

Introduction to Tax Strategy Patents



BACKGROUND ON PATENT LAW



We as a nation have decided to grant patents in order to encourage innovation.



We interpret our patent laws broadly – anything under the sun made by man can be patented.



Many believe our patent policy is responsible for much of our nation's economic success.



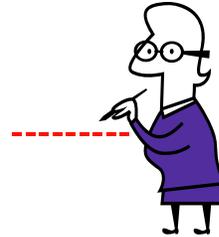
A patent gives its owner the right to exclude others from making using, selling, etc. the patented invention.



A patent is not a government seal of approval.



An application for a patent filed with the PTO must disclose the invention with specificity.



The PTO grants patents according to statutory criteria of novelty, usefulness, and non-obviousness.



The PTO cannot consult others outside of the PTO in examining a particular patent application.



Prior art is used to judge novelty and non-obviousness of patent applications.



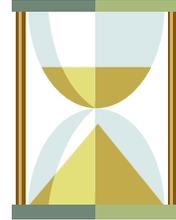
Prior art needs to be publicly available, including through data bases.



Patent examiners are generally trained as engineers and scientists.



They have limited time to review patent applications.



They can ask the applicant for additional information needed to examine the application properly.



Some applications are made public 18 months after date of filing.



Once granted, patents are presumed valid.



An alleged infringer must prove invalidity by clear and convincing evidence.



The penalty for infringement is compensation for actual damages, which is no less than a reasonable royalty plus interest and costs.



Infringement does not require intent or actual knowledge.



Treble damages can be awarded for willful infringement.



Liability also exists for inducing infringement.



Tax advisors, this could mean you!



Because patent litigation is so expensive, defendants often decide to settle.



TAX PATENTS AS A TYPE OF BUSINESS METHOD PATENT



State Street Bank is the key case establishing business method patents.



It involved a computer program designed to enable a partnership of investment funds to satisfy the sec. 704 regulations.



Business methods quickly became the fastest growing area of patent applications.



The PTO has established a subclass, 36T, for tax strategy patents.



As of August 20, 2008 it had granted 68 patents and published 116 applications in this subclass.



The SOGRAT patent and litigation received considerable press.



There is an issued patent on convertible debt instruments with contingent payments.



A recent patent application proposes a combined 1031-1033 exchange.



A large number of issued patents involve retirement, deferred compensation, and other ERISA issues



Patents of interest to tax practitioners appear in other classes as well.



For example, a patent for hedging deferred compensation is in a subclass for portfolio selection, planning or analysis.



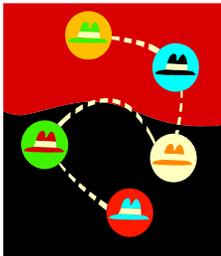
**RECENTLY PROPOSED
REGULATIONS UNDER
SECTIONS 601 AND 6111**



Regulations proposed in September would make use of any patented tax strategy a reportable transaction.



In general, the proposed regulations require reporting when fees are paid for the right to use a tax planning method that is the subject of a patent.



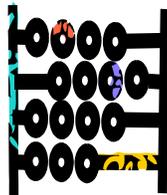
The regulations would define a tax planning method as

- any plan, strategy, technique or structure
- designed to affect
- Federal income, estate, gift, generation skipping transfer, employment or excise taxes



“Tax planning method” does not include a patent issued solely for

- tax preparation software or other tools
- used to perform or model mathematical calculations or
- provide mechanical assistance
- in the preparation or tax or information returns



There is concern about the breadth of this exclusion and the breadth of a similar provision in the House bill.

- Contrast the PTO's category for subclass 31: a computerized arrangement for determining or submitting a tax or tax form to a governmental entity.



Example of how the regulations would operate.

- A holds a patent on a tax planning method. B pays A a fee to use A's patent.
- A's tax return reflects the fee as income. B's tax return reflects the fee as a deduction.
- Both A and B will need to report the transaction.



Note: The term "patent" includes patents that have been applied for but not yet granted.

- Thus, patent applicants who deduct the patent application fee engage in reportable transactions.



Note: The regulations do not treat as a fee subject to reporting amounts paid in settlement of, or as the award of damages in, a suit for patent infringement.



Threshold amounts under sec. 6111(b) are reduced for material advisors for this type of transaction.

- From \$50,000 to \$250
- From \$250,000 to \$500



Proposed effective date

On or after Sept. 26, 2007