THE JOHN MARSHALL
REVIEW OF INTELLECTUAL PROPERTY LAW

THE PROLIFERATION OF TAX STRATEGY PATENTS: HAS PATENTING GONE TOO FAR?

ANISH PARIKH

ABSTRACT

Many people employ an accountant or tax attorney to assist them with the paying of their taxes. Tax practitioners may utilize various tax strategies in determining how a taxpayer should allocate his money. These tax strategies fall into the category of business methods. It was widely held that patents could not be granted for methods of doing business; however, this changed in 1998 when the Court of Appeals for the Federal Circuit upheld the patentability of an investment structure in *State Street Bank & Trust Company v. Signature Financial Group, Inc.* More recently, in *Wealth Transfer Group v. Rowe*, the scenario of being sued for using a patented tax strategy was illustrated. The current state of patent law makes no mention of tax strategies; however, after analyzing the characteristics of tax strategies with the elements required for patentability, it is determined that tax strategies should not be patentable subject matter. This proposal suggests that the patent laws be amended, as they have been in the past, to remove tax strategies from being patent-eligible subject matter, a solution which lies in Congress' hands.

Cite as Anish Parikh, Comment, *The Proliferation of Tax Strategy Patents: Has Patenting Gone Too Far?*, 7 J. MARSHALL REV. INTELL. PROP. L. 202 (2007).

THE PROLIFERATION OF TAX STRATEGY PATENTS: HAS PATENTING GONE TOO FAR?

Anish Parikh*

INTRODUCTION

Imagine the already daunting task of walking into your tax attorney's office. As the two of you sit down to discuss your taxes as you have done numerous times in the past, you realize things seem a bit more difficult than usual. As your attorney looks for ways to save you money, he realizes that instead of saving money, you may be required to pay money because the patented strategies you would like to use or have previously used command a royalty. Shockingly, this could be the scenario that many Americans face if the Unites States Patent and Trademark Organization ("USPTO") continues to issue patents for tax strategies.

Tax strategies are methods a taxpayer may employ to reduce overall tax payments.[1] Examples of patented tax strategies include the use of computers[2] and structure-based approaches which target gifts and estates.[3] Numerous other methods of saving money during tax season exist.[4] For example, people have found that placing funds in special off-shore accounts allows them to dodge paying taxes on that money.[5] Others lower their own taxable income by transferring various portions

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* J.D. Candidate, January 2009, The John Marshall Law School. B.S. Finance, University of Illinois at Urbana-Champaign, May 2005. The author would like to thank his mom, dad, Nirali, Amish, Steve, Rani, and all of his other friends and family for their constant love and support. He would also like to thank his Articles Editor, Alisha Taylor, for all of her time and effort spent on this comment, The John Marshall Law School, the RIPL staff, and candidacy editors, Jacob Bachman, Philip Brandt, and Patrick McCarthy, for their invaluable assistance. This comment would not have been possible without any of these people.

** Available at www.jmripl.com.

[1] *See* JOINT COMMITTEE ON TAXATION, BACKGROUND AND ISSUES RELATING TO THE PATENTING OF TAX ADVICE 2 (July 12, 2006), *available at* http://www.house.gov/jct/x-31-06.pdf ("Patented tax strategies that have attracted recent attention include methods that purport to reduce taxes in connection with wealth transfers such as estate and gift planning as well as other situations.").

[2] *See id.* at 19 (explaining one such computer-based tax approach is the leveraging of split dollar life insurance, which is a tax approach where premiums and proceeds are split between the employer and employee).

[3] *Id.* at 19–20 (giving an example of a structure-based tax strategy patent "which describes an estate planning structure designed to minimize estate and gift tax liability through the use of a grantor retained annuity trust ("GRAT") funded with nonqualified stock options").

[4] *See generally* Tracy Byrnes, *10 Ways to Save on Your Taxes*, MONEY MAG., Feb. 15, 2006, *available at* http://money.cnn.com/2006/02/03/pf/taxes/10taxsavings_money_0603/index.htm (listing tips on how to save on taxes).

[5] *See* Mark Drajem & Ryan J. Donmoyer, *Senators Set Sights on Overseas Tax Havens*, WASH. POST, Feb. 18, 2007, at A10. *See also* Doris Dobkins, *Your Best Tax Strategy-Start a Side-Business*, FRUGALFUN.COM, http://www.frugalfun.com/sidebusiness.html (explaining another example of a tax strategy suggests starting a home business because the home owner may qualify for a home office deduction if the business uses the home "regularly and exclusively for administrative or management activities").

of the income to other family members.[6] Taxpayers even go the extreme of actually "[donating] appreciated property to charities to avoid capital gains tax."[7] A simple Internet search will reveal a plethora of other methods to minimize taxes.

Tax strategies are encompassed within the business method category of the patent system.[8] Because business methods are patentable material,[9] "the Patent Office has begun granting patents to people who claim to have invented novel ways of avoiding taxes."[10]

In 2003, John Rowe, executive chairman and CEO of Aetna Inc., attempted to engage in a tax strategy whereby he would transfer money to his family while decreasing the amount of gift tax[11] money he and his family paid to the Internal Revenue Service ("IRS").[12] The strategy reduced the amount of taxes due because Rowe would take stock options and place them in annuity trusts,[13] "a trust designed to deliver asset appreciation to beneficiaries at a minimal gift tax cost."[14] The trusts, in turn, would pay Rowe an annual amount for a set period and, after that, whatever was left in the trust would be paid to Rowe's family,[15] thus creating enormous tax savings.[16] However, a company known as Wealth Transfer Group learned of Rowe's strategy and, in January 2006, sued him claiming infringement of Wealth Transfer Group's tax strategy patent.[17]

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[6] Tax Guide Online, Personal Tax Strategies, http://www.taxguideonline.com/ContentPages/ID_Strategies.html (last visited Nov. 8, 2007) (suggesting as a personal tax strategy to "lower your own income by shifting income to other family members").

[7] *Id.*

[8] E. Anthony Figg, *Should the Patent Laws Exempt Certain Innovations from Patent Eligibility?*, INTELL. PROP. L. NEWSLETTER, Vol. 24 No. 4 at 3, 46 (Summer 2006). Even though tax strategy patents account for just a small percentage of patents awarded, they have nevertheless been issued. *Id.*

[9] *See* Jeremey Kahn, *Taxes: Patent that Loophole*, FORTUNE, Aug. 30, 2006, http://money.cnn.com/2006/08/30/pf/taxes/patents.fortune.

