02/21/2008

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Subject
Reporting of Patented Tax Transactions Oral Testimony - 2/21/08

Internal Revenue Service Public Hearing - February 21, 2008 Proposed Rules (REG - 129916-07) on Reporting of Patented Tax Transactions
Outline of oral testimony

Thank you for the opportunity to appear this morning.

My name is Dennis Drapkin. I am the co-chair of the American Bar Association Section of Taxation Task Force on Patenting of Tax Strategies. I am also a former chair of the Tax Section. My testimony is presented on behalf of the Tax Section. It does not represent the views of the American Bar Association or of my law firm.

We again commend the IRS and the Treasury Department for publishing the proposed regulations. They address a subject of great importance to tax administration and tax policy, namely, the availability of patents with respect to tax strategies.

The Tax Section has been active in this area for over two years. We have sought to understand the nature and significance of these patents. Our principal focus has been on education. We have provided a large number of programs at our meetings devoted to this subject, and are grateful for the participation of government representatives in these programs. We also maintain current information on our website, including an extensive bibliography. In addition, we have worked with the US Patent and Trademark Office in training their patent examiners on how to find relevant prior art when considering tax patent applications.

A year ago, in response to your request, we submitted a letter recommending that you gather information pertaining to tax patents and patent applications under the authority granted by section 6011(a) of the Code using the reportable transaction framework provided by section 1.6011-4 of the regulations. We were therefore pleased to see your proposals when they were published last fall.

I will first address the fundamental need for this information.
As long as patents may be granted for inventions with respect to tax matters, it is essential that you receive up to date information regarding the types of patents that are being sought and how they are being used. This information is necessary so that you can assess the actual and potential impact on tax policy and tax administration, and take whatever actions seem appropriate to safeguard the integrity of the tax system.

Why is this important?

As the Supreme Court has stated:

"Taxes are the life-blood of government, ...."*

Tax compliance is obligatory. Equal treatment by the government of all taxpayers is fundamental. Yet a patentee has the right for 20 years to exclude others from using the invention. Tax patents, therefore, result in private control of portions of the tax system. The patentee, rather than Congress, decides who is eligible to use the patented process. Without regard to whether or not this type of private control is desirable, we believe that you must have prompt access to all relevant information.

Tax patents will increase the costs and uncertainties of tax compliance. Taxpayers and their advisers will need to consider how to take into account their potential significance, including the need to conduct patent searches and evaluations. If patents are potentially applicable, taxpayers may need to negotiate for their use, or pay to develop alternative strategies or methods of compliance. The complexities of the tax system could be multiplied substantially by these overlapping concerns with patent compliance.

The standards for granting patents are not necessarily compatible with sound tax policy. Indeed, patent examiners cannot consider policy other than patent policy in granting patents. Thus the consequences of tax patents may be different from and, indeed, even conflict with the goals of tax policy and tax administration. For example, the patent law does not preclude the issuance of patents that have the potential for facilitating tax avoidance, including those for aggressive tax strategies.

It has been suggested that instead of these proposed regulations, you rely exclusively on information made public pursuant to the patent law. In addition to the deficiencies already noted, current patent law does not require that patent applications or patent licenses be made public. Moreover, you would then be limited to only the information that the patent law requires to be made public, and would not obtain information that is more focused on tax matters, as proposed by these regulations.

For similar reasons, we believe that the information should be obtained at the earliest possible time, including, where possible, as patent applications are submitted.

Treasury and IRS need adequate time to analyze and assess the consequences of tax patents. There is a substantial time lag between the submission of a patent application and the grant of a patent, and even more time may elapse before data regarding patent use may be
available, if at all. Given the potential significance of the information, we see no reason why the Treasury and the IRS should be placed at a significant disadvantage by not having any meaningful information about the subject matter of a tax patent until the patent is granted, and no information concerning how the patent is being used.

To summarize, we believe that Treasury and the IRS should not be treated as ordinary members of the public with respect to patents that could affect tax policy or tax administration. Thus,

- you should have current information regarding how tax patents and tax patent applications are being used;

- you should have the earliest opportunity to consider adjustments to the tax laws in response to even the possibility that a patent right might be granted; and

- you should not be prevented from reacting for several years while a tax patent application is being examined.

Let me briefly turn to other matters discussed in our comments.

The proposed regulations are intended to be effective as of September 26, 2007. Given the new types of transactions and data that would need to be reported, we ask you to reconsider requesting information as of that date, and recommend delaying the effective date of the regulations until they are finalized, without any retroactive impact.

We also recommend monitoring published tax patent applications and tax patent grants as they are made public under existing patent law. Although as previously stated, this information has its limitations, nevertheless, it is available to be studied and may inform your overall review.

Finally, as stated in the preamble to the proposed regulations and often mentioned elsewhere, it is possible that taxpayers may confuse the grant of a tax patent with a governmental seal of approval of the underlying tax strategy, tax advice or tax compliance method. While this may be a valid concern, we do not see expansion of reportable transactions as a cure. Instead, we urge the IRS to consider outreach to taxpayers and other stakeholders to make clear that a patent grant provides no such assurance and that you retain the right to challenge any such strategy or advice. In addition, we recommend that you consider amending the regulatory definition of "authority" under section 6662 of the Code to reinforce this point.

That concludes my prepared remarks.

I would be pleased to answer any questions.

*Bull v. United States, 295 U.S. 247, 259 (1935).*