

February 28, 2007

The Honorable Max Baucus
Chairman
Senate Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Charles Grassley
Ranking Minority Member
Senate Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Charles B. Rangel
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Jim McCrery
Ranking Minority Member
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Patents for Tax Strategies

Dear Chairman Baucus, Chairman Rangel, Senator Grassley, Representative McCrery:

The American Institute of Certified Public Accountants (AICPA) believes that patents for tax strategies undermine the integrity, fairness, and administration of the tax system and are contrary to sound public policy. We would like to work with you to develop and enact legislation to restrict this type of patent as soon as possible.

The AICPA is the national professional association of approximately 350,000 Certified Public Accountants throughout the country. We have worked closely with Congress and taxing authorities for many years to ensure equity, fairness and simplicity in our tax system. Our members play a major role helping millions of individual taxpayers and businesses, located in every state in the United States, to comply with federal, state and local tax law. The AICPA and our members have extensive experience in rendering advice to taxpayers on matters of tax planning and compliance. From this unique vantage point, we have considered the broad impact of tax strategy patents on taxpayers, professional tax advisers, and the public interest.

EXECUTIVE SUMMARY

In our view, patents granted for tax strategies:

- Limit the ability of taxpayers to utilize fully interpretations of tax law intended by Congress;
- May cause some taxpayers to pay more tax than Congress intended and may cause other taxpayers to pay more tax than others similarly situated;
- Complicate the provision of tax advice by professionals;
- Hinder compliance by taxpayers;

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- Mislead taxpayers into believing that a patented strategy is valid under the tax law; and
- Preclude tax professionals from challenging the validity of tax strategy patents.

DISCUSSION

Our concern is with patents for methods used by taxpayers in arranging their affairs to minimize tax obligations. Patents on tax strategies may limit the ability of taxpayers to utilize fully interpretations of the law intended by Congress. As a result, they thwart Congressional intent and thus undermine the integrity of, and the public's confidence in, the tax system. They also unfairly cause some taxpayers to pay more tax than intended by Congress and cause some taxpayers to pay more tax than others similarly situated. The conflict with Congressional intent highlights a serious policy reason against allowing patent protection for interpreting the law. Allowing patents on strategies for complying with any law or regulation is not sound public policy because it creates an exclusivity on interpreting the law.

We are concerned as well with simplicity and administration of tax law. Tax strategy patents greatly complicate tax advice provided by tax professionals and compliance by taxpayers, both of whom need to understand the impact of such patents on their ability to comply with the tax law. Tax law is already quite complex. The addition of rapidly proliferating patents on tax planning techniques and concepts will render tax compliance much more difficult.

Patents are granted by the federal government, posing a significant risk in the case of tax strategy patents. Taxpayers may be misled into believing that a patented tax strategy bears the approval of other government agencies, such as the IRS, and therefore is a valid and viable technique under tax law. This is not the case.

Furthermore, tax professionals may be unable as a practical matter to challenge the validity of tax strategy patents as being obvious or lacking novelty, or to defend themselves from patent infringement lawsuits because of their professional obligations of client confidentiality. The U.S. Patent and Trademark Office will also find it difficult, if not impossible, to determine whether proposed tax strategies meet the statutory requirements for patentability because tax advice is generally provided on a confidential basis.

The usefulness of tax strategy patents is also questionable. It appears that some of these patents may be sought for the purpose of preventing tax advisers and taxpayers from using otherwise legally permissible tax planning techniques unless they pay a royalty.

PROPOSED SOLUTION

We have considered administrative solutions to this issue and concluded that they are not sufficient to solve the problems identified above. Therefore, the AICPA encourages your

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respective tax-writing committees to develop legislation to eliminate the harmful consequences of tax strategy patents by either: (1) restricting the issuance of patents for tax strategies; or (2) providing immunity from patent infringement liability for taxpayers and tax practitioners. We recognize that there may be value in patents for certain commercially available tax preparation and reporting software and concur with IRS Commissioner Mark Everson, who has publicly stated that granting a patent for such software, as discussed in section V of our attached analysis, could be beneficial to taxpayers and should not be prohibited by any new legislation.

Our analysis and recommendations are more fully stated in the enclosed paper. [This analysis is available electronically at <http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm>.] We also generally concur in the views expressed by IRS Commissioner Mark Everson, Professor Ellen Aprill, and Mr. Dennis Belcher, who testified at the July 13, 2006, Subcommittee on Select Revenue Measures of the House of Representatives Committee on Ways and Means hearing, and the New York State Bar Association Tax Section in a letter dated August 17, 2006 to the leadership of the tax-writing committees and Subcommittee.

CONCLUSION

As Congress considers whether to make any changes to the rules governing patents for tax strategies, we hope these suggestions will be considered. We look forward to working with you and Congress on this issue.

If you have any questions or if we can be of further assistance, please contact me at jeffrey.hoops@ey.com, or (212) 773-2858; Justin P. Ransome, Chair, AICPA Tax Patent Task Force, at justin.ransome@gt.com, or 202-521-1520; or Eileen Sherr, AICPA Technical Manager, at esherr@aicpa.org, or (202) 434-9256.

Sincerely,



Jeffrey R. Hoops
Chair, AICPA Tax Executive Committee

Enclosures

CC: The Honorable Patrick J. Leahy, Chairman, Senate Committee on the Judiciary
The Honorable Arlen Specter, Ranking Minority Member, Senate Committee on the Judiciary
The Honorable John Conyers, Jr., Chairman, House Committee on the Judiciary
The Honorable Lamar S. Smith, Ranking Minority Member, House Committee on the Judiciary