[10] *See* JOINT COMMITTEE ON TAXATION, *supra* note 1, at 2 ("Patents have increasingly been sought and issued for various tax-related claimed inventions, including strategies for reducing a taxpayer's taxes.").

[11] *See generally* Internal Revenue Service, Gift Tax Questions, http://www.irs.gov/businesses/small/article/0,,id=108139,00.html (last visited Nov. 8, 2007) ("The gift tax is a tax on the transfer of property by one individual to another while receiving nothing, or less than full value, in return. The tax applies whether the donor intends the transfer to be a gift or not.").

[12] *See* Steve Seidenberg, *Taxation Innovation Patent Office*, INSIDE COUNSEL MAG., Dec. 2006, at 22–24, *available at* http://www.insidecounsel.com/issues/insidecounsel/15_238/ip/771-1.html. After receiving tax advice from a financial planner, CEO of Aetna Inc. John Rowe engaged in a tax strategy which minimized the amount of money he paid in taxes while transferring millions of dollars to his family. *Id.*

[13] *Id.* This method which utilized annuity trusts to avoid taxes was later come to be known as the stock option grantor retained annuity trusts ("SOGRAT") method of avoiding taxes. *Id.*

[14] Thomas Munro, *That Tax Deduction Method You Use Might Be Patented*, N.M. BUS. WEEKLY, July 13, 2007, http://albuquerque.bizjournals.com/albuquerque/contactus/contact_editor.html ("Concerns arose when the holders of the SOGRAT patent, which uses stock options to fund a grantor retained annuity trust (a trust designed to deliver asset appreciation to beneficiaries at a minimal gift tax cost), filed an infringement suit in early 2006.").

[15] Seidenberg, *supra* note 12, at 22–24.

[16] *See id.* Rowe's tax strategy worked because it resulted in dramatic gift-tax savings. *Id.*

[17] Wealth Transfer Group, LLC v. Rowe, No. 3:06CV00024 (AWT) (D. Conn. Mar. 9, 2007). *See also* Seidenberg, *supra* note 12, at 22–24. Wealth Transfer Group contacted Rowe and informed him that they owned the patent that Rowe wanted to use and that he would have to pay for its use. *Id.*

In light of *Rowe* and the recent issuing of tax strategy patents, tax practitioners and taxpayers are asking whether patentable subject matter is too broad. The first tax strategy patent was issued in 2003.[18] By September 2006, the USPTO issued approximately fifty tax strategy patents and had another sixty pending review.[19] With the number of applications increasing and the threat of major ramifications on taxpayers and attorneys, the debate of whether patents for tax strategies should be issued turns on whether these tax avoidance methods contain the elements required for patentability.

This comment begins with an overview of patent law, how the issue of tax strategy patents came into existence, and what actions are currently being taken to cope with the issue. Part II analyzes the elements of patentability and applies them to tax strategies in order to determine whether these strategies are proper subject matter for patentability. Finally, Part III proposes a possible solution to the debate surrounding tax strategies and discusses the ramifications on various groups of people.

I. BACKGROUND

As with any other patent, tax strategy patents must meet the requirements of patentable subject matter to be considered eligible for patentability.[20] Part A of this section addresses patent law and its exceptions. Part B examines the key case, *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*,[21] which is relevant to the patentability analysis. Finally, Part C discusses the current state of patent law and what actions have been taken to address the issue.

A. Patent Law and Its Exceptions

The purpose of patent law is to "promote the Progress of Science and useful Arts."[22] 35 U.S.C. § 101 provides that anyone who invents a "new and useful process" may be eligible to obtain a patent.[23] Eligible inventions must be useful, novel, and non-obvious.[24]

Wealth Transfer Group sued Rowe in January 2006 seeking damages as well as an injunction. *Id.*; Complaint, *Wealth Transfer Group*, No. 3:06CV00024 (AWT).

[18] U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003) (patent was granted for an "estate planning method for minimizing tax liability"). *See also* Andrew A. Schwartz, *Tax Strategies are not Patentable Inventions*, INTELL. PROP. L. NEWSLETTER, Vol. 25 No. 1 at 35 (2006) (discussing how the USPTO awarded its first ever tax strategy patent in 2003 thus conveying the idea that tax strategies constitute patentable subject matter).

[19] Kahn, *supra* note 9.

[20] JOINT COMMITTEE ON TAXATION, *supra* note 1, at 2.

[21] 149 F.3d 1368 (Fed. Cir. 1998).

[22] U.S. CONST. art. I, § 8, cl. 8 ("To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.").

[23] 35 U.S.C. § 101 (2006). *See also* Paul Devinsky, John Fuisz & Thomas Sykes, *Whose Tax Law Is It?*, IP SUPPLEMENT TO LEGAL TIMES ONLINE, Oct. 2006, at 1, *available at*

The simplest requirement to fulfill is that of usefulness[25] set forth in 35 U.S.C. § 101.[26] Some courts have held that the usefulness requirement is met if it can be shown the invention is "minimally operable towards some practical purpose."[27] However, if something is illegal or against public policy, then the courts would likely find that the invention does not meet the useful requirement.[28]

In order for a patent to be issued, it must be shown by a preponderance of the evidence that all of the requirements of the patent statutes have been met.[29] It is also important to note that only the "first inventor" may obtain a patent.[30] The Supreme Court has interpreted the patent statutes so broadly as to "include anything under the sun that is made by man."[31] However, anything not made by man is not considered patentable subject matter.[32]

Courts have recognized three major exceptions of patentable subject matter under the patent laws: laws of nature, natural phenomena, and abstract ideas.[33] For example, Einstein could not have patented his mathematical equation $E=mc^2$.[34] Similarly, laws of gravity, a new plant found in the wild, tornados, and the Pythagorean Theorem could not be patented.[35] The underlying principle behind these exclusions is that the innovations were not actually invented by man; rather, they were always in existence awaiting discovery.[36]

There is a way around these exclusions. While laws of nature, natural phenomena, and abstract ideas at their core are not patentable, an application of

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http://www.mwe.com/info/pubs/legaltimes101806.pdf. ("Congress enacted 35 U.S.C. § 101, which provides that whoever invents a 'new and useful process' may obtain a patent.").

