out to be illegal.[26] Finally, those opposed to tax strategy patents argued that allowing these patents would greatly burden tax practitioners and individuals using tax-saving techniques.[27]

***496** With respect to the USPTO's ability to review tax strategy patents, both sides made valid points. On the one hand, tax law is very complex and because this is not a traditional area of patenting, the USPTO might have trouble analyzing these methods for their novelty and non-obviousness.[28] On the other hand, this same problem comes along with any newly-emerging technology, and the USPTO has been able to overcome these obstacles in the past.[29] There is probably truth to both sides of this issue, and the problem--if one still exists--is likely to go away once the USPTO puts the right knowledge base in place and builds a substantial record of prior art through which to analyze tax strategy patents.

The concern over whether the government's granting a patent might mislead the public into believing that the government--or more specifically, the I.R.S.-- has endorsed a particular tax-avoidance strategy has some merit. However, because these strategies are mostly targeted to individuals with large amounts of wealth (i.e., the individuals who must worry about estate and gift taxes), one could argue that these are sophisticated clients who would not make such a false assumption. Either way, this type of cause-and-effect relationship is difficult to measure. Thus, although proponents of tax strategy patents may have a valid concern here, such immeasurable effects should not guide the debate.

The final area of debate before the Committee on Ways and Means involved a discussion of the possible adverse effects that patented tax strategies could have on tax planners and the tax system as a whole.[30] As Professor Aprill stated, "Compliance with the tax laws is enormously expensive and time consuming. However diligent and well-intentioned taxpayers and their advisers may be, compliance becomes more difficult every year. Proliferation of tax strategy patents will add to that difficulty."[31]

In this author's opinion, this final concern presents the most important argument against the patentability of tax strategies. Moreover, it introduces--through a specific example--the problems that may arise if the patent system, through the use of business method patents, is allowed to invade the "business" of practicing law. Section IV, infra, will discuss this aspect of the debate in detail.

III. The Patent Policies are Not Compatible With the Tax System

Although there are many facets to this debate, most of them, unfortunately, are in the abstract--the types of arguments for which definitive answers may never be found. For some of the issues, a lack of readily available ***497** empirical evidence hampers the discussion, leading to uncertainty in the debate.[32] For others, the concern is with the effectiveness of the USPTO in general and not necessarily a criticism specific to the patenting of tax strategies.[33]

However, one aspect of this debate, which has received only a very little attention, may be the key to the entire discussion. Namely, the founders of our country established the patent system to spur innovation, or "To Promote the Progress of Science and the useful Arts."[34] This has been--and continues to be--one of the key policies behind the U.S. patent system.[35] The idea behind this policy is that inventors should be rewarded with a limited monopoly when they exert the time and effort to create something new and useful; that without the incentive of the limited monopoly, people will not be eager to innovate or share their innovations with others in fear of a second party copying the innovation and reaping the rewards of the innovator's work without having to pay any of the innovator's development costs. This policy has long served the patent system and our country as a whole, contributing greatly to our technological dominance in many areas of industry and trade.[36]

However, this policy does not fit well into the field of tax strategies. People simply do not need the promise of a limited monopoly to spur ingenuity in reducing their tax burden--that is an incentive already built into the tax system itself. True, those who have argued against the patentability of business methods and other new, emerging technologies have made this same argument,[37] but there is a fundamental difference between the tax system and these other areas of innovation: Paying taxes is mandatory, engaging in business is not.

This distinguishing characteristic, although subtle at first, should be fundamental to the analysis of the debate; yet none of the commentators seem to have addressed it in any depth. In a recent publication of IPL Newsletter, for example, the former Chair of the ABA Section of Intellectual Property Law noted:

> Critics of tax-related patents argue that tax planning and preparation are complex and difficult but that the availability of patent protection will not provide incentives for the discovery and development of valuable new methods for solving the problems associated with this complex system. This argument is illogical. Traditionally, the availability of ***498** patent protection for a commercially valuable invention provides an incentive for investing the resources necessary to discover solutions to complex problems.[38]

This response is typical of those defending the patentability of tax strategies; and although it is hard to argue against the position when applied to innovations in other areas of industry and trade, it seems to overlook some of the fundamental differences between the tax system and other more traditional "patent industries."

For one thing, the mandatory nature of taxes already provides a strong incentive for individuals to discover new ways of reducing their tax burden. Simply put, nobody wants to pay more than their fair share of taxes, and nobody should have to. As Judge Learned Hand once penned, "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."[39] Thus, any incentive provided by the promise of a patent monopoly is an incentive that already exists--the patent incentive is redundant and unnecessary in the tax world.