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The Honorable Howard L. Berman, Chairman Subcommittee on Courts, the Internet, and Intellectual Property, House Committee on the Judiciary
The Honorable Howard Coble, Ranking Minority Member, Subcommittee on Courts, the Internet, and Intellectual Property, House Committee on the Judiciary
Mr. Jon W. Dudas, Under Secretary of Commerce for Intellectual Property and Director of the U.S. Patent and Trademark Office
Mr. Wynn Coggins, Director of Technology Center 3600, U.S. Patent and Trademark Office
Mr. Russell Sullivan, Staff Director, Senate Committee on Finance
Mr. Kolan Davis, Republican Staff Director, Senate Committee on Finance
Mr. Patrick G. Heck, Chief Tax Counsel, Senate Committee on Finance
Mr. Mark Prater, Republican Chief Tax Counsel, Senate Committee on Finance
Ms. Elizabeth Paris, Republican Tax Counsel, Senate Committee on Finance
Mr. Ryan Abraham, Tax Assistant, Senate Committee on Finance
Mr. Nick Wyatt, Republican Tax Assistant, Senate Committee on Finance
Ms. Janice Mays, Staff Director and Chief Counsel, House Committee on Ways & Means
Mr. John Buckley, Chief Tax Counsel, House Committee on Ways & Means
Mr. Brett Loper, Republican Staff Director, House Committee on Ways and Means
Mr. John Traub, Republican Chief Tax Counsel, House Committee on Ways and Means
Mr. Chris Giosa, Chief Economist and Tax Adviser, House Committee on Ways and Means
Mr. John Gimigliano, Senior Tax Counsel, House Committee on Ways and Means, Subcommittee on Select Revenue Measures
Mr. Thomas A. Barthold, Acting Chief of Staff, Joint Committee on Taxation
Mr. Melvin C. Thomas, Jr., Senior Legislation Counsel, Joint Committee on Taxation
Mr. Eric Solomon, Assistant Secretary for Tax Policy, Treasury Department
Mr. Michael J. Desmond, Tax Legislative Counsel, Tax Legislative Counsel, Treasury Department
Ms. Catherine Hughes, Tax Legislative Counsel, Attorney-Adviser, Treasury Department
Mr. Mark Everson, Commissioner, IRS
Ms. Aileen Condon, Chief, Estate and Gift Tax Program, SBSE, SB/SE Headquarters
SE:S:C:CP:EG, IRS
Mr. Edward Saylor, Senior Program Manager, IRS

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Chairman
Subcommittee on Courts, the Internet,
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House Committee on the Judiciary
B-352 Rayburn House Office Building
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The Honorable Howard Coble
Ranking Minority Member
Subcommittee on Courts, the Internet,
and Intellectual Property
House Committee on the Judiciary
B-336 Rayburn House Office Building
Washington, D.C. 20515

Re: Patents for Tax Strategies

Dear Chairman Leahy, Chairman Conyers, Chairman Berman, Senator Specter, Representative Sensenbrenner, Representative Coble:

Today, patents granted for tax strategies are contrary to sound public policy because they undermine the integrity, fairness, and administrability of the tax system. The American Institute of Certified Public Accountants (AICPA) has a real concern that the growing number of such patents will interfere with the voluntary tax compliance system, and we would like to work with you to develop and enact legislation to restrict the application of this type of patent as soon as possible.

The AICPA is the national professional association of approximately 350,000 Certified Public Accountants throughout the country. We have worked closely with Congress and taxing authorities for many years to ensure equity, fairness and simplicity in our tax system. Our members play a major role helping millions of individual taxpayers and businesses, located in every state in the United States, to comply with federal, state and local tax law. The AICPA and our members have extensive experience in rendering advice to taxpayers on matters of tax planning and compliance. From this unique vantage point, we have considered the broad impact of tax strategy patents on taxpayers, professional tax advisers, and the public interest.

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EXECUTIVE SUMMARY

In our view, patents granted for tax strategies:

- Limit the ability of taxpayers to utilize fully interpretations of tax law intended by Congress;
- May cause some taxpayers to pay more tax than Congress intended and may cause other taxpayers to pay more tax than others similarly situated;
- Complicate the provision of tax advice by professionals;
- Hinder compliance by taxpayers;
- Mislead taxpayers into believing that a patented strategy is valid under the tax law; and
- Preclude tax professionals from challenging the validity of tax strategy patents.

DISCUSSION

Our concern is with patents for methods used by taxpayers in arranging their affairs to minimize tax obligations. Patents on tax strategies may limit the ability of taxpayers to utilize fully interpretations of tax law intended by Congress. As a result, they thwart Congressional intent and thus undermine the integrity of, and the public's confidence in, the tax system. They also unfairly cause some taxpayers to pay more tax than intended by Congress and cause some taxpayers to pay more tax than others similarly situated. The conflict with Congressional intent highlights a serious policy reason against allowing patent protection for interpreting the law. Allowing patents on strategies for complying with any law or regulation is not sound public policy because it creates an exclusivity on interpreting the law.

We are also concerned with administration of the tax law, as well as with the interrelationship of tax and patent law. Tax strategy patents greatly complicate the provision of tax advice by professionals and compliance by taxpayers, both of whom need to understand the impact of such patents on their ability to comply with the tax law. Tax law is already quite complex. The addition of rapidly proliferating patents on planning techniques and concepts will render compliance much more difficult.

Patents are granted by the federal government, posing a significant risk in the case of tax strategy patents. Taxpayers may be misled into believing that a patented tax strategy bears the approval of other government agencies, such as the IRS, and therefore is a necessarily valid and viable technique under tax law. This is not the case.

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Furthermore, the fact that patents are government approved imposes a further potential risk. Tax professionals may be unable as a practical matter to challenge the validity of tax strategy patents as being obvious or lacking novelty, or to defend themselves from patent infringement lawsuits because of their professional obligations of client confidentiality. The U.S. Patent and Trademark Office will also find it difficult, if not impossible, to determine whether proposed tax strategies meet the statutory requirements for patentability because tax advice is generally provided on a confidential basis.

Furthermore, tax professionals may be unable as a practical matter to challenge the validity of tax strategy patents as obvious or lacking novelty, or to defend themselves from patent infringement lawsuits because of their professional obligations of client confidentiality. The U.S. Patent and Trademark Office will also find it difficult, if not impossible, to determine whether proposed tax strategies meet the statutory requirements for patentability because tax advice is generally provided on a confidential basis.

The usefulness of tax strategy patents is also questionable. It appears that some of these patents may be sought for the purpose of preventing tax advisers and taxpayers from using otherwise legally permissible tax planning techniques unless they pay a royalty.