[24] Merchant & Evans, Inc. v. Roosevelt Bldg. Prods. Co., 963 F.2d 628, 639 (3d Cir. 1992).

[25] *In re* Fisher, 421 F.3d 1365, 1371 (Fed. Cir. 2005) ("Simply put, to satisfy the 'substantial' utility requirement, an asserted use must show that that claimed invention has a significant and presently available benefit to the public.").

[26] 35 U.S.C. § 101.

[27] *Id.* The usefulness requirement is typically fulfilled unless it is shown that the invention is "totally incapable of achieving a useful result." *Id.*

[28] *Id.*

[29] *See In re* Oetiker, 977 F.2d 1443, 1445 (Fed. Cir. 1992) ("[P]atentability is determined on the totality of the record, by a preponderance of evidence with due consideration to persuasiveness of argument."); Devinsky, *supra* note 23, at 2.

[30] Pfaff v. Wells Elecs., 525 U.S. 55, 61 (1998) ("Thus, assuming diligence on the part of the applicant, it is normally the first inventor to conceive, rather than the first to reduce to practice, who establishes the right to the patent.").

[31] Diamond v. Chakrabarty, 447 U.S. 303, 309 (1980) (holding that a micro-organism was a new bacterium with markedly different characteristics from any found in nature and thus constituted a manufacture or a composition of matter to qualify as patentable subject matter under 35 U.S.C. § 101). *See also* Devinsky, Fuisz & Sykes, *supra* note 23, at 1 ("[I]n *Diamond v. Chakrabarty*, a case involving a bacterium that could break down crude oil, the Supreme Court interpreted §101 so broadly as to cover 'anything under the sun that is made by man.'").

[32] Schwartz, *supra* note 18, at 35.

[33] *See* Lab. Corp. of Am. Holdings v. Metabolite Lab., Inc., 126 S. Ct. 2921, 2922 (2006).

[34] *Id.* (noting also that Newton could not have patented the law of gravity).

[35] *See* Schwartz, *supra* note 18, at 35. Other provided examples of non-patentable subject matter include a new mineral discovered in the earth, volcanic eruptions, the tides, thermodynamics, quantum physics, mathematical concepts and algorithms, calculus, and the Fourier series. *Id.*

[36] *Lab. Corp.*, 126 S. Ct. at 2923 ("[Courts have] treated fundamental scientific principles as 'part of the storehouse of knowledge' and manifestations of laws of nature as 'free to all men and reserved exclusively to none.'").

these principles into something concrete may be patentable.[37] For example, a rollercoaster ride at an amusement park utilizes certain laws of physics and gravity to make the coaster run. While the laws of physics and gravity would not be patentable, the actual roller coaster design incorporating physics and gravity would be.[38]

In *Rowe*, although Wealth Transfer Group received the benefit of having their patent presumed valid,[39] Rowe still presented numerous defenses.[40] For example, he stipulated that the patent was invalid because it was improperly granted.[41] He additionally attempted to show that the elements of patentability had not been met, mainly that the invention was not novel or non-obvious.[42] Finally, Rowe denied that the patentee was the first inventor of the strategy and therefore the patent was incorrectly granted.[43] If the court found merit to any of his arguments, he would not be liable for patent infringement.

B. State Street*: Introducing the Problem*

Before 1998, it was widely held that patents could not be granted for "methods of doing business."[44] However, all of this changed with the decision from the United States Court of Appeals for the Federal Circuit ("Federal Circuit") in the monumental case,[45] *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*[46] In *State Street*, two corporations, State Street and Signature, were "acting as custodians and accounting agents for multi-tiered partnership fund financial services."[47] State Street wanted to use Signature's patented investment structure and sought to negotiate a license for the use of this patent.[48] When the negotiations fell through, State Street sought a declaratory judgment against Signature alleging invalidity, unenforceability, and non-infringement of Signature's patent.[49] The district court

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[37] Schwartz, *supra* note 18, at 35.

[38] *See id.* at 35. For example, The Wright brothers' airplane was able to fly because it exploited certain laws of physics that are inherent in the universe. *Id.* Though the laws of physics were not patentable, the airplane utilizing those laws was. *Id.*

[39] 35 U.S.C. § 282 (2006). *See also* Michael Brier, *Patently Foolish?*, FIN. ADVISOR MAG., Mar. 2007, http://www.fa-mag.com/issues.php?id_content=2&idArticle=1333.

[40] Amended Answer and Counterclaim at 3–7, Wealth Transfer Group, LLC v. Rowe, No. 3:06CV00024 (AWT) (D. Conn. Oct. 13, 2006).

[41] *Id.* at 4.

[42] *Id.*

[43] *Id.* at 2. Any defendant being sued for patent infringement may not be liable if he or she can prove that they used the invention before the inventor. 35 U.S.C § 102(a).

[44] *See* Devinsky, Fuisz & Sykes, *supra* note 23, at 1 ("Before then, inventors and patent lawyers generally recognized the exception to the patent laws that excluded protection for methods of doing business.").

[45] JOINT COMMITTEE ON TAXATION, *supra* note 1, at 2. *State Street* is characterized as a monumental decision that allowed the patenting of business methods of all types. *Id.*

[46] 149 F.3d 1368, 1373 (Fed. Cir. 1998) ("[W]e hold that the transformation of data . . . by a machine through a series of mathematical calculations . . . constitutes a practical application of a mathematical algorithm . . . because it produces 'a useful, concrete and tangible result' . . . .").

[47] *Id.* at 1370.