The logical counter argument here is that there are incentives in addition to the patent incentive in other industries (e.g., free market forces, etc.), yet the patent system has proven effective in spurring innovation in those fields. Hence, the argument goes, the existence of other incentives in the tax strategy arena does not necessarily mean the patent incentive is without value. Again, this argument fails to account for the mandatory nature of taxation. In any other industry, innovation has a net cost;[40] and there can be scenarios where, regardless of the other incentives present, the patent system is needed to offset that cost through the grant of a limited monopoly. In the tax system, innovation actually results in a net gain--not a net cost. So this traditional role of the patent system is diminished, if not altogether eliminated.

To illustrate, imagine a hypothetical company embarking on the task of developing a new product. Before putting any time or effort into the development of this new product, the company has zero net cost. After paying a number of workers for the research and development of the product, the company realizes a net loss. If the company is the first to market the product, it may recoup some of the costs of development by charging a premium on the product. However, one could imagine that, in a world without patent protection, the innovating company would not be able to realize a profit from the product before another company reverse engineers the new product, manufactures its own version, and begins selling it in the market. In this case, the second company would probably be able to sell the product for less than the first company because it did not incur any of

the ***499** development costs. The innovating company would have to lower its price on the product and may end up realizing a net loss for having developed the product. The fact that the company began the development with zero net cost and ended up with a net loss means that the company would have been better off had it not developed the product.

Enter the patent system. Assuming this is a useful, novel, and non-obvious product, the innovating company could patent the product and either prohibit the second company from making and selling it or charge the second company a licensing fee for its use and sale of the product. Here, the patent rights would allow the innovating company to realize a profit from the development of the product. In other words, where an innovator would have incurred a loss for having developed a useful, novel, and non-obvious product, the patent system allows it to profit.

The illustration continues with a look at the tax system. Here, before putting any time or effort into the development of a new tax strategy, a taxpayer begins with a net loss. This net loss results from the fact that the taxpayer is required by law to pay taxes.[41] In stark contrast to the company developing a product, the taxpayer, after paying a tax planner to develop a tax strategy, realizes a net gain.[42] Two facts lend overwhelming support to this conclusion: (1) the tax planner gets paid for the time spent developing the tax strategy, and (2) the taxpayer has reduced his tax bill enough to make the whole transaction worthwhile. Put differently, if there were no net gain for these types of transactions, taxpayers would not pay tax planners to develop tax strategies. The size and success of the tax planning community strongly suggest that these are net gain transactions.

Throughout these transactions, the tax planner's goal is to minimize the client's tax burden. Thus, the incentive to achieve the best possible result is already a vital piece of the tax system. Any incentive attached to the promise of a patent monopoly is redundant and, arguably, would not result in any additional benefits to the taxpayer.

Admittedly, the foregoing illustration is couched mainly under the assumption that tax planners generally do not spread the cost of developing tax strategies to multiple clients. One might question this assumption and argue that allowing these types of patents could spur an industry dedicated to developing novel tax strategies for multiple clients, strategies that are so complex that they would be too costly to develop for just one client. However, the individual nature of tax planning already ***500** allows for strict confidentiality agreements between the tax planner and his client.[43] Unlike a patented product sold on the open market, the tax planner wishing to spread the cost of developing a novel tax strategy can use the existing confidentiality mechanism (i.e., trade secret) to accomplish his goal. Thus the tax system is already equipped in such a way that, whether the cost of developing a tax strategy is borne by one or multiple clients, the promise of a patent monopoly is unnecessary to ensure that these transactions are net gain transactions.

Finally, at a certain level of abstraction, developing new tax strategies is a cost-saving measure.[44] Does this mean that all cost-saving measures should be excluded from the realm of patentable subject matter? Proponents of a wide-reaching patent system have argued that "carving out areas of patent-eligible subject matter in response to the lobbying of interest groups is a slippery slope that ultimately will weaken a system that has served our country so well."[45] Would excluding tax strategies from the realm of patentable subject matter lead to this kind of slippery slope? After all, the free market already rewards (as against competitors) parties who can achieve results at a reduced cost, so it would seem like similar reasoning to that employed with respect to tax strategies should apply to all cost-saving techniques. Perhaps for this reason it would be unwise to make an exception for patenting tax strategies.

Although this argument might pass first muster, it is an extension of the argument against patenting tax strategies that should not be made. Again, the mandatory nature of paying taxes provides an important distinction that will not apply to other areas encompassed by our patent system. In other industries, the activity that creates the cost in the first place, whether it is innovation itself or figuring out how to cut costs on an already existing process or product, is discretionary. If the business cannot bear the cost of working around a patent or paying a royalty in order to use the patented product or method, it can always cease the underlying cost-creating activity. This option is not available in the tax system. An individual wishing to transfer wealth must pay taxes at the time of the transaction; or, if the individual decides not to perform the transaction because someone has patented the tax strategy, the individual will pay taxes at some later point (even if it is through the estate tax after the individual dies). The government will always collect its share of the wealth.