PROPOSED SOLUTION

We have considered administrative solutions to this issue and concluded that they are not sufficient to solve the problems identified above. The AICPA encourages your respective Judiciary Committees to develop legislation to eliminate the harmful consequences of tax strategy patents by either: (1) restricting the issuance of patents for tax strategies; or (2) providing immunity from patent infringement liability for taxpayers and tax practitioners (see analysis section V.). We recognize that there may be value in patents for certain commercially available tax computation software and concur with IRS Commissioner Mark Everson, who has publicly stated that granting a patent for such software, as discussed in section V of our attached analysis, could be beneficial to taxpayers and should not be prohibited by any new legislation.

Our analysis and recommendations are more fully stated in the enclosed paper. [This analysis is available electronically at <http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm>.] We also generally concur in the views expressed by IRS Commissioner Mark Everson, Professor Ellen Aprill, and Mr. Dennis Belcher, who testified at the July 13, 2006, Subcommittee on Select Revenue Measures of the House of Representatives Committee on Ways and Means hearing, and the New York State Bar Association Tax Section in a letter dated August 17, 2006 to the leadership of the tax-writing committees and Subcommittee.


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CONCLUSION

As Congress considers whether to make any changes to the rules governing patents for tax strategies, we hope these suggestions will be considered. We look forward to working with you and the entire Congress on this issue.

If you have any questions or if we can be of further assistance, please contact me at jeffrey.hoops@ey.com, or (212) 773-2858; Justin P. Ransome, Chair, AICPA Tax Patent Task Force, at justin.ransome@gt.com, or 202-521-1520; or Eileen Sherr, AICPA Technical Manager, at esherr@aicpa.org, or (202) 434-9256.

Sincerely,



Jeffrey R. Hoops
Chair, AICPA Tax Executive Committee

Enclosures

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The Honorable Charles B. Rangel, Chairman, House Ways and Means Committee
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Mr. Jon W. Dudas, Under Secretary of Commerce for Intellectual Property and Director of the U.S. Patent and Trademark Office
Mr. Wynn Coggins, Director of Technology Center 3600, U.S. Patent and Trademark Office
Ms. Susan Davies, Chief Counsel, Intellectual Property, Senate Committee on the Judiciary
Ms. Ryan Triplette, Counsel, Republican Staff, Senate Committee on the Judiciary
Mr. Dave Jones, Counsel, Republican Staff, Senate Committee on the Judiciary
Ms. Shanna Winters, Chief Counsel and Staff Director, Subcommittee on Courts, the Internet, and Intellectual Property, Committee on the Judiciary,
Mr. Blaine Merritt, Minority Staff Director, Subcommittee on Courts, the Internet, and Intellectual Property, Committee on the Judiciary

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Analysis and Legislative Proposals Regarding

Patents for Tax Strategies

February 28, 2007

I. Introduction

The American Institute of Certified Public Accountants (AICPA), the national professional association of approximately 350,000 Certified Public Accountants (CPAs) throughout the country, has developed our analysis and recommendations regarding tax strategy patents.¹

The AICPA has worked closely with Congress and taxing authorities for many years to ensure equity, fairness and simplicity in our tax system. Our members play a major role helping millions of individual taxpayers and businesses, located in every state in the United States (U.S.), to comply with federal, state and local tax law. The AICPA and our members have extensive experience in rendering advice to taxpayers on matters of tax planning and compliance. From this unique vantage point, we have considered the broad impact of the tax strategy patents on taxpayers, professional tax advisers, and the public interest.

II. Executive Summary

The AICPA believes that patents for tax strategies undermine the integrity, fairness, and administration of the tax system and are contrary to sound public policy. We would like to work with Congress to develop and enact legislation to restrict this type of patent as soon as possible.

In our view, patents granted for tax strategies:

- Limit the ability of taxpayers to utilize fully interpretations of tax law intended by Congress;
- May cause some taxpayers to pay more tax than Congress intended and may cause other taxpayers to pay more tax than others similarly situated;
- Complicate the provision of tax advice by professionals;
- Hinder compliance by taxpayers;
- Mislead taxpayers into believing that a patented strategy is valid under the tax law; and
- Preclude tax professionals from challenging the validity of tax strategy patents.

Our concern is with granting of patents for methods used by taxpayers in arranging their affairs to minimize tax obligations. Patents on tax strategies may limit the ability of taxpayers to utilize

¹ This analysis is available electronically at <http://tax.aicpa.org/Resources/Tax+Patents/AICPA+Urges+Congress+to+Address+Tax+Strategy+Patents.htm>.

fully interpretations of the law intended by Congress. As a result, they thwart Congressional intent and thus undermine the integrity of, and the public's confidence in, the tax system. They also unfairly cause some taxpayers to pay more tax than intended by Congress and cause some taxpayers to pay more tax than other taxpayers who are similarly situated (*see* Section IV.A. below). The conflict with Congressional intent highlights a serious policy reason against allowing patent protection for interpreting the law. Allowing patents on strategies for complying with any law or regulation is not sound public policy because it creates an exclusivity on interpreting the law.

We are concerned as well with simplicity and administration of tax law. Tax strategy patents greatly complicate tax advice provided by professionals and compliance by taxpayers, both of whom need to understand the impact of such patents on their ability to comply with the law. Tax law itself is already quite complex. The addition of rapidly proliferating patents on planning techniques and concepts will render compliance much more difficult (*see* Section IV.B. below).

Patents are granted by the federal government, posing a significant risk in the case of tax strategy patents. Taxpayers may be misled into believing that a patented tax strategy bears the approval of other government agencies, such as the IRS, and therefore is a valid and viable technique under tax law. This is not the case.

Furthermore, tax professionals may be unable as a practical matter to challenge the validity of tax strategy patents as being obvious or lacking novelty, or to defend themselves from patent infringement lawsuits because of their professional obligations of client confidentiality. The U.S. Patent and Trademark Office (Patent Office) will also find it difficult, if not impossible, to determine whether proposed tax strategies meet the statutory requirements for patentability because tax advice is generally provided on a confidential basis (*see* Section IV.D below).