[48] *Id.* Signature's U.S. Patent No. 5,193,056 is directed to a business method for data processing in implementing a financial structure. *Id.*

[49] *Id.*

granted State Street's motion for partial summary judgment, holding that Signature's patent was invalid subject matter under 35 U.S.C. § 101.[50]

On appeal, the Federal Circuit held Signature's invention to be proper subject matter for patent eligibility.[51] The court held that since Signature's patent involved the practical application of a mathematical algorithm vis-à-vis computer software, the invention was not merely an abstract idea, but was a useful and tangible invention.[52] The court's decision resulted in business methods being eligible for patenting.[53]

Many people, such as judges, lawyers, and legal scholars, disagree with the decision in *State Street*.[54] For example, U.S. Supreme Court Justice Breyer dissented in the Court's decision to dismiss a recent business method patent case.[55] Justice Breyer explained that the Supreme Court has never recognized a patentable process as one that, according to the court in *State Street*, produces a "useful, concrete, and tangible result."[56] Additionally, while addressing the issue of injunctive relief as it pertained to business methods, Justice Anthony Kennedy in his concurring opinion in *eBay Inc. v. MercExchange, L.L.C.*[57] explained that business method patents were often vague and lacked economic significance in earlier times.[58]

C. Current State of Patent Law

The law does not explicitly bar business methods such as tax strategies from being patented.[59] In fact, many opponents of tax strategy patenting, including taxpayers, tax professionals, and estate-planners, are attempting to amend the patent laws[60] to state a specific exclusion of eligibility for tax strategies.[61] While the notion of amending the patent laws seems excessive, it is important to note that revisions have occurred in the past. "In 1954, for example, lawmakers created an 'exception' to § 101 by enacting 42 U.S.C. § 2181, which bars patent protection for

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[50] *Id.* *See also* 35 U.S.C. § 101 (2006) (permitting "[w]hoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof" to be eligible for a patentable invention.).

[51] *State Street*, 149 F.3d at 1377 (reversing the appellate court's decision granting State Street's motion for summary judgment "for failure to claim statutory subject matter under § 101").

[52] *Id.*

[53] *See* Devinsky, Fuisz & Sykes, *supra* note 23, at 2. *See also* Figg, *supra* note 8, at 45 ("There is little dispute that the surge of patent applications claiming business methods following the Federal Circuit's decision in *State Street Bank* caught the PTO off guard.").

[54] *See* Devinsky, Fuisz & Sykes, *supra* note 23, at 2.

[55] Lab. Corp. of Am. Holdings v. Metabolite Lab., Inc., 126 S. Ct. 2921 (2006) (Breyer, J., dissenting) (dismissing the writ of certiorari as improvidently granted).

[56] *Id.* at 2928 (quoting *State Street*, 149 F.3d at 1373).

[57] 126 S. Ct. 1837 (2006) (Kennedy, J., concurring). This case involved a business method patent on electronic market designed to assist in the sale of goods between private individuals. *Id.* at 1839.

[58] *Id.* at 1842 (suggesting "injunctive relief may have different consequences" for business method patents because an injunction could be used as a "bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent").

[59] Devinsky, Fuisz & Sykes, *supra* note 23, at 1.

[60] *See* Figg, *supra* note 8, at 3.

[61] *Id.* at 3.

inventions that are 'useful solely in the utilization of special nuclear material or atomic energy in an atomic weapon.'"[62]

Even Democratic presidential nominee and current Illinois Senator Barack Obama is taking measures to regulate patentable material, such as tax strategies.[63] In February of 2007, Obama, along with Michigan Senator Carl Levin and Minnesota Senator Norm Coleman, sought to pass a bill[64] that would prohibit the USPTO from issuing patents intended to "minimize, avoid, defer, or otherwise affect liability for federal, state, local, or foreign tax."[65] Although the bill aims to prevent tax avoidance through offshore accounts,[66] the bill effects the patenting of all tax strategies.[67] The bill is still in the first stages of the legislative process.[68]

The closest opponents have come to putting an end to the patenting of tax strategies occurred in September of 2007. Rick Boucher, a representative from Virginia, sponsored an amendment to the Patent Reform Act of 2007.[69] The bill, which was designed to restrict tax strategy patents, was approved by the House Judiciary Committee on July 18, 2007 and by the full House of Representatives on September 7, 2007.[70] The Senate's version of the bill, on the other hand, does not address the issue of tax planning methods.[71]

In light of precedent and recent developments, taxpayers and attorneys are worried about the cost of licensing fees for using a particular tax strategy or even being prohibited from using certain strategies in the future.[72] The question then becomes whether tax strategies should be considered patentable subject matter so

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[62] Devinsky, Fuisz & Sykes, *supra* note 23, at 2 (citing 42 U.S.C. § 2181 (2006)).

[63] *See* Drajem & Donmoyer, *supra* note 5, at A10.

[64] Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007). S. 681's purpose is "[t]o restrict the use of offshore tax havens and abusive tax shelters to inappropriately avoid Federal taxation, and for other purposes." *Id.*

[65] Drajem & Donmoyer, *supra* note 5, at A10.

[66] *Id.* (discussing how the bill is designed to "impose tougher requirements on U.S. taxpayers using offshore secrecy jurisdictions, give the U.S. Treasury the authority to take action against foreign jurisdictions that impede tax enforcement, stiffen penalties against abusers and close offshore trust loopholes"). According to Obama, Coleman, and Levin, over 100 billion dollars in tax revenue are lost each year because of the use of overseas tax havens. *Id.*

[67] *See id. See also* Leroy Baker, *Yet Another Levin Bill to 'Stamp Out Offshore Tax Evasion by Americans'*, TAX-NEWS.COM, Feb. 20, 2007, http://www.tax-news.com/archive/story/Yet_Another_Levin_Bill_To_Stamp_Out_Offshore_Tax_Evasion_By_Americans_xxxx26425.html. The Senators' tax patent bill imposes stricter penalties on promoters of tax strategies, prohibits the USPTO from issuing patents on inventions claiming to minimize or avoid taxes, and makes it tougher for Americans to use over sea tax havens. *Id.*

[68] *See* Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007).

[69] Amendment to the Amendment in the Nature of a Substitute to H.R. 1908, 110th Cong. § 10 (2007) (offered by Rep. Boucher of Virginia). *See also Tax Strategy Patent Amendment Added to House Legislation*, VA SOC'Y CERTIFIED PUBLIC ACCT., July 26, 2007, http://www.vscpa.com/Press_Room/News_Releases/press07260702.aspx.

[70] *See* LIBRARY OF CONGRESS, STATUS OF H.R. 1908, http://thomas.loc.gov/cgi-bin/bdquery/z?d110:HR01908:@@@X (last visited on Nov. 9, 2007).

[71] *See* S. 1145, 110th Cong. (2007); *See also* INTELLECTUAL PROPERTY OWNER'S ASSOCIATION, PATENT REFORM (110TH CONGRESS): A COMPARISON OF H.R. 1908 (AS PASSED BY THE HOUSE) AND S. 1145 (AS REPORTED OUT OF THE SENATE JUDICIARY COMMITTEE) HIGHLIGHTING PRIMARY DIFFERENCES 3, *available at* http://www.ipo.org/actioncenter (last visited Nov. 9, 2007).

