Patented Tax Strategies – Ethical Concerns for the Tax Lawyer and Estate Planner

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What Every Tax and Estate Planning Lawyer Should Know About Patented Tax Strategies

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I. Basic Issues in Representing a Client

A. Before implementing a tax planning strategy, do you need to do a patent search? If so, under what circumstances?

B. What is the risk if you do not do a patent search? Can you protect yourself by referring your client to a patent lawyer? By issuing a disclaimer?

C. If by search or otherwise you learn of a patented tax strategy that might be useful to a client, what must you weigh in deciding whether to recommend the strategy to the client? What duties do you have if you arrange for a license for your client to use the strategy? If you conclude the patent is invalid, is there still any risk to you in proceeding without arranging a license for you client?

D. Might you have a duty to advise a client to seek out the patent holder directly?

E. If there is no patented tax strategy and you develop a tax strategy for a client that seems novel and non-obvious, what considerations should you weigh in considering whether to seek a patent with respect to the strategy? What duties will impact or affect your decision to seek a patent? If your client is paying for your services, can your client apply for a patent on the strategy? As between you and your client, who is entitled to the patent?

II. Issues Affecting the Lawyer Who is Seeking or Holds a Patent

A. Who owns the patent rights? If a lawyer prepares and implements a tax planning strategy for a client, who is entitled to patent the strategy, the lawyer of the client? Should this be covered in the engagement letter?

B. Legal strategy patents – A new paradigm? Can legal ethical rules and Circular 230 apply to aspects of a lawyer's activities in obtaining and/or holding a patent? If so, how?

1. When a lawyer licenses a patented tax planning strategy to a client, is the licensing of the patent the provision of "law-related services" under MRPC 5.7? See Comment 9.

a. If yes, what are the consequences to the lawyer and the client? See Comments 1 and 3.

b. If no, should MRPC 5.7 be extended to cover this situation?

2. Does MRPC 1.8(a) apply to the lawyer's licensing of a patented tax planning strategy to a client? How would the application of MRPC 1.8(a) differ from the application of MRPC 5.7 in these circumstances?

    a. Standard applicable to license fee – MRPC 1.8 v. 1.5.

    b. Which approach would be preferable?

3. Should MRPC 5.7 be amended to expressly include licensing a legal planning strategy to the holder's own client as the provision of a "law-related service"?

    a. Licensing property vs. providing services

    b. Other implications under the Model Rules

C. When does a patent application or advice with regard to a patent trigger application of Circular 230?

1. Does an application for a patent on a tax planning strategy constitute practice before the Internal Revenue Service under Circular 230, § 10.3. Note that Circular 230, § 10.2(a)(4) now defines practice before the Service to include "rendering written advice with respect to any entity, transaction, plan, arrangement, or other plan or arrangement having a potential for tax avoidance or evasion."

2. If so, what are the consequences if the person obtaining the patent is not admitted to practice before the Service? Does this create a conflict between the patent laws and Circular 230? Or is the applicant exempt from Circular 230 under the patent law and the Supremacy Clause. *Cf. Sperry v. Florida, 373 U.S. 379 (1963).*

3. If the patent applicant is admitted to practice before the Internal Revenue Service, do the covered opinion and written advice rules of Circular 230, §§ 10.35 and 10.37 apply to the submission of the patent application? To the patent? To the licensing agreement between an attorney or CPA patent holder and either an attorney acting for a client or a client using the patent? Do these rules apply with respect to other written advice provided to a user of the patent by the attorney or CPA patent holder or an

attorney representing either the patent holder or the user of the patent?

D. Relationship of patent holder to lawyer seeking license and to ultimate client.

What is the relationship of the patent holder to another lawyer who licenses the patent for use on behalf of a client? What is the relationship of the patent holder to the ultimate client? What duties does the patent holder owe to the other lawyer and/or the ultimate client? Does it matter whether advice is provided with the license? The answers to these questions will determine the degree to which a number of existing ethical rules apply.