In the end, the mandatory nature of the tax system is what sets it apart from other areas of patentable subject matter. It is a distinction that has seemingly been overlooked thus far in the debate, but it is a distinction that leads to the conclusion that the tax system should not be subject to the invasion of the patent system.

*501 IV. Legal Methods Should Not Be Patentable

As discussed in Section III above, there are very different policies behind the tax system (or tax-avoidance system) and the patent system; and these differences arguably support excluding tax strategies from the realm of patentable subject matter. However, there is another more general argument that leads to the same conclusion. This argument was made by Professor Ellen Aprill in her written testimony for the hearing before the Committee on Ways and Means:

> I suggest that this Subcommittee view tax strategy patents not as an instance of the now-established category of business method patents, but as an instance of a potential new category--legal method patents. Tax strategy patents differ from other business method patents in that they depend on the validity of an interpretation of law. If patents are permitted for interpretation of the federal tax laws, creative minds coupled with economic incentive will seek--and obtain--valid patents relating to interpretations of other areas of law, including, for example, litigation strategies. I ask the Subcommittee whether this is a desirable goal for a country based on the rule of law.[46]

Although this comment was not one of Professor Aprill's main points, instead appearing in one of the concluding paragraphs of her testimony, it apparently caught the attention of at least one member of the committee who later asked Professor Aprill "whether [she] think[s] down the line all these bright and intelligent lawyers will then be seeking a patent on legal advice for picking a jury, setting up the insanity defense, all kind of other things that go on in the course of trial?"[47] Except for Professor Gruner's limited answer to this specific question during the hearing,[48] the testimony is void of any response that would dispel this concern. In addition, none of the commentary (of which this author is aware) following the hearing has addressed the issue.[49]

A. Lessons Learned from Tax Strategy Patents

Admittedly, the desirability of allowing patents on legal methods is a debate that falls into the "hard to prove" category. There may never be a good way to measure the effects--good or bad--of such patents. However, the debate surrounding the patenting of tax strategies gives at least a concrete example on which to base the discussion.

***502** For starters, the SOGRAT patent itself gives an indication of what we can expect if patents on legal methods are allowed to proliferate. Specifically, reading the SOGRAT patent is like reading a chapter in any law school Wills and Estates casebook. Imagine if, at the end of every chapter in a casebook, the following disclaimer was present: "Although the previously described method has withstood I.R.S. scrutiny and is therefore legal, it has been patented and, thus, may not be used without the permission of the patent holder."

Perhaps this is too pessimistic, a parade of horribles that could never come to pass. Obviously, there is no way of knowing for sure, but the tax system is one that fosters creativity.[50] In addition, prior to the issuance of the SOGRAT patent in 2003, many tax practitioners were unaware of the fact that tax strategies could be patented.[51] This same sentiment surrounded business method patents prior to the State Street decision[52] (i.e., most people believed that business methods were not patentable). In his testimony, James Toupin pointed out the effect that State Street had on the number of business method patent filings:

> While State Street did not change United States law and practice, it did create a new awareness that business method claims could be patented. For example, [prior to State Street] in fiscal year 1998 there were fewer than 1,500 filings in the U.S. classification area 705, which includes much of what is commonly known as computer-implemented "business method" inventions. By contrast, [after State Street] there were approximately 9,000 filings in fiscal year 2001; approximately 7,400 filings in fiscal year 2002; approximately 7,700 filings in fiscal year 2003; approximately 8,200 filings in fiscal year 2004; and approximately 8,200 filings again in fiscal year 2005.[53]

Arguably, the SOGRAT case could have this same kind of effect. Namely, if the SOGRAT patent is upheld as valid, there may be a rush to the patent office to patent the different techniques that practitioners have developed to help their clients. Ten years from now, the standard Wills and Estates casebook may very well be peppered with the type of disclaimers mentioned previously.

The real harm in that, however, is not the additional paper and ink used in printing the disclaimers. Rather, this state of affairs

would place heavy burdens on both tax planners and individuals who use tax planners. As Professor Aprill pointed out, "[T]axpayers, their advisers, and others may need to begin considering whether to conduct patent searches in connection with any tax planning activity, whether to seek expert advice, and depending on the results, what course of action to pursue in response to a possible patent claim."[54]

***503** The former Chair of the ABA IP Section responded to this argument, noting that "[v]irtually every other field of commercial endeavor carries potential risks of patent infringement" and that "[a]s a society, we have concluded that the benefits of a viable patent system outweigh the time-limited restrictions on the commercial activities of individuals."[55]

Although this statement is true of commercial activities, it does not seem to address the fact that the legal profession is not per se a commercial activity.[56] With respect to a business developing a product, part of the cost of doing business may be hiring a patent lawyer to perform due diligence for the new product clearance (i.e., make sure the new product is not infringing on any existing patented products). Thus, it is the commercial entity that must worry about complying with patent laws, and the commercial entity directly hires the patent lawyer to advise as to the situation.