The usefulness of tax strategy patents is also questionable. It appears that some of these patents may be sought for the purpose of preventing tax advisers and taxpayers from using otherwise legally permissible tax planning techniques unless they pay a royalty.

We have considered administrative solutions to this issue and concluded that they are not sufficient to solve the problems identified above. Therefore, the AICPA encourages Congress to develop legislation to eliminate the harmful consequences of tax strategy patents by either: (1) restricting the issuance of patents for tax strategies; or (2) providing immunity from patent infringement liability for taxpayers and tax practitioners (*see* analysis section V.). We recognize that there may be value in patents for certain commercially available tax computation software and concur with IRS Commissioner Mark Everson, who has publicly stated that "granting a patent for a novel type of tax computation software" could be beneficial to taxpayers and should not be prohibited by any new legislation (*see* section V. below).

III. Background

The patentability of tax strategies is a growing concern among tax practitioners and taxpayers.

The Patent Act of 1952 (Patent Act) provides that patents may be granted for innovations that are useful, novel, and non-obvious.² A patent gives its holder the exclusive right to make, use and sell the patented invention.³ The consequences of infringing a patent can be substantial. The remedies for patent infringement include injunctive relief and money damages equal to lost profits or a reasonable royalty.⁴ Money damages can be trebled in cases of willful infringement, and attorney's fees can be awarded to the prevailing party in exceptional cases.⁵ Issued patents are presumed valid, and an accused infringer must overcome this presumption with clear and convincing evidence to invalidate a patent.⁶ Even if an accused infringer is not found liable, the cost of defending the lawsuit can be millions of dollars.⁷

In 1998, the U.S. Federal Circuit Court of Appeals, in *State Street Bank & Trust v. Signature Financial Group, Inc.*, held that business methods could be patented.⁸ Since then, 51 patents for tax strategies have been granted and 83 patent applications for tax strategies are pending.⁹ Patents for tax strategies have already been granted in a variety of areas, including the use of financial products, charitable giving, estate and gift tax, pension plans, tax-deferred exchanges, and deferred compensation. We expect many more tax strategy patents to be issued, directly targeting average taxpayers in a host of areas including: (1) income tax minimization; (2) alternative minimum tax (AMT) minimization; and (3) income tax itemized deduction maximization.

² Pub. L. No. 82-593, 66 Stat. 792. See 35 U.S.C. §§ 101-103 & 112 (2007).

³ 35 U.S.C. § 271 (2007).

⁴ 35 U.S.C. §§ 283-84 (2007).

⁵ 35 U.S.C. § 284-85 (2007).

⁶ 35 U.S.C. § 282 (2007).

⁷ According to the 2005 economic survey prepared by the American Intellectual Property Law Association (AIPLA), the total cost to litigate a patent infringement suit with \$1 million to \$25 million at risk ranged from \$1.25 to \$3.5 million, and from \$3.1 to 9.4 million when more than \$25 million was at risk. AIPLA Report of the Economic Survey 2005, Law Practice Management Committee, American Intellectual Property Association, 2005, at 23, I-109, 110. These costs cover a "typical case with no unusual complications" involving only one patent. *Id.* at 2-3.

⁸ 149 F.3d 1368 (Fed. Cir. July 23, 1998). Business methods include business practices in many fields such as: health care management, insurance and insurance processing, reservation and booking systems, financial market analyses, point of sale systems, tax processing, inventory management, and accounting and financial management.

⁹ The Patent Office now classifies tax strategy patents as subclass 36T in Class 705, "Data Processing: Financial, Business Practice, Management, or Cost/Price Determination." (See <http://www.uspto.gov/go/classification/uspc705/sched705.htm>.) As of January 3, 2007, the Patent Office website lists 51 patents that have been issued in that subclass and that 83 such applications are pending (published applications not yet examined/granted). (See <http://patft.uspto.gov/netacgi/nph-Parser?Sect1=PTO2&Sect2=HITOFF&u=/netahtml/PTO/searchadv.htm&r=0&p=1&f=S&l=50&Query=ccl/705/36T&d=PTXT> and <http://appft1.uspto.gov/netacgi/nph-Parser?Sect1=PTO2&Sect2=HITOFF&u=%2Fnetacgi%2FPTO%2Fsearchadv.html&r=0&f=S&l=50&d=PG01&OS=ccl%2F&RS=CCL%2F705%2F36T&PrevList1=Prev.+50+Hits&TD=81&Srch1=705%252F36T.CCLS.&StartNum=&Query=ccl%2F>).

The primary catalyst for the AICPA's concern, and the concern of other tax practitioners, was the filing of an infringement suit over "the *SOGRAT* patent" in early 2006.¹⁰ Awarded by the Patent Office to Mr. Robert C. Slane of Wealth Transfer Group, L.L.C, the *SOGRAT* patent describes an estate planning technique called a grantor retained annuity trust (GRAT) that is funded with nonqualified stock options. GRATs are permitted by the Tax Code.¹¹ Tax professionals were surprised that a patent could be granted for a variation of such a common transfer tax planning technique.

Congressional taxwriters have become concerned with the patenting of tax strategies as well. On July 13, 2006, the Subcommittee on Select Revenue Measures of the House of Representatives Committee on Ways and Means (Subcommittee) held a hearing on the patenting of tax strategies. The AICPA voiced its concerns about tax strategy patents to Congressional staff prior to the hearing. We also generally concur in the views expressed by IRS Commissioner Mark Everson, Professor Ellen Aprill, and Mr. Dennis Belcher, who testified at the July 13, 2006, Subcommittee hearing, and the New York State Bar Association Tax Section in a letter dated August 17, 2006 to the leadership of the tax-writing committees and Subcommittee.¹²

IV. Issues and Concerns Regarding Tax Policy

Based on our long experience with the nation's tax system, the AICPA has many public policy concerns with the issuance of tax strategy patents. For the reasons below, we believe that such patents will do significant harm to the tax system and to its key participants, including taxpayers, Congress, the IRS and tax practitioners. Because of our expertise and experience, we believe that the public harm to the tax system and its participants will far outweigh any public benefit derived from tax strategy patents.

