Congress recently enacted legislation intended, with limited exceptions, to prohibit patents on tax strategies. The events leading to adoption of this statute and the potential aftermath present important issues relating to the differing objectives of the tax and patent systems.

The possibility that tax strategies could be patented can be traced to the Federal Circuit’s 1998 decision in *State Street Bank & Trust Co. v. Signature Financial Group*, 149 F.3d 1368. Although *State Street* is known as the seminal case on the patentability of business methods, the patent claims at issue included tax reduction strategies. *State Street* may therefore be the first tax patent case. Tax patents received modest attention after *State Street* until the filing in January 2006 of a patent infringement action involving a tax and estate planning method for transferring compensatory stock options (the “SOGRAT” strategy). The SOGRAT lawsuit dramatically raised public awareness of tax patents not only because it implicated a tax planning strategy but also because many estate planners considered that strategy to be an obvious and well-known technique. The case provoked widespread concern regarding the potential for patenting tax strategies and the attendant implications for the tax system.

Tax patents have inspired disparate reactions in the tax and patent communities. Patent experts perceived the issue as a small part of the much larger question of whether business methods, including tax strategies, could be patented at all, a subject that the Supreme Court recently sidestepped in *Bilski v. Kappos*, 130 S. Ct. 3218 (2010). For patent lawyers, there was no important policy reason to distinguish tax strategy business

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methods from other business methods. Patent law, they argued, should be applied neutrally across technologies, whether by judicial analysis or statute, and regardless of the concerns expressed by tax practitioners. They noted that although problems had often arisen as the patent law was applied to new technologies, exceptions had not been created as a result. In one sense, the problems with tax patents, even if valid, were simply a cost of maintaining the integrity of the patent system.

The reaction to tax patents among tax professionals was profoundly different. Knowledge of tax strategies is generally available through discussion, publication, and otherwise; this minimizes the significance of one policy justification – dissemination of new ideas – for granting patents. Encouraging innovation, another important policy justification for patents, struck many as singularly inappropriate for tax patents. As Professor Ellen P. Aprill testified at a July 2006 Congressional hearing “… it would be hard to identify a subject less in need of further innovation than tax planning. Existing economic incentives already provide ample inducement for the development, promotion, and implementation of tax planning strategies.” Moreover, the source and focus of tax strategies – laws enacted by governments – seemed ill-suited to the right to exclude others from using the invention protected by a patent. In addition, the existence of tax strategy patents posed challenging questions as to ownership of the invention, which party could be held responsible for infringement, and ethical and other professional responsibility concerns. Finally, the initial experience with the patent system did not inspire confidence that administrators could apply basic patent requirements such as novelty and non-obviousness on a consistent basis to identify tax strategies that should be recognized as patentable inventions.
The congressional response to tax patents was consistently negative, starting with hearings held in July 2004 and July 2006, and followed by numerous legislative proposals introduced in early 2007 and afterward. The principal obstacle to enacting a legislative response was jurisdictional. As a practical matter, a legislative remedy could be fashioned only in the judiciary committees, not the tax writing committees. This dilemma was finally resolved by incorporating a tax patent statute within the broader context of a patent reform bill, which was eventually enacted.

It remains to be seen whether the new patent law provides a satisfactory solution from the perspective of tax professionals. Some believe that creative drafting of patent claims may be used to avoid the intended objectives of the new law. Others have noted that exceptions in the statute for tax preparation programs and for financial management may provide room to work around the new limitations. Moreover, it may take years of administrative experience, litigation, and judicial decisions before the scope of the new statute becomes clear. Finally, the courts must still grapple with the general issue of whether and under what circumstances business methods, including tax strategies, may be patented, a process that also may take some time to yield useful guidance. In the interim, tax practitioners may take comfort from the recent sympathetic intervention by Congress, which may influence future administrative and judicial responses.