Applying a similar requirement to tax planners, in essence, will force them to hire patent lawyers on their behalf to determine whether the method they have developed to minimize their clients' taxes can be used without violating any patents. This would be a strange situation whereby a tax lawyer retained to give advice to an individual would be required, in turn, to retain a patent lawyer to advise as to the propriety of using a certain tax planning technique.

Admittedly, this would be great for the patent bar, as it would represent a new type of client that previously did not exist. However, the fact that paying taxes is mandatory[57] again seems to distinguish the tax system and the giving of tax advice from traditional commercial activities. Businesses can forego the development of products that might infringe another's patent, but taxpayers do not have the ability to forego paying taxes. In allowing tax strategy patents, the patent system seems to be injecting inefficiencies into the tax system--costs that are borne by individual tax payers and tax planners alike. In light of the tax system's already built-in incentives to innovate,[58] it is a tenuous proposition that "[a]s a society, we have concluded that the benefits of a viable patent system outweigh"[59] these costs.

B. Non-Tax-Related Reasons to Prohibit the Patenting of Legal Methods

The preceding discussion was couched in terms of tax strategy patents, but there is nothing within the patent system that would prohibit the arguments in favor of tax strategy patents from applying to any other area of legal advice. For tax strategy patents, the mandatory nature of paying taxes is a factor that may prove to ***504** differentiate it from traditional areas of patenting. In many areas where individuals or businesses seek legal advice, however, no analogy to the mandatory nature of taxes exists. Yet, there is something unsettling about the idea that someone could patent a legal method and preclude all other attorneys from using the same method.

Obviously, this is not just conjecture. The SOGRAT patent itself is a patented legal method.[60] U.S. Patent No. 6,049,811 claims a method for drafting a patent application by use of a computer;[61] this claim is arguably a legal method as well. Chances are, other patents have issued that claim monopolies on legal methods. It may be that they are the types of methods that make enforcement difficult (e.g., infringement that is difficult to detect, methods for which it would not be economically feasible to sue an infringer, etc.). Or it may be that, as was the case for both business methods and tax strategies, practitioners are unaware that the methods they use in the legal practice may by patentable.

Whatever the case, allowing patents on legal methods runs the risk previously described with respect to tax strategy patents. Namely, the patent lawyer may become the ultimate advisor, not only advising traditional clients in matters of patent law, but also advising attorneys in all other fields of practice, helping them to make sure they are not practicing a legal method "owned" by another attorney or individual. These extra costs could be enough to significantly hamper the legal system and the rule of law in our society.

V. Solutions to the Problem

In light of the foregoing, it is clear that there are problems specifically with patenting tax strategies and generally with patenting legal methods. But what is the proper response? A number of options, including compelled licensing, outright

exclusion from patentable subject matter, and practitioner immunity, are arguably available and are discussed next.

A. Compelled Licensing

One of the arguments against allowing tax strategy patents hinges on the perceived inequality involved in permitting individuals to effectively claim portions of the Tax Code as their own.[62] Similar concerns have been raised in areas other than tax law, generally involving the intersection of patent law with some other regulatory scheme.[63] With respect to patents covering government-imposed health ***505** and safety standards, one commentator has suggested that "[w]hen government mandates a technological standard . . . any entity holding patent rights in the subject matter of the standard should be required to license all users at reasonable commercial terms."[64]

Handling tax strategy patents in a similar fashion could provide a workable solution to the problem. At the very least, it would alleviate any concerns about patent holders being able to absolutely exclude others from using a technique authorized by the Tax Code. In other words, although individuals could claim portions of the Tax Code as their own, this solution would force them to share.

However, with respect to tax strategy patents, compelled licensing may be inconsistent with one of the main arguments against full enforcement. As discussed in Section III, the patent system does not provide any benefit to the tax system that does not already exist. Compelled licensing would inject additional costs on the taxpayer, yet the taxpayer would arguably get nothing in return. Thus, it may be that for tax strategy patents, another solution will be more appropriate.

With respect to legal methods in general, compelled licensing may also be only a "second best" solution. It would remove the burden of having to get patent clearance for all transactions, but it would still inject unnecessary cost into an already costly legal system.

B. Enact a "Practitioner Immunity Statute"

In 1996, Congress enacted the Physicians Immunity Statute[65] in response to a controversial lawsuit in which one physician sued another for infringing a patent claiming a method of performing surgery.[66] Under this statute, the patent holder generally cannot obtain damages or injunctive relief against a licensed medical practitioner with respect to the performance of a medical activity that would otherwise qualify as patent infringement.[67]

In a similar vein, Congress could enact a "Tax Practitioner Immunity Statute" or a "Legal Practitioner Immunity Statute" to shield those employing tax strategies, legal methods, or both from patent infringement liability. The advantages of this approach include: (1) the USPTO does not have to be concerned with classifying a patent application as a tax strategy or legal method, and (2) the patent system policy of disclosure of novel ideas is, to some extent, furthered.[68]

***506** Like compelled licensing, however, this approach may have costs that would make it a less than optimal solution. In particular, this approach gives someone accused of patent infringement an absolute defense if the patented method is a tax strategy or legal method. Unfortunately, it may be difficult to precisely define "tax strategy" or "legal method."[69] This difficulty could conceivably require the accused infringer to exert more time and money presenting a statutory defense than if the patent was never allowed in the first place.