[72] *See* Devinsky, Fuisz & Sykes, *supra* note 23, at 1. Patent holders are not required to license their invention for others to use. *Id.* Therefore, the invention may be unusable for the duration of the patent term. *Id.*

that any strategy, which meets the necessary requirements for patentability under the patent laws, would be eligible to receive a patent.

II. ANALYSIS

Due to the controversy surrounding these patents, it must be determined whether tax strategies constitute patentable innovations. Part A looks at whether the strategies are patentable under the patent statutes. Part B analyzes whether tax strategies fall into any of the three exceptions to the patent statutes and whether they are "inventions" as required by 35 U.S.C. § 101. In Part C, the Prior User Defense is analyzed as it pertains to tax strategies. Finally, Part D provides arguments against as well as for the patenting of tax strategies.

A. Tax Strategies Are Not Properly Patentable Under the Patent Statutes of the United States

Whether tax strategies fall into the realm of patentable innovations depends greatly on the relevant patent statutes[73] and legislation passed by Congress.[74] In order for something to be patentable, the invention must be useful, novel, and non-obvious.[75]

At their core, tax strategies are simply methods by which taxpayers can save significant money in paying their taxes while legally complying with the laws established by the IRS.[76] Stated another way, tax strategies are interpretations of the law[77] which attorneys and tax practitioners use to lower the amount of tax owed to the IRS.

Anyone can admit that finding ways to avoid paying taxes to the government is useful. Tax strategies increase liquid assets that can be reinvested later. Therefore,

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[73] Lawrence I. Richman, *Tax Strategy Patents*, J. PASSTHROUGH ENTITIES (CCH), Jan./Feb. 2007, at 12. James Toupin, general counsel of the USPTO, says that when analyzing an application for a tax strategy patent, the reviewers are to use the same statutory requirements under 35 U.S.C. §§ 101, 102, 103, and 112. *Id.* at 11–12. This illustrates the point that tax strategies must conform to the same requirements as any other invention in order to qualify for a patent. *Id.*

[74] Devinsky, Fuisz & Sykes, *supra* note 23, at 2. James Toupin, general counsel of the USPTO, presented a written statement to the House Ways and Means Subcommittee on Select Revenue Measures in July of 2006. *Id.* In the statement, Toupin stipulated that the "definition of 'patentable subject matter' begins with legislation." *Id.* Hence, when determining patentable subject matter and the patentability of claimed inventions, the USPTO must follow the laws passed by Congress. *Id.*

[75] Merchant & Evans, Inc. v. Roosevelt Bldg. Prods. Co., 963 F.2d 628, 639 (3d Cir. 1992).

[76] *USPTO Is Getting it Wrong on Tax Strategy Patents*, FULCRUM INQUIRY TAX ADVICE AND NEWS, July 2006, http://www.fulcruminquiry.com/Tax_Strategy_Patents.htm (stating that granted tax strategy patents, as well as pending applications, allege unique ways with complying with the Internal Revenue Code). *See also* Devinsky, Fuisz & Sykes, *supra* note 23, at 1 (opening the article by asking whether you can patent a method of complying with the law).

[77] Kahn, *supra* note 9. The issue that tax lawyers have with the patenting of tax strategies is that most strategies are designed by interpreting the tax laws in various ways. *Id.* These tax attorneys argue that the law should be available to everyone and that this would not be the case if people are required to pay licensing fees for the use of a patented tax strategy. *Id.*

tax strategies meet the useful requirement of § 101 because they more than minimally operate towards the practical purpose of saving money.

The novel and non-obvious requirements are generally more difficult to establish than the useful requirement. A strategy is novel when it is unique from prior inventions and knowledge,[78] and it is non-obvious when it is unique or different to an ordinary person in the given industry or art.[79] In *Rowe*,[80], John Rowe would not be liable if he was able to show that while the patented tax strategy was useful, it lacked the novelty element required by § 102[81] and perhaps even the non-obvious element in § 103[82] because it is apparent to the average tax practitioner.[83]

Tax strategies have been around for many years; therefore, it will be rare that a strategy is found to be novel and non-obvious. Additionally, because many tax strategies are computations or equations, they are not unique from previous inventions and thus do not constitute new knowledge. Another difficulty arises because of the privileges associated with paying taxes. The attorney-client privilege as well as some of the privileges enumerated in the Internal Revenue Code ("IRC") ensures that paying taxes remains a confidential matter.[84] If it were not for the presence of privileges, much of the work associated with paying taxes would be public information potentially available to everyone.[85]

However, courts have held in the past that in order to invalidate a patent on its novelty, it must be shown that the patentable invention was publicly known.[86] Thus, the law is in flux. On one hand, the law is stating that something is novel if it is not known by anyone; however, courts have gone on to say that in order to defeat the novelty requirement, it must be shown that the invention was publicly known.[87] Therefore, given the private and confidential nature of paying taxes,[88] it would be fairly simple for someone seeking a patent to show that the novelty requirement has been met because all they would need to show is that their method is not publicly known. Thus, a court would likely find that a given tax strategy meets the novelty requirement of § 102.

Whether a tax strategy is found to be obvious is unpredictable. To illustrate, consider a tax strategy which claims to minimize taxes by taking a deduction for

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[78] FULCRUM INQUIRY TAX ADVICE AND NEWS, *supra* note 76.

[79] Graham v. John Deere Co., 383 U.S. 1, 14 (1966) ("Patentability is to depend, in addition to novelty and utility, upon the 'non-obvious' nature of the 'subject matter sought to be patented' to a person having ordinary skill in the pertinent art.").

[80] Wealth Transfer Group, LLC v. Rowe, No. 3:06CV00024 (AWT) (D. Conn. Mar. 9, 2007).

[81] 35 U.S.C. § 102 (2006).

[82] 35 U.S.C. § 103.

[83] Brier, *supra* note 39.

[84] Devinsky, Fuisz & Sykes, *supra* note 23, at 3. Prior art is protected by the attorney-client privilege in many instances. *Id.*

[85] *Id.*

[86] Brier, *supra* note 39.

[87] *Id.* *See also* JOINT COMMITTEE ON TAXATION, *supra* note 1, at 10 (noting a confidential report circulating internally in a corporation would not be considered public).