A. Tax Strategy Patents Undermine Congressional Authority and Intent Regarding Tax Law, Create Inequalities Between Taxpayers, and Threaten to Preempt Tax Law.

Patenting of tax strategies will undermine the integrity of our nation's voluntary tax system.

¹⁰ On January 6, 2006, Wealth Transfer Group L.L.C., filed a complaint in the United States District Court for Connecticut against Dr. John W. Rowe alleging that he infringed its *SOGRAT* patent for establishing and managing grantor retained annuity trusts funded with nonqualified stock options (*see Wealth Transfer Group L.L.C. v. John W. Rowe*, Docket No. 3:06-cv-00024-AWT (D. Conn.)). Wealth Transfer Group L.L.C. sought an injunction and damages against Mr. Rowe. On February 6, 2007, the parties filed a joint motion to stay the case, stating that they have agreed in principle to resolve the matter and are in the process of negotiating a formal settlement agreement.

¹¹ Specifically, GRATs are authorized in section 2702 of the Tax Code and in the Treasury regulations thereunder. *See* Treas. Reg. section 25.2702-3.

¹² *See* <http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=492> and http://www.nysba.org/Content/ContentGroups/Section_Information1/Tax_Section_Reports/1115rpt.PDF

The AICPA's *Tax Policy Concept Statement On – Guiding Principles of Good Tax Policy* contains the AICPA's ten guiding principles for good tax policy.¹³ The first of these principles is *Equity and Fairness*. Similarly situated taxpayers should be taxed similarly and have the same opportunities to apply all provisions of federal, state and local tax law. Taxpayers should pay only the minimum amount of tax required without having to pay a patent royalty or other toll charge to so comply.

Tax strategy patents undermine these goals. Tax strategy patents could require taxpayers to choose between paying a royalty and paying higher taxes than required by federal, state, or local tax law. This is contrary to public policy which demands fairness in application of tax law.

Tax strategy patents also preempt Congress's prerogative to have full legislative control over tax policy. Congress enacts tax law provisions applicable to various taxpayers and intends that taxpayers will be able to use them. Tax strategy patents thwart this Congressional intent by giving tax strategy patent holders the power to decide how select tax law provisions can be used and who can use them. If Congress wanted to restrict the use of a particular provision in this manner, that restriction would be written into the tax law. A patent holder should not be able to unilaterally restrict the use of a particular tax provision.

We are particularly concerned with the potential for private interests to apply for tax strategy patents in contemplation of tax legislation. Even before enactment, a tax strategy patent holder would have both a potential monetary windfall and an exclusive right to implement the proposed provision in a particular manner. For example, Congress may consider legislation in a specific area, such as charitable remainder trusts. As Congress is contemplating the provision, an entrepreneur or large company could develop a strategy to implement that provision and apply for a patent on it as soon as or even before the law is passed. Once the law is enacted, the patent holder could control the use of the applicable Tax Code provisions. That one individual or firm could prevent others from using the new tax provision (and thus become the sole source of tax planning that was enabled by Congress's new tax provision) or require them to pay royalties to use the provision. Congressional intent would be sabotaged by the patent holder, who would receive a windfall from Congress's actions.

The conflict with Congressional intent highlights a serious policy reason against allowing patent protection for interpreting the law. Granting patent protection for tax strategies ties the hands of Congress by limiting its ability to develop broad public policy. The Tax Code, like other laws enacted by Congress (and state legislatures), is intended to protect the public's collective interest. In a world of tax strategy patents, whenever Congress wants to pass a tax provision to accomplish a public policy goal, it will increasingly find that the provision serves the private interest of a patent holder instead of being equally available to all. Allowing private monopolies in the form of patent protection undercuts that legislative intent. Such patents permit one person to either: (a) exclude others from the advantages of particular laws; or (b) impose a surcharge on those who want to comply with particular laws. Furthermore, such patents interfere with the ethical and moral obligations that tax professionals owe to their clients to represent them to the full extent of the law.

¹³ AICPA *Tax Policy Concept Statement One - Guiding Principles of Good Tax Policy*, available at http://tax.aicpa.org/NR/rdonlyres/AC230E51-D650-4D65-B160-C7450A9381F4/0/2I_08a.pdf.

B. Tax Strategy Patents Make It More Difficult, Costly, and Confusing to Comply with and Administer the Tax Code.

Another AICPA guiding principle for good tax policy is *Economy in Collection*. Tax compliance and administration costs should be kept to a minimum for both taxpayers and federal, state and local governments. Tax strategy patents will sharply increase such costs.

According to AICPA *Tax Policy Concept Statement Two – Guiding Principles for Tax Simplification*, the ability of tax agencies to administer, provide guidance, and enforce the law must be considered in the development of legislation and administrative guidance. Tax strategy patents threaten the IRS’s ability to enforce the law, as patents are granted without ensuring that they are compliant with the Tax Code. We share the concern that IRS Commissioner Everson voiced at the Subcommittee hearing when he stated, “taxpayers may attempt to patent abusive tax schemes We recognize that the potential for significant problems could exist.” The IRS will have to expend additional resources to monitor the patented tax strategies and issue guidance or pursue additional means if a patented strategy does not comply with tax law.

Another AICPA guiding principle of good tax policy is *Transparency and Visibility*. Taxpayers should know that a tax exists and when and how it is imposed upon them. Taxpayers and practitioners will incur significant new costs to evaluate the degree to which the best method available for a taxpayer to comply with the law is covered by a patent and whether a royalty is required and should be paid. The complexity and cost of this task might cause taxpayers and practitioners to abandon a superior method under the belief that it is patented. Many taxpayers might view either royalty payments or their inability to freely use a methodology authorized by Congress as a backdoor tax increase.

Tax practitioners, regardless of whether they use a particular strategy, might become inundated with patent infringement warning letters from tax strategy patent holders, notifying them of the existence of a patent, and demanding royalties to avoid an infringement action. Some practitioners are likely to pay the royalty, whether warranted, because they fear the harsh consequences of patent infringement and a costly courtroom battle. In such cases, many taxpayers and tax practitioners might view royalty payments as a form of “legalized extortion.” If they are sued for patent infringement, they will have to bear additional costs to protect their right to apply a strategy that might not have been novel or nonobvious.