C. Remove Legal Methods from Patentable Subject Matter

In light of the deficiencies of the previous solutions, the outright removal of legal methods from the realm of patentable subject matter may prove to be the optimal response. For one, this would nearly eliminate the unnecessary costs that tax strategy or legal method patents are bound to create.[70] In addition, this solution presents an avenue that either Congress or the judiciary may take.[71]

In either case, Congress or the courts could justify this solution based on the policy grounds discussed in Sections III-IV. In addition, one could argue that legal methods are not in the "useful arts" as that term is used in the Constitution.[72] Although an in-depth discussion on the judicial interpretation of the useful arts is beyond the scope of this paper,[73] it may suffice to note that the legal practice is strikingly absent from any of the literature that covers the topic.[74] In other words, commentators have

traditionally assumed that the practice of law does not qualify as a useful art for purposes of the Constitution's patent clause.

Proponents of a wide-sweeping patent system may argue that patentable subject matter includes "anything under the sun that is made by man,"[75] and that State Street, in blessing the business method patent, puts legal methods on the same pedestal.[76] However, those decisions can be distinguished because in both cases, there was an underlying "machine or manufacture" claimed in the patent. Specifically, in Diamond v. Chakrabarty, the patent claimed an engineered micro- ***507** organism;[77] in State Street, the underlying invention was a piece of software used to track investments.[78] Where a method is a purely legal method, no "machine or manufacture" need be involved.

Thus, legal methods present a problem different from those encountered by the patent system in the past. To eliminate the burdens that tax strategy and legal method patents place on practitioners and citizens alike, Congress or the courts should remove legal methods from the realm of patentable subject matter.

VI. Problems with the Solution

The solution discussed in Section V.C presents a problem that is similar to the one encountered with respect to business methods. Namely, how does one define "legal method" ? If legal methods are to be excluded from patentable subject matter, the courts and the USPTO must be able to figure out when they are looking at a legal method and when they are looking at something other than a legal method.

In the debate over tax strategy patents, comparing a method such as the one described in the SOGRAT patent with, for example, a patent on software to help individuals file a tax return highlights this difficulty. Use of a SOGRAT appears to be more of a pure legal method whereas tax return software looks more like software. The SOGRAT patent does mention its implementation via computer software;[79] in that case, is it still a pure legal method or does it change the character of the patent claim?

With respect to tax-related software, the question of patentability should focus on the point of novelty of the claims. Where a tax strategy itself is the point of novelty, the USPTO should reject the claims; where the point of novelty is something other than a tax strategy, the USPTO should allow the claims (assuming they meet all other criteria for patentability). Arguably, then, a tax strategy like that in the SOGRAT patent--regardless of whether it is fully implemented in software--should be unpatentable because its novelty is the tax strategy itself rather than some other feature of the software.

Similar problems of classification will undoubtedly arise for legal methods outside the realm of tax strategies. To address this issue, there is a body of law from which the patent system may be able to borrow. Courts have long regulated the unauthorized practice of law; in order to do so, they have grappled with this exact question, namely, how the "practice of law" should be defined. ***508** Although this issue is one that has traditionally been left to the states,[80] existing doctrines can help guide the patent system.

VII. Conclusion

Tax strategy patents present unique concerns for the patent system and highlight the different policies between it and the tax system. These differences--specifically that paying taxes is mandatory while engaging in business is not--argue for removing tax strategies from the realm of patentable subject matter. In addition, the entire debate sheds light on the more general problem of patenting legal methods, a practice that, if allowed, could do significant harm to our legal system and the rule of law in our society. Because of this, either Congress or the judiciary should take the earliest opportunity to remove legal methods (including tax strategies) from patent-eligible subject matter. Although carving out this exception from the patent system may lead to difficulties in defining exactly what constitutes a legal method, the courts can borrow from state-developed definitions that are used in cases concerning the unauthorized practice of law.

Footnotes

[a1] University of Texas School of Law, J.D. candidate, expected graduation May 2007. The author would like to thank Pamela Banner Krupka for bringing this topic to light; Professors David Wille and John Golden for their insight and helpful comments; and his

wife, Emily, for her steadfast support.

[1] Complaint, Wealth Transfer Group, L.L.C. v. Rowe, No. 06CV00024, 2006 WL 434187 (D. Conn. Jan. 6, 2006).

[2] Id.