[88] Brier, *supra* note 39 (noting tax advice is generally confidential in nature and even when the advice is disseminated, it is usually not done through a publication which would make the information publicly known).

dependants.[89] This method would likely be found obvious because so many people actually utilize this strategy and because presumably every tax practitioner knows about it.[90]

The tax strategy in question in *Rowe* involved the transferring of assets to family members, a commonly used estate-planning method.[91] Plaintiff Wealth Transfer filed for its patent on December 1, 1999[92]; however, Rowe claimed the method had been around for many years.[93] In addition, many tax practitioners claimed that the method is obvious because practitioners used it for many years prior to 1999.[94] Thus, tax practitioners argue, the method should not have received patent protection because there is nothing inventive about it.[95] Other strategies, however, may prove to be more complicated and complex so as to render it non-obvious.[96]

B. Tax Strategies Utilize Mathematical Equations and Are Not Discoveries Under § 101 Thus Rendering Them Unpatentable Subject Matter

Courts have held that laws of nature, natural phenomena, and abstract ideas are unpatentable.[97] A claimed invention falling under one of the above categories is precluded from receiving patent protection.[98] However, because inventions utilizing an application of one of these abstract ideas may be patented,[99] tax strategies may be eligible. Section 101 also requires that patentable subject matter be an actual invention or discovery.[100] Section 101 may be met if it is shown that a given tax strategy employs a law of nature to achieve its desired result.[101] However, while some argue that tax strategies use laws of nature in the form of mathematics, others argue that they do not use laws of nature, but rather different interpretations of legislation or laws of man.[102]

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[89] Floyd Norris, *Patent Law Is Getting Tax Crazy*, INTERNATIONAL HERALD TRIBUNE, Oct. 19, 2006, *available at* http://www.iht.com/articles/2006/10/19/business/norris20.php (discussing the ramifications of patenting tax strategies).

[90] *Id.*

[91] U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003) (patent was granted for an "estate planning method for minimizing tax liability").

[92] *Id.*

[93] Amended Answer and Counterclaim at 6, Wealth Transfer Group, LLC v. Rowe, No. 3:06CV00024 (AWT) (D. Conn. Oct. 13, 2006).

[94] Seidenberg, *supra* note 12. Tax advisers and estate planners were employing the method which Wealth Transfer received a patent for many years prior to the company being granted a patent. *Id.* The method in question had been around at least since 1990 because that is when Congress amended the laws to approve their use. *Id.*

[95] *Id.*

[96] *Id.*

[97] Diamond v. Chakrabarty, 447 U.S. 303, 309 (1980).

[98] *Id. See also JOINT* COMMITTEE ON TAXATION, *supra* note 1, at 8.

[99] Schwartz, *supra* note 18, at 35–36. The difference between laws and applications of these laws can be compared to the difference of work between engineers and scientists. *Id.* Scientists attempt to understand laws of nature; whereas, engineers apply these laws of nature to construct, design, or create methods and machines to benefit humans. *Id.* at 36.

[100] 35 U.S.C. § 101 (2006).

[101] Diamond v. Dehr, 450 U.S. 175, 187 (1981).

[102] *See* Schwartz, *supra* note 18, at 36.

Courts and the USPTO may rule either way on whether a tax strategy is an invention; however, the overwhelming evidence is that tax strategies are not inventions or discoveries as required under § 101 because they depend upon laws of humans.[103] Many tax strategies utilize mathematical equations. The equations used stem from man-made statutes.[104] When determining what would be best for a client, tax practitioners rely on various interpretations and loopholes in the statutes.[105]

For example, the tax strategy in question in *Rowe*, which Wealth Transfer Group patented, is known as stock option grantor retained annuity trust ("SOGRAT").[106] The SOGRAT strategy works by exploiting § 2702 of the IRC.[107] The IRC is legislation designed by humans as opposed to a law of nature.[108] Therefore, the SOGRAT method of avoiding taxes does not meet all of the requirements for patentability and thus should not have been given protection by the patent statutes. Tax strategies should not be given patent protection because they simply exploit laws made by humans.[109]

C. Tax Strategies Should Not Be Patentable Due to the Prior User Defense

Legislation providing for the Prior User Defense was passed shortly after and partly in response to *State Street*.[110] The premise behind the defense is to allow long-time users of a business method to continue using the method despite the issuance of a patent covering the method.[111] The defense, which gives infringers a potential defense if they can show that they had used the method at least one year prior to the plaintiff's patent being filed,[112] is important because it could significantly minimize the number of infringement cases.[113]

Many tax strategies have presumably been employed in the past by numerous practitioners. Since tax strategies are patentable subject matter, many tax professionals may rush to the USPTO to file an application.[114] Once this occurs, that patent holder will enjoy the benefit of being paid a licensing fee and being able to sue for infringement against anyone who uses the tax strategy. However, if an alleged infringer successfully invokes the Prior User Defense, a long-time user of a tax strategy will be relieved from liability.

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[103] *Id.* Although a concrete definition of laws of humans could not be found, the basic understanding is that they are laws expressly created by humans such as legislatures or scientists.

[104] *Id.*

[105] *Id.*

[106] U.S. Patent No. 6,567,790 (filed Dec. 1, 1999) (issued May 20, 2003) (patent was granted for an "estate planning method for minimizing tax liability").

[107] 26 U.S.C. § 2702 (2006) (enumerating rules that are to be used in the valuation of transfers of interests in trust).

[108] Schwartz, *supra* note 18, at 36.

[109] *Id.*

[110] Brier, *supra* note 39.

[111] Ostby & Barton Co. v. Jungersen, 65 F. Supp. 652, 656 (D.N.J. 1946).

[112] Brier, *supra* note 39.

[113] JOINT COMMITTEE ON TAXATION, *supra* note 1, at 12.

[114] Norris, *supra* note 89. Tax professionals who invent a new method are likely to be the ones to rush to file an application in order to maximize their business and to make money off of licensing agreements. *Id.*

There are some disadvantages to the Prior User Defense. Paying taxes and receiving tax advice is confidential in its nature; therefore, confidentiality is essential.[115] For example, an accountant or a financial advisor may have clear and convincing evidence that he or she has used a patented strategy over a year before a patent was granted[116]; however, the difficulty lies in exposing that evidence because their clients will be reluctant in having their private records disclosed.[117] Nonetheless, disclosure may be a ramification tax strategy innovators take to protect them from infringement or to protect their inventions.