Another AICPA guiding principle for good tax policy is *Simplicity*. The tax law should be as simple as possible so that taxpayers can understand the rules and correctly apply them in a cost-efficient manner. AICPA *Tax Policy Concept Statement Two* provides that the compliance and administrative burden, in terms of both time and money, should be minimized and should be commensurate with the resources and abilities of the affected taxpayers. Tax strategy patents will significantly increase the compliance burden and costs. To minimize potential liability, both taxpayers and tax practitioners will have to take a series of additional steps in response to known tax strategy patents. These additional steps might include:

1. The need to determine if a particular course of action selected for a taxpayer is a patented strategy;

2. If patented or similar to something covered by a patent, the need to determine whether royalties should be paid, or whether professional patent counsel is needed to investigate the patent further and determine whether the proposed action infringes on the patent;
3. If a strategy falls into a gray area, the need to determine if the risk of infringement is low enough to avoid paying a royalty; and
4. If it is determined that a patent does apply, the need to determine whether to negotiate with the patent holder in order to utilize the strategy.

Implementing these steps is likely to prove costly and impractical for many taxpayers and tax practitioners. Even a simple transaction can involve the application of numerous provisions of the Tax Code; it is difficult to imagine how taxpayers and practitioners will determine whether the application of so many provisions infringes any of what could, someday, be hundreds or thousands of tax strategy patents.

Another AICPA guiding principle of good tax policy is *Certainty*. The tax rules should clearly specify when, how and what amount of tax should be paid. Tax strategy patents create traps for taxpayers. We are especially concerned that the public will be misled into believing that if a tax strategy is patented, it meets the requirements of the Tax Code and is audit-proof. In fact, this is not the case. The Patent Office issues tax strategy patents without determining their permissibility under the tax law and without consulting the IRS. The use of a patented strategy that is not permitted under the Tax Code can subject innocent taxpayers to additional taxes, plus penalties and interest. The IRS does not view a patent as an appropriate basis to waive penalties.¹⁴

We believe that it will be difficult, if not impossible, to “teach” unsuspecting taxpayers that a patent’s government imprimatur and validation does not carry with it the authorization of the IRS. Should a taxpayer learn about this in an IRS audit, we believe the taxpayer might feel cheated, tricked, and confused by the government. In addition, we believe that many tax strategies may be patented solely to take advantage of the public’s misperception. We expect patent strategy marketers to entice unsuspecting taxpayers to pay royalties for tax strategies, only because of perceived government validation. While many tax strategies are targeted at wealthy taxpayers, it is likely that new “patented” tax methods will be aimed at average taxpayers. For example, tax strategy patents might be aimed at maximizing medical, real estate tax and other deductions, or reducing gross or taxable income.

¹⁴ For example, patents are not specifically listed as: (1) a source of “substantial authority” for securing IRS waiver of the accuracy-related penalty under Tax Code section 6662; (2) “reasonable cause” for IRS penalty waiver generally under the Tax Code; or (3) a basis for meeting the “realistic possibility of success” standard, for professional tax preparers to avoid a preparer penalty under section 6694 of the Tax Code.

C. Patent Protection is Not Needed to Encourage Tax Innovation. Tax Strategy Patents Could Hinder Innovation by Creating a Stifling Effect on Tax Planning and Curtailing Analysis and Debate.

Unlike other areas of innovation, patents are not needed to encourage the creation of new tax strategies. For example, compare the tax system to the pharmaceutical industry. Pharmaceutical companies need patent protection to encourage them to invest significant sums for research, development and clinical testing of new drugs.¹⁵ Patent protection is so crucial to the pharmaceutical industry that Congress enacted patent term extensions to compensate innovators for the time it takes their patent-protected drugs to undergo the regulatory approval process.¹⁶

In contrast, as Professor Ellen Aprill pointed out at the Subcommittee 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.”¹⁷ People already have substantial incentives to comply with tax law and lower their taxes. Individual taxpayers do not need to worry about other taxpayers copying their new strategies because tax returns are kept confidential. In addition, taxpayers have a right to minimize their taxes within the limit of the law. Thus, even if one taxpayer or tax practitioner is an “innovator” with regard to a particular tax strategy, that individual should not be able to prevent other taxpayers from complying with the law in the same way.

Tax strategy patents also inhibit the flow of information between tax professionals. For example, practitioners seeking patent protection may decide not to publish or discuss their ideas until a patent is issued. The existence of tax strategy patents could also discourage tax practitioners from freely discussing tax issues with other professionals out of fear that they will be exposed to infringement liability. For example, one patent holder obtained a list of attendees at a meeting in the area of law related to his patent and sent all the attendees a letter suggesting that they might be infringing his patent.¹⁸ Tax professionals attending conferences and other meetings might choose to remain silent about their ideas rather than run the risk of alerting a patent holder to their interest in a particular tax strategy. By limiting the free flow of discussion, tax strategy patents will hinder, rather than advance, the discovery of new tax strategies. This stifling of innovation is contrary to the intent of the Patent Act and the Patent Clause of the U.S. Constitution.¹⁹

Tax strategy patents curtail rather than enhance innovation. The existence of these patents is just beginning to restrict the broad, free and open public discussion that has long been a hallmark of

¹⁵ See Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, ch. 3, at 9 (Oct. 2003).

¹⁶ See Drug Price Competition and Patent Term Restoration Act of 1984, Pub. L. No. 98-417, 98 Stat. 1585 (codified at 35 U.S.C. § 156 *et seq.*).

¹⁷ *Statement of Ellen Aprill*, Testimony Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means (July 13, 2006).

¹⁸ *Id.*

¹⁹ U.S. Const. art. I, § 8; *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989).

our nation's tax system. This public discussion is held in many live, print, video and online forums that comprehensively support the constant development, broad public exposure, analysis and refinement of tax strategies. These forums include: 1) annual national, state and local practitioner meetings, seminars and conferences; 2) tax treatises and tax manuals; 3) daily, weekly and monthly professional tax publications; 4) taxpayer newsletters; and 5) analysis in print, broadcast and online media.