E. Conflicts of interest – MRPC 1.7, Comment 10; MRPC 1.8(a); Circ. 230, § 10.29.

1. Can a lawyer advise the client to use a patented tax planning strategy where the lawyer is the patent holder or owns an interest in the patent? If so, under what circumstances?

a. Lawyer's personal interests.

1) Lawyer's financial interest in charging for use of the patent.

2) Lawyer's interest in having the patent used and validated, perhaps despite uncertainty about whether the hoped for tax consequences will result.

3) Lawyer's possible reluctance to explore other tax planning alternatives for which the lawyer would not be able to charge for a license to use a patent – a charge which may not be subject to ethical rules limiting legal fees.

b. Requirements for "waiving" conflict.

1) The lawyer must reasonably believe s/he can provide competent and diligent representation.

2) Informed consent, confirmed in writing, depending on the jurisdiction. Circular 230, § 10.29(b) now requires that the consent be confirmed in writing **by each affected client**

within a reasonable period not exceeding 30 days after the consent. Such consents must also be retained for 36 months after the conclusion of the representation and provided on request to the Service. § 10.29(c).

3) For "informed consent," see Comments 18 and 19 to MRPC 1.7.

2. Patent applied for by lawyer. If a lawyer prepares and implements a tax planning strategy on behalf of a client, do the conflict of interest rules affect the lawyer's ability to seek a patent for the strategy because the lawyer is seeking a personal benefit from work done on behalf of the client? If so, can the conflict be waived with the client's informed consent?

3. The patent holder's ability to decide whether to license the patent to others may allow the patent holder to create a monopoly with respect to the particular tax planning strategy, thus limiting the client's ability to have counsel of his/her choice. See MRPC 5.6, generally prohibiting lawyers from making or offering agreements that restrict a lawyer's right to practice, to which Comment [1] adds that such an agreement "also limits the freedom of clients to choose a lawyer."

F. Confidentiality of client information – MRPC 1.6.

1. MRPC 1.6 does not permit a lawyer to reveal information relating to the representation of a client without the client's informed consent. There is no exception for information provided to the U.S. Patent and Trademark Office in connection with a patent application.

2. Suppose the lawyer requests the client's informed consent by offering to reduce the client's fee. See MRPC 1.7, regarding concurrent conflicts of interest. In this situation, the lawyer wants to disclose the information in order to obtain the patent, while the client may prefer nondisclosure, perhaps to avoid the possibility of an audit or simply for privacy reasons.

3. Proposed Treas. Reg. §1.6011-4(b)(7) would add the patented transactions category to the categories of reportable transactions defined in the regulations issued under IRC § 6011, for which disclosures by material advisors are required under IRC § 6111. This could be a new exception to MRPC 1.6.

G. Fees – MRPC 1.5 (a); Circ. 230, § 10.27.

1. Can a lawyer charge a client for work that benefits the client and is integrated into a patent application covering the planning technique used for the client?

2. Allocation between patent application costs and client costs.

3. Does MRPC 1.5 impose any limit on how much a lawyer holding a patent on a tax planning strategy may charge a client for the use of the patented strategy? That is, is a payment by the client for a license to use the strategy a legal fee subject to MRPC 1.5 and similar state bar rules? Is a licensing agreement between a lawyer patent holder and a patent user (or the attorney for a patent user) subject to the fee provisions of § 10.27 of Circular 230? If so, how?

H. Required submission of requested information to Service – Circular 230, § 10.20. When does this apply to information requested about a patent or patent application?

I. Advertising and solicitation – Which documents about the patent, including the patent application, the patent, a license agreement and any supporting documents and other communications, are subject to MRPC 7.1, 7.2 and 7.3 restrictions on advertising and solicitation, as appropriate, as well as Circular 230, § 10.30? This is particularly important since patents are granted without regard to the viability of the "invention," that is, in the case of a tax planning strategy, without consideration of the likelihood that the hoped for results of using the strategy will be achieved.