D. Arguments Against Tax Strategy Patents Exceed Arguments in Favor of Tax Strategy Patents

Critics argue tax strategy patents deprive people of the notion that similarly treated taxpayers should be treated the same way.[118] For example, if Taxpayer A is in a comparable income class as Taxpayer B, Taxpayer A may not be allowed to pay his taxes in the same way as Taxpayer B if Taxpayer B has a tax strategy patent. Next, critics believe that the USPTO is not properly equipped to determine which tax strategies meet the requirements of patentability because of the USPTO's inexperience with such methods.[119] Additionally, opponents argue that allowing tax strategies to be patented will result in an unfair market because patentees will realize considerable gains.[120] Opponents finally argue that allowing tax strategis to be patented will increase costs for tax practitioners,[121] decrease federal funds,[122] and increase the attempts to patent other various strategies such as legal strategies.[123]

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[115] Brier, *supra* note 39.

[116] *Cf.* Mycogen Plant Sci., Inc. v. Monsanto Co., 243 F.3d 1316, 1332 (Fed. Cir. 2001) (finding the defendant demonstrated with clear and convincing evidence that he reduced to practice his invention before the patentee received a patent on his invention).

[117] Brier, *supra* note 39. For example, a tax consultant or financial advisor may possess certain correspondence they had with their client regarding the use of a given method occurring over a year ago; however, it could very well be that the client does not want to disclose their private records to the courts. *Id.*

[118] Devinsky, Fuisz & Sykes, *supra* note 23, at 3. The notion that similarly situated taxpayers should be treated the same is considered to be one of the fundamental principals of the federal tax system. *Id.*

[119] *Id.* The argument is that the USPTO lacks the knowledge and expertise of the tax field to determine whether a given method meets the basic requirements, such as novel or non-obvious, for patentability. *Id.* The USPTO has taken steps to address this issue by hiring examiners who possess knowledge in financial services and business methods. Figg, *supra* note 8, at 45.

[120] Devinsky, Fuisz & Sykes, *supra* note 23, at 3. The hypothetical that Devinsky and his colleagues use is that if a company were to receive a legitimate patent on a certain tax strategy, then that company would realize substantial gains from using the strategy, from licensing it to others to use, or from simply precluding other parties from using it. *Id.* Without the patent, companies, while not obligated to share the strategy with its competitors, face the risk of other parties learning of the strategy and employing it to their own use. *Id.*

[121] Figg, *supra* note 8, at 45. The increase in costs incurred will be due both to additional expenses related to using or not using a patented strategy as well as the costs of litigation. *Id.*

[122] *Id.* at 46.

[123] Devinsky, Fuisz & Sykes, *supra* note 23, at 3. The concern is that other strategies such as legal defenses employed by attorneys, if patentable, would result in major ramifications. *Id.* The

Advocates argue that tax strategy patents will help promote new ideas and technology.[124] Next, advocates say that patenting tax strategies will help the economic flow of the nation.[125] Advocates finally contend that the development of new ideas greatly benefits people because it saves taxpayers money.[126]

III. PROPOSAL

As the tax strategy patent debate continues to unfold, possible solutions to the problem must be addressed. As an effective and complete solution, this comment proposes that Congress should amend the patent laws to remove tax strategies from patentable subject matter. If this solution is implemented, the issue of tax strategy patents would be resolved.

In the past, Congress has successfully removed certain items from patentable subject matter.[127] For example, Congress created an exception to the patent laws in 1954 by removing nuclear materials and atomic energy from the realm of patentable subject matter.[128] The same should be done for tax strategy patents.[129] Although tax strategy patents may arguably meet the requirements for patentable subject matter, the policy implications and burdens on both taxpayers and tax professionals outweigh any potential gain likely to result from issuing such patents.

At a recent Congressional hearing, the Select Revenue Measures of the House Ways and Means Committee addressed tax strategy patents.[130] All present at the meeting conceded that tax strategies could be considered patentable subject matter; however, this was not the focus of the meeting.[131] Instead, the meeting addressed the policy issues associated with the issuing of these patents.[132]

The IRS expressed concerns about what would happen if patenting was allowed for methods of complying with the law.[133] The IRS also stated that only it has the

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contention would be that because these are aspects of the law, these patents are flawed because no one should be permitted to own parts of the law. *Id.*

[124] *Hearing on Issues Relating to the Patenting of Tax Advice: Hearing Before the S. Comm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. 2 (2006).

[125] Figg, *supra* note 8, at 46. The overall patent system is designed to positively impact the economic flow and overall well-being of the country. *Id.*

[126] *Id.* "The development of methods for avoiding unnecessary tax payments should be commended, not condemned." *Id.*

[127] *See* Devinsky, Fuisz & Sykes, *supra* note 23, at 2.

[128] 42 U.S.C. § 2181 (2006). *See also* Devinsky, *supra* note 23, at 2. "This field involves massive public-policy concerns, so the reason behind the exclusion is obvious." BRIAN W. SMITH, E-COMMERCE: FINANCIAL PRODUCTS AND SERVICES 228 (Law Journal Press 2001).

[129] Drajem & Donmoyer, *supra* note 5, at A10. The proposed bill by Barack Obama and the other senators proposes nearly the same thing suggested by this comment. *Id.* The three senators behind the bill say that over $100 billion in governmental tax revenues are lost each year due to the use of certain tax strategies. *Id.*

[130] *Hearing on Issues Relating to the Patenting of Tax Advice: Hearing Before the S. Comm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. 2 (2006) (announced by Dave Camp, Chairman, S. Comm. on Select Revenue Measures of the Committee on Ways and Means). *See also* Schwartz, *supra* note 18, at 35. Present at this hearing were the Commissioner of Internal Revenue as well as the General Counsel of the USPTO. *Id.*

[131] Schwartz, *supra* note 18, at 35.