At any given time, the participants in this discussion may include taxpayers, tax practitioners, IRS representatives, Treasury Department officials, academics, elected officials and their staff aides, and members of the tax and the general press. This free and open exchange has been, and continues to be, enormously comprehensive in volume, breadth, depth and scope. In fact, the public discussion is so extensive that we believe it is not likely that truly novel and innovative tax strategies would be developed that have not already been discussed and vetted. This broad national, regional and local discussion and vetting, especially among tax practitioners or between tax practitioners and taxpayers, constitutes or should constitute the prior art that defeats the legitimacy of patent claims.

Based on the AICPA's decades of experience playing a major role in fostering this public discussion, we believe that the very issuance of tax strategy patents will be the vehicle that curtails its freedom, as the public discussion is captured by private interests.

D. Tax Strategy Patents Have Several Important Distinctions from Other Business Method Patents that Make Them Unsuitable for Patent Protection, Including Interfering with Client Confidentiality and Privilege.

1. Because Tax Strategy Patents Involve Compliance with the Law, Taxpayers Might Not Be Able To Avoid Infringing Certain Tax Strategy Patents.

Tax strategy patents differ from other types of patents in that they are based on interpretations of, and affect compliance with, the tax law. Unlike other business methods, certain legally-required actions could constitute infringement of tax strategy patents. For example, a taxpayer might use a tax strategy based on advice from a tax professional, who would then prepare and file a tax return reflecting that strategy. If that strategy is patented, it is possible that the tax practitioner's giving of advice, the taxpayer's use of the underlying business transaction, the preparation of the tax return, and even the filing of the tax return itself could each be considered an act of patent infringement. However, once a taxpayer has concluded a transaction, the preparer and the taxpayer are legally obligated to properly reflect the impact of the transaction on the tax return. Compliance with legal obligations should not be considered patent infringement. We strongly believe that it is against public policy to allow the preparation and filing of a legally-required tax return, or an action to minimize the taxes due on a tax return, to constitute an act of patent infringement.

2. Tax Professionals Might Be Unable to Defend Themselves from Patent Infringement Lawsuits by Using the Prior User Defense Because of their Professional Obligations of Client Confidentiality and Privilege.

After the *State Street* decision clarified that business methods could be patented, Congress created an infringement defense for prior users of business methods as trade secrets. Section 273 of the Patent Act provides a defense if the accused infringer “acting in good faith, actually reduced the subject matter [of the business method] to practice at least one year before the effective filing date of such patent, and commercially used the subject matter before the effective filing date of such patent.”²⁰ The purpose of this section was to “protect companies that choose to protect their inventions through trade secret laws instead of patent protection and companies in sectors that until recently were denied patents.”²¹ This section was specifically enacted in response to the *State Street* decision, after it was found that thousands of “back office” processes were being patented. Prior to that decision, companies thought that the only protection available for these back office processes was trade secret protection. Although the text of the Patent Act applies to “a method” generally, the legislative history shows that it was intended for only “business methods and processes.”²²

This defense is only useful, however, if the defendant can show a reduction to practice of the invention one year before the filing date and commercial use of the method sometime before the filing date of the patent. Unlike accused infringers of other business method patents, tax practitioners might not be able to utilize this defense because of their obligations of client confidentiality and privilege under sections 6713, 7216, and 7525 of the Tax Code, the AICPA Code of Professional Conduct and state law. In particular, sections 6713 and 7216 of the Tax Code generally prohibit tax practitioners from sharing tax return information with third parties. Additionally, our member CPAs are subject to both state regulation and the provisions of the AICPA Code of Professional Conduct, which have strict client confidentiality rules that would prevent them from sharing their previously implemented tax strategies with others.

As a result of these confidentiality and privilege obligations, CPAs may find themselves in an indefensible position when challenged by a tax strategy patent holder because confidential client tax return information cannot be used to show a prior reduction to practice or commercial use of the method before the filing date of the patent. The CPA would not be able to provide client tax return information without the client’s permission, unless compelled to do so by a court of law. Likewise, without client permission or court order, confidential client tax return information cannot be used to prove a patented tax strategy has been previously utilized and is not novel. The inability of tax practitioners to defend themselves against tax strategy patents places them in a position of potential exploitation by patent holders that is not faced by users of other types of business methods.

²⁰ 35 U.S.C. § 273 (2007).

²¹ H.R. Rep. No. 106-287, pt. 1, at 44 (1999).

²² *Id.*

CPAs, attorneys, and other tax practitioners also have professional and fiduciary obligations to act in their clients' best interests and to put their clients' interests ahead of their own when providing tax advice. When a patent holder seeks to restrict a tax practitioner from providing information that would be in a client's best interest, the patent holder interferes with the tax professional's fiduciary obligation. For example, AICPA *Statements on Standards for Tax Services*, TS Sections 9100.47 and 9100.48 require the CPA to perform certain processes when rendering tax planning advice or evaluating a tax planning transaction. Both processes include the analysis and evaluation of pertinent authorities, including the Tax Code, and the drawing of conclusions based on those authorities. A tax strategy patent might prevent CPAs from adhering to these standards, particularly in a situation where the patent holder obtains an injunction against the practitioner.

Additionally, the rules of Circular 230²³ regarding conflicting interests prevent a practitioner from representing a client before the IRS if the representation involves a conflict of interest. A conflict of interest exists if there is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client or former client, a third person, or by a personal interest of the practitioner. The personal interest of the practitioner in protecting themselves from an infringement lawsuit could prevent a practitioner from representing a client in an audit before the IRS. Tax strategy patents thus could pose serious problems for practitioners in representing their clients on audit.

3. Because of the Confidential and Privileged Nature of Tax Strategies, It is Difficult to Evaluate and Demonstrate the Invalidity of Tax Strategy Patents.