[3] Although this author is unaware of any empirical evidence supporting this proposition, because the average patent infringement case in 2005 typically cost between $650,000 and $2,000,000 for each party when there was less than $25,000,000 at risk, Report of the Economic Survey, 2005 Am. Intell. Prop. L. Ass'n L. Prac. Mgmt. Committee Rep. 22, it would seem that pure economic forces would militate against this occurrence. It just so happens that in this suit, the individual being sued is Dr. John W. Rowe, the Executive Chairman and former CEO of Aetna, Inc., one of the nation's leading health care and related benefits organizations. According to Forbes.com, Dr. Rowe's total compensation as CEO of Aetna in 2005 alone was $22.5 million, with a five-year compensation total of $57.7 million. Forbes.com, Forbes Executive Pay, http:// www.forbes.com/static/execpay2005/name.html (choose "Ri - Sa" from the drop-down box under the heading "Search Results") (last visited Dec. 7, 2006). Apparently, Dr. Rowe has deep enough pockets that bringing a patent infringement suit against him could make economic sense.

[4] See E. Anthony Figg, Keeping Current with the Chair, 24 No. 4 Intell. Prop. L. Newsl., Summer 2006, at 3, 46 n.1, available at http:// www.abanet.org/intelprop/newsletter/IPLsummer06.pdf (noting that "[t]he ABA Section of Intellectual Property Law offered to testify at this [Ways and Means] hearing but was not able to do so because the Section of Real Property, Probate, and Trust objected to the IPL Section's request for blanket authority to present its proposed testimony").

[5] See, e.g., Steve Seidenberg, Taxation Innovation: Patent Office Receives Criticism for Issuing Patents on Tax Strategies, InsideCounsel, Dec. 2006, available at http://www.insidecounsel.com/issues/insidecounsel/15_ 238/ip/771-1.html.

[6] Hearing on Issues Relating to the Patenting of Tax Advice: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means, 109th Cong., 2d Sess. (July 13, 2006), http:// waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=492&comm =6 [hereinafter Ways and Means Hearing] (printed hearing not yet available) (last visited Dec. 7, 2006).

[7] U.S. Patent No. 6,567,790, at [57] (filed Dec. 1, 1999), available at http://www.freepatentsonline.com/6567790.html.

[8] See Diamond v. Chakrabarty, 447 U.S. 303, 309 (1980) ("The Committee Reports accompanying the 1952 Act inform us that Congress intended statutory subject matter to 'include anything under the sun that is made by man."' (citations and footnotes omitted)).

[9] See Deborah L. Jacobs, Patent Pending, Bloomberg Wealth Manager, May 2005, at 41, 42 (noting that as early as October 2004, an "elite group of some 200 trusts and estates lawyers" met to discuss the SOGRAT patent and the effect that it--and other tax strategy patents--could have on their trade).

[10] United States Patent and Trademark Office, US Patent Full-Text Database Manual Search, http://patft.uspto.gov/netahtml/PTO/search-adv.htm (enter "ccl/705/36T" in the "Query" field; then click the "Search" button) (last visited Apr. 11, 2007). In addition, the USPTO reports that there are eighty-five published but still-pending tax strategy patent applications. United States Patent and Trademark Office, US Published Application Full-Text Database Manual Search, http://appft1.uspto.gov/netahtml/PTO/search-adv.html (enter "ccl/705/36T" in the "Query" field; then click the "Search" button) (last visited Apr. 11, 2007).

[11] Robert L. Moshman, Esq., Good GRATs and Great GRATs: And An Interview With Robert C. Slane, Estate Analyst (FinancialCounsel.com, Chicago, Ill.), Apr. 2006, http:// www.financialcounsel.com/Articles/EstatePlanning/ARTEST0000090-GreatGRATs.pdf (last visited Dec. 7, 2006).

[12] Id.

[13] Id.

[14] Id. The distribution to the beneficiaries may be immediate or the payment may be delayed through some other estate planning technique such as an irrevocable life insurance trust (ILIT). See U.S. Patent No. 6,567,790, at [57] (filed Dec. 1, 1999), available at http:// www.freepatentsonline.com/6567790.html.

[15] Moshman, supra note 11.

[16] Hence, SOGRAT: "Stock Option Grantor Retained Annuity Trust."

[17] U.S. Patent No. 6,567,790 (filed Dec. 1, 1999), available at http://www.freepatentsonline.com/6567790.html.

[18] Id. at fig. 3.

[19] The maximum gift tax rate at the time of the patent filing was 60%. Id. at col.4 l.65.

[20] Id. It doesn't matter that, after the ten-year term of the SOGRAT, it is estimated that the beneficiaries will actually receive approximately $8,000,000. Id. at col.5 l.50.

[21] Seidenberg, supra note 5.

[22] Camp Announces Hearing on Issues Relating to the Patenting of Tax Advice: Advisory from the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means, 109th Cong., 2d Sess. (June 27, 2006), http:// waysandmeans.house.gov/hearings.asp?formmode=view&id=5075 (last visited Dec. 21, 2006).