[132] *Id.*

[133] FULCRUM INQUIRY TAX ADVICE AND NEWS, *supra* note 76.

power to determine what complies with the IRC and to grant this power to the USPTO would only cause confusion.[134] Finally, the IRS vowed to educate the USPTO as to why tax strategy patents should not be allowed.[135]

Patenting tax strategies would greatly impact tax professionals. Once a tax strategy is patented, tax attorneys and advisors would need to be educated on the patented methods.[136] Additionally, tax professionals would be required to either pay a licensing fee for the use of the strategy or be prohibited from using it all together.[137] Requiring tax professionals to pay licensing fees or banning them from using tax strategies would change how people deal with their taxes. Practitioners would be required to pursue further education in order to learn about methods which can work in the alternative. Furthermore, what happens when all of these methods become patented? If practitioners were required to pay licensing fees, the patent holder could potentially enjoy a monopoly simply through holding that patent.[138]

Moreover, the USPTO lacks the expertise to determine whether a given tax strategy is patentable.[139] Utilizing tax strategies requires knowledge of the field. Only educated tax professionals would know whether prior art exists or whether a strategy is considered novel and non-obvious to an average practitioner in the tax field.[140] If patent examiners without tax training have authorized patents on strategies which do not meet the full requirements for patentability, an individual might receive protection where protection is not proper.[141]

Additionally, tax strategies should not be eligible for patenting because of the ramifications on other patent-eligible items. For example, because many of these strategies are in essence advice, what is to stop other types of advice such as legal advice from being patented?[142] If tax strategy patents become acceptable, a

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[134] *Id.*

[135] *Id.*

[136] Norris, *supra* note 89. One lawyer working for Jones Day in Dallas expressed his opposition of tax strategy patents by asking what the future would be like if these types of patents continued to issue. *Id.* He noted the difficulty it would cause to lawyers and accountants if they were required to find out whether a given method had a patent tied to it. *Id.* Furthermore, the lawyer described how doing taxes would become even more expensive due to practitioners having spending time and money on researching and licensing fees. *Id.*

[137] *See* 35 U.S.C. § 154(a) (2006).

[138] *Id.* The article discusses what would happen if these types of strategies became acceptable. *Id.* One concern is that a company could potentially figure out a new strategy which would save both them as well as their clients a lot of money. *Id.* However, they can then refuse to license the strategy or charge substantial fees for their use. *Id.* If either of these is done, the costs of doing business for other companies would increase due to them having to find an alternative or having to pay those high licensing fees for the use of the patented strategy. *Id.*

[139] Devinsky, Fuisz & Sykes, *supra* note 23, at 3. Tax law has been known to be very arcane. Kahn, *supra* note 9. Those opposing tax strategy patents question whether the USPTO is up-to-date with all of the latest tax methods. *Id.*

[140] Kahn, *supra* note 9. The concern is that the Patent Office lacks sufficient information about a given tax strategy. *Id.*

[141] George G. Jones & Mark A. Luscombe, *Patenting Tax Strategies: A Troubling Storm Develops*, WEBCPA, Aug. 21, 2006, http://www.webcpa.com/article.cfm?articleid=21538&pg=newsarticles. Some have suggested that the IRS team up with the USPTO when an application for a tax strategy patent come in; however, this would pose an undue burden on the IRS who has other duties to carry out. *Id.*

[142] Kahn, *supra* note 9. For example, if a given legal defense were patented, that would mean that a defendant would be precluded from using that defense without paying a fee. *Id.* If someone

precedent will be set which potentially allows these other forms of advice to be patented.

Finally, because of the confidential nature of tax returns and monies paid to the government, these patents would be extremely difficult to enforce. Absent documents regarding a taxpayer's paid money, a holder of a tax strategy patent would not be able to determine whether someone has infringed his patent.[143] Even if the patent holder pursued the matter by outsourcing the task of finding patent infringers to an outside company, the patent holder's costs would rise and perhaps, even get to the point that holding such a patent is not worth it. If the tax patents cannot be enforced, tax strategies should not be eligible for patent protection.

Removing tax strategies from patentable subject matter would remedy all of the above mentioned problems.[144] Tax strategy patents are not necessary, do not promote the useful arts nor encourage invention. Rather, tax strategy patents serve as a burden to everyone except for the holder of the patent. The impacts on public policy should be carefully taken into account. After considering the public policy ramifications of tax strategies, the answer is clear that Congress should create an exception to the patent laws for tax strategies.

CONCLUSION

Under the patent statutes for something to be eligible for patenting, it must be a novel and non-obvious man-made creation.[145] Whether a tax strategy can be patented and whether it should be patented are two different issues. Although the statutes make no mention of business methods or, specifically, tax strategies, the issue still exists due to the decision in *State Street*,[146] which held business methods constituted patentable material.

Rowe[147] sheds some light on the possible scenarios that may occur should tax strategies continue to be patentable subject matter. An individual using a given strategy to save money on taxes may be hauled to court for infringing on a patented strategy owned by another party. This is precisely what happened to John Rowe in *Rowe*[148] after he used a tax avoidance method known as SOGRAT.

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was being prosecuted for murder and they were claiming self-defense, their entire strategy would have to change or would become more expensive if that defense was patented. *Id.* This could also mean that the murder suspect might not even have a defense. *Id.*

[143] FULCRUM INQUIRY TAX ADVICE AND NEWS, *supra* note 76.

[144] Jones & Luscombe, *supra* note 141. The Jones article also suggests alternative solutions to the issue surrounding tax strategy patents. *Id.* The suggestions in the article include: add additional examiners to the USPTO who possess knowledge in the area of tax; pass statutes which would limit patenting; instruct practitioners of the due diligence duties required by them as a result of the patents; require strict disclosure of confidential records; and restrict what types of strategies may be patented. *Id.* Finally, the last suggestion advises that at the very least, accountants, attorneys, and other tax practitioners be immune from any incidental infringements attributable to them. *Id.*

[145] *Id.*

[146] 149 F.3d 1368, 1373 (Fed. Cir. 1998).

[147] Wealth Transfer Group, LLC v. Rowe, No. 3:06CV00024 (AWT) (D. Conn. Mar. 9, 2007).

[148] *Id.*

After analyzing the characteristics of tax strategies against the elements required for patentable subject matter, it is clear how the USPTO can find certain strategies patentable. However, the overwhelming evidence shows that most tax strategy patents lack at least one or more of the elements required for patentability. Even if tax strategies are found to meet the subject matter requirements for patentability, they may be precluded due to the Prior User Defense, or by a finding that the strategy is not considered an invention.

As this comment suggests, the solution lies in Congress's hands. Congress must act quickly to remedy the issue of tax strategy patents before a dangerous precedent is established allowing a myriad of advice and tax strategies to be patented. If Congress removed tax strategies from the realm of patentable subject matter, the issue would be resolved. In the mean time, let us hope we are never faced with John Rowe's daunting scenario of being sued for patent infringement while filing our taxes.