In addition, it is difficult for the Patent Office to determine whether proposed tax strategies meet the statutory requirements of novelty and nonobviousness for patentability. We are concerned that the Patent Office is granting patents on tax planning strategies that are not unique or novel. For example, placing stock options in a GRAT is not novel, but was rather common among estate planners (at least before the issuance of the SOGRAT patent). We are particularly concerned that such tax strategy patents will be granted without proper prior art analysis and study, because the Patent Office does not confer with the IRS to review the novelty or nonobviousness of tax strategy patent applications.

The Patent Office has limited access to, and awareness of, tax strategy prior art. In other areas of innovation, the Patent Office is able to search through prior art patents and other printed publications to determine whether a proposed invention is novel and nonobvious. Much of the prior art in the tax world, however, consists of confidential or privileged communications that are not discoverable during the patent examination process. In addition, many techniques commonly used to prepare client's tax returns are not described in printed publications.

²³ Treasury Department Circular No. 230 (Rev. 6-2005) *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service*, Department of the Treasury Internal Revenue Service, Title 31 Code of Federal Regulations, Subtitle A, Part 10, revised as of June 20, 2005. See § 10.29(b)(2).

V. AICPA Legislative Proposals

Legislative reform is needed to counteract the harmful effects of tax strategy patents on the integrity of the tax system. The AICPA has considered various legislative and administrative options and believes that the two best options for legislative reform are either to restrict the issuance of patents on tax strategies or to provide some form of immunity from patent infringement liability for taxpayers and tax practitioners. We believe this legislation would be in the best interest of taxpayers, tax practitioners, and federal, state, and local governments. We agree, however, with IRS Commissioner Mark Everson's public remarks that granting a patent for certain commercially available tax computation software could be beneficial to taxpayers and should not be prohibited by any new legislation.

Recommendation 1 – Restrict the Patent Office from Issuing Patents for Tax Strategies.

This legislation would provide that patents could not be issued for tax strategies based on interpretations of federal, state, or local tax laws. Such strategies would include: interpretations of tax law; application of tax principles; and structuring of transactions and the ownership of property to assist taxpayers in meeting their non-tax and tax minimization objectives.

AICPA does not object to patents for tax preparation software, such as TurboTax™, which helps taxpayers perform the administrative tasks associated with preparing tax returns. This type of tax preparation software does not raise the policy concerns discussed above because it does not undermine Congressional authority or create an exclusivity on interpreting tax law. Taxpayers can continue to comply with the Tax Code whether or not they use this software.

Although some types of tax software should continue to be patentable, patents should not be allowed for tax strategies or tax planning advice under the guise of patenting tax-related software.²⁴ For example, the SOGRAT patent could be considered a “software” patent because the method it describes is implemented in computer software.²⁵ Unlike tax preparation software, this patent undermines Congressional authority for the reasons discussed above. Extending patent protection to this tax strategy, regardless of whether it is phrased in terms of software, does not change this result. The Tax Code allows anyone to fund GRATs with stock options. The SOGRAT patent holder should not be granted an exclusivity on this common estate planning technique.

²⁴ As the New York State Bar Association pointed out in its August 17th letter, the distinction between software that should be patentable and software that should not be patentable “may be difficult to describe in words.” Letter of the New York State Bar Association, Aug. 17, 2006 (p. 2, n. 3).

²⁵ It describes a “method for minimizing transfer tax liability . . . performed at least in part within a signal processing device,” *i.e.*, a computer. U.S. Pat. No. 6,567,790, claim 1. In the preferred embodiment, the method is “encoded in a software program,” such as Microsoft Excel™. *Id.* at col. 3, lines 17-33.

Recommendation 2 – Provide Immunity from Patent Infringement Liability for Taxpayers and Tax Practitioners.

In the alternative, legislation should provide that tax practitioners who disseminate tax advice and taxpayers who implement tax strategies cannot be sued for infringing a tax strategy patent. This legislation would deprive tax patent strategy holders of monetary and injunctive remedies against tax practitioners and taxpayers. This immunity could be similar to the immunity from patent infringement that the medical community obtained as part of the *Omnibus Consolidated Appropriations Act of 1996*.²⁶

We believe that an immunity provision is an even more appropriate legislative solution in this context than in the case of medical procedures. In the medical context, only the professionals performing medical procedures had to worry about infringement liability -- patients did not have to worry that they would get sued for being treated by a doctor. But in the tax strategy patent context, tax professionals and ordinary taxpayers could be liable for infringement. Furthermore, unlike doctors who have a choice of different procedures to use, taxpayers might infringe a tax strategy patent while simply performing their compulsory obligations under the tax laws. Tax practitioners have ethical and moral obligations to represent their clients' interests to the fullest extent of the law. Congress should not permit tax strategy patents to curtail those ethical and moral obligations.

We recommend the following legislative text be added to the Patent Act as Section 287(d):

(1) With respect to a tax practitioner's performance of tax advice services and a taxpayer's use of such tax advice services that constitutes an infringement under section 271(a) or (b) of this title [covering both direct infringement and inducement of infringement], the provisions of sections 281 [remedy for infringement of patent], 283 [injunction], 284 [damages], and 285 [attorney fees] of this title shall not apply against the taxpayer, tax practitioner or against a related firm or entity with respect to such tax advice services.

(2) For the purposes of this subsection the term "tax advice services" means the providing of tax advice, tax strategy planning, or tax preparation services for a taxpayer.

VI. Conclusion and Recommendations

The AICPA is greatly concerned that the Patent Office is granting patents on methods of interpreting and complying with the law. In particular, patents on strategies for complying with tax, accounting, and auditing rules, laws, and regulations preclude taxpayers from applying the tax laws as they were enacted by Congress and state legislatures. In this respect, tax strategy patents differ from other types of business method patents, as they are based on interpretations of, and affect compliance with, the tax law. Accordingly, patents should not be granted for any strategies involving compliance with federal, state, or local tax law.

²⁶ Pub. L. No. 104-208, Section 616, 110 Stat. 3009 (1996). See 35 U.S.C. § 287(c) (2007).

Tax strategy patents should be restricted, or at a minimum, taxpayers and tax practitioners should be made immune from liability for tax strategy patent infringement.

The AICPA is pleased to assist Congress in its efforts related to tax strategy patents.