[23] Ways and Means Hearing, supra note 6.

[24] Ways and Means Hearing, supra note 6.

[25] Ways and Means Hearing, supra note 6 (statements of James Toupin, General Counsel, U.S. Patent and Trademark Office; The Honorable Mark Everson, Commissioner, I.R.S.; Richard S. Gruner, Professor, Whittier Law School; Ellen Aprill, Professor, Loyola Law School; Dennis I. Belcher, Partner, McGuire Woods LLP; and Stephen T. Schreiner, Partner, Hunton & Williams LLP).

[26] Ways and Means Hearing, supra note 6 (statements of The Honorable Mark Everson, Commissioner, I.R.S.; Richard S. Gruner, Professor, Whittier Law School; Dennis I. Belcher, Partner, McGuire Woods LLP; and Stephen T. Schreiner, Partner, Hunton & Williams LLP).

[27] Ways and Means Hearing, supra note 6 (statements of The Honorable Mark Everson, Commissioner, I.R.S.; Richard S. Gruner, Professor, Whittier Law School; Ellen Aprill, Professor, Loyola Law School; and Dennis I. Belcher, Partner, McGuire Woods LLP).

[28] Ways and Means Hearing, supra note 6 (statements of The Honorable Mark Everson, Commissioner, I.R.S.; Ellen Aprill,

Professor, Loyola Law School; and Dennis Belcher, Partner, McGuire Woods LLP).

[29] Ways and Means Hearing, supra note 6 (statement of Stephen T. Schreiner, Partner, Hunton & Williams LLP).

[30] Ways and Means Hearing, supra note 6 (statements of The Honorable Mark Everson, Commissioner, I.R.S.; Richard S. Gruner, Professor, Whittier Law School; Ellen Aprill, Professor, Loyola Law School; and Dennis I. Belcher, Partner, McGuire Woods LLP).

[31] Ways and Means Hearing, supra note 6 (statement of Ellen Aprill, Professor, Loyola Law School).

[32] See supra Section II (discussing the immeasurability of the harm that might come from the public's misperception that a patent indicates the I.R.S. approval of a tax strategy).

[33] See supra Section II (concluding that the USPTO should be able to effectively analyze tax strategy patents once a sufficient knowledge base is established).

[34] U.S. Const. art. I, §8, cl. 8.

[35] Ways and Means Hearing, supra note 6 (statement of Ellen Aprill, Professor, Loyola Law School).

[36] Figg, supra note 4, at 3.

[37] See Ways and Means Hearing, supra note 6 (statement of Stephen T. Schreiner, Partner, Hunton & Williams LLP) (discussing the various times in the history of our patent laws where critics argued that emerging technologies should not be patentable).

[38] Figg, supra note 4, at 3.

[39] Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

[40] In fact, the policy of incentivizing innovation must rest, at least partly, on the premise that costs are incurred by those who innovate. Otherwise, there would be no reason to compensate inventors.

[41] One could argue that some taxpayers begin at zero net cost just like the product manufacturer. However, this doesn't weaken the argument because this would only be the case for the taxpayer who is unable--through any tax strategy whatsoever--to reduce his tax bill. In other words, the taxpayer that begins with zero net cost has already realized his minimum tax bill. People in that position are not the kind of taxpayer with which this debate is concerned, since no tax strategies can help them.

[42] Admittedly, the taxpayer is still in the red as far as the tax bill is concerned; nobody can escape taxation. But, through the use of the tax strategy, the taxpayer's tax bill is lower than it was at the beginning of the transaction. Thus, there is a net gain for the overall transaction.

[43] See Jacobs, supra note 9, at 44 ("Before the [patent] system was put in place, people would keep things secret to maximize their competitive advantage .... With financial services, in particular, advisers and their clients were often asked to sign a confidentiality agreement as a condition of learning the specifics of a particular strategy." (citations omitted)).

[44] This because the taxpayer starts the transaction with a net loss, and the tax strategy reduces that cost.

[45] Figg, supra note 4, at 3.

[46] Ways and Means Hearing, supra note 6 (statement of Ellen Aprill, Professor, Loyola Law School).

[47] Ways and Means Hearing, supra note 6 (question from Congresswoman Stephanie Tubbs Jones, Member, House Comm. On Ways and Means, found in the Hearing Transcript).

[48] Professor Gruner responded by saying, "Well, let me just say that it is not as scary as that suggests because the techniques used in the courtroom and legal practice generally are the common techniques. That is the methodology that is already known." Ways and Means Hearing, supra note 6 (response from Richard S. Gruner, Professor, Whittier Law School, found in the Hearing Transcript). Professor Gruner's response was probably accurate because Congresswoman Tubbs Jones' question did not present any novel methods. However, Professor Gruner did not address the underlying thrust of the question, namely, whether allowing patents on legal methods would be detrimental to our country's legal system.

[49] See Figg, supra note 4, at 3 & 46 n.6 (summarizing the criticisms presented at the Ways and Means hearing, but failing to mention the argument that legal methods may present different problems for the patent system).

[50] See supra Section III.

[51] Ways and Means Hearing, supra note 6 (statement of Dennis I. Belcher, Partner, McGuire Woods LLP).

[52] State St. Bank & Trust Co. v. Signature Fin. Group, Inc., 149 F.3d 1368 (Fed. Cir. 1998).

[53] Ways and Means Hearing, supra note 6 (statement of James Toupin, General Counsel, U.S. Patent and Trademark Office).

[54] Ways and Means Hearing, supra note 6 (statement of Ellen Aprill, Professor, Loyola Law School).

[55] Figg, supra note 4, at 45 (citations omitted).

[56] Cf. William H. Rehnquist, The Legal Profession Today, 62 Ind. L.J. 151 (1987) (noting that in 1905, Louis D. Brandeis lamented that the practice of law was becoming more like a business).

[57] See supra Section III.

[58] See supra Section III.

[59] Figg, supra note 4, at 45 (citations omitted).

[60] See supra note 7 and accompanying text.

[61] U.S. Patent No. 6,049,811 col.17 l.41 (filed Nov. 26, 1996), available at http://www.freepatentsonline.com/6049811.html (last visited Apr. 14, 2007).

[62] Ways and Means Hearing, supra note 6 (statement of Dennis I. Belcher, Partner, McGuire Woods LLP).

[63] See Press Release, Bill Lockyer, Att'y Gen., State of California, Attorney General Bill Lockyer Files "Friend of Court" Brief Over Unocal Gasoline Patent (Sept. 14, 2000), http://ag.ca.gov/newsalerts/release.php? id=743&year=2000&month=9 (describing the brief in which Lockyer argued "that an oil company should not be able to 'hijack and distort' the state regulatory process by claiming a patent on gasoline formulas developed in cooperation with the government to meet clean air standards") (last visited Apr. 15, 2007).

[64] Janice M. Mueller, Patent Misuse Through the Capture of Industry Standards, 17 Berkeley Tech. L.J. 623, 684 (2002).

[65] 35 U.S.C. §287(c) (2006).

[66] See generally Eric M. Lee, 35 U.S.C. § 287(c)--The Physician Immunity Statute, 79 J. Pat. & Trademark Off. Soc'y 701 (1997) (describing the statute and the background leading to its enactment).

[67] 35 U.S.C. §287(c).

[68] In contrast to removing legal methods from the patentable subject matter allowed by 35 U.S.C. §101.

[69] See discussion infra Section VI.

[70] See discussion supra Sections III-IV. Admittedly, there will likely be costs associated with improperly granted patents (e.g., the cost of litigating to an invalidity result, invalidity opinions, etc.). No system will be perfect. However, proclaiming these methods unpatentable will at least signal to tax planners and legal practitioners alike that they should not waste resources attempting to patent aspects of their profession.

[71] Because Congress has been recently unable to agree on any patent reform proposals, the opportunity for a solution through judicial response is a plus to anyone supporting reform.

[72] See U.S. Const. art. I, §8, cl. 8.

[73] Many law review articles address this topic. E.g., Alan L. Durham, "Useful Arts" in the Information Age, 1999 BYU L. Rev. 1419; Robert I. Coulter, The Field of the Statutory Useful Arts: Part II, 34 J. Pat. Off. Soc'y 487 (1952).

[74] See Durham, supra note 73; Coulter, supra note 73.

[75] Diamond v. Chakrabarty, 447 U.S. 303, 309 (1980) (quotation and citation omitted).

[76] Cf. State St. Bank & Trust Co. v. Signature Fin. Group, Inc., 149 F.3d 1368 (Fed. Cir. 1998).

[77] 447 U.S. at 305.

[78] 149 F.3d at 1370.

[79] The preamble to claim 1 declares, "A method for minimizing transfer tax liability of a grantor for the transfer of the value of nonqualified stock options to a family member grantee, the stock options having a stated exercise price and a stated period of exercise, the method performed at least in part within a signal processing device and comprising ...." U.S. Patent No. 6,567,790 col.7 l.62 (filed Dec. 1, 1999) (emphasis added), available at http://www.freepatentsonline.com/6567790.html.

[80] As an example, the Texas legislature has defined the practice of law:
[T]he "practice of law" means the preparation of a pleading or other document incident to an action or special proceeding or the management of the action or proceeding on behalf of a client before a judge in court as well as a service rendered out of court, including the giving of advice or the rendering of any service requiring the use of legal skill or knowledge, such as preparing a will, contract, or other instrument, the legal effect of which under the facts and conclusions involved must be carefully determined.
Tex. Gov't Code Ann. §81.101(a) (Vernon 2005).