J. Handling infringement litigation.

1. Confidentiality of client information.

2. Conflict of interest between lawyer and client.

3. Withdrawal? MRPC 1.16.

K. Lawyer/Firm conflicts – Who owns the patent as between the creating lawyer and the lawyer's firm? If the lawyer joins another firm, can the first firm prevent the lawyer from using the patent for a client of the second firm?

III. Issues Affecting a Lawyer Who Is Advising a Client but Has No Financial Interest in the Patent

A. Due diligence – MRPC 1.3 – Must a lawyer exercise due diligence to determine whether the tax plan proposed for the client is patented? See section H below.

B. Communication to the client – MRPC 1.4 – The lawyer must disclose and explain to the client the existence of the patent, the availability or non-availability of a license to use the patent, the possible consequences of using the patented technique without a license (noting that not knowing of the patent's existence is not a defense against liability for infringement), and the merits and costs of alternative unpatented planning techniques.

C. Conflicts of interest with lawyer's personal interests.

1. Lawyer's personal interests.

    a. Avoiding risk of liability for inducing infringement.

    b. Avoiding cost of defending against dubious infringement claims, possibly based on a defense that the patent is invalid.

    c. Impact of license cost on lawyer's ability to collect reasonable fee from client.

    d. Avoiding malpractice claims.

    e. Retention of the client.

2. Under what conditions can the lawyer continue to represent the client? See MRPC 1.7(b) and Circular 230, §10.29, discussed in outline above at III,E,1 for the requirements for informed consent to waive the conflict.

D. Duty to refer client to patent holder? – Might a lawyer have a duty to refer a client to the patent holder if the patent holder refuses to license the patent for use by the lawyer's client as represented by the lawyer or the patent holder waives any license fee for his or her own clients?

E. Confidentiality of client information – MRPC 1.6 – The lawyer may need to ask the client's informed consent to disclose protected client information in order to ask the patent-holder for a license to use the patent.

F. Relationship of lawyer to patent holder.

1. What is the relationship of the lawyer to the patent holder? Can the lawyer rely on the patent holder's statements about the tax consequences of the patented strategy? If so, what does this imply about the patent holder's duties? Or must the lawyer independently evaluate the tax consequences?

2. If the patent holder is a lawyer, does the fee-sharing rule apply? If so, how? See MRPC 1.5(e), which requires, *inter alia*, either that an allocation of fees be in proportion to the services performed by each lawyer or the assumption by each lawyer of joint responsibility for the representation.

3. If a patent holder who is not a lawyer engages in activities with respect to marketing the patent that constitute the unauthorized practice of law, is a lawyer in violation of MRPC 5.5(b) if, in advising a client, the lawyer arranges for the client to license the patented tax strategy? Is the lawyer engaging in disreputable conduct, subject to sanction, under Circular 230, § 10.51(a)(11) if the patent holder is not eligible to practice before the Service?

G. Handling infringement litigation – Similar issues to those discussed above in section III, H, I and J. Note, however, that if care is taken with respect to the roles of trial counsel and opinion counsel where opinion counsel's advice is relied upon as a defense, disclosure of opinions will not waive attorney-client privilege with respect to communications with trial counsel. *In re Seagate, 2007 U.S. App. LEXIS 19768 (Fed. Cir., en banc, 2007).*

H. Malpractice liability potential

1. General principles – conflicts, diligence, competence, etc.

   For a recent comprehensive review of tax malpractice in the estate and gift tax field, see Jacob L. Todres, Recent Tax Malpractice Developments in the Estate and Gift Tax Area, 39 TAXES No. 39 (Oct. 2005).

2. Duty to search for patent

   a. Is there such a duty on the part of a tax lawyer?

   b. If not, is there a duty to consult with a patent lawyer?

   c. Is the cost to the client relevant in either case?

   c. What factors would support the existence such a duty?

d. Suppose you fail to find the patent despite a search.

d. Can you protect yourself with a disclaimer?

3. If there is a relevant patent

a. Is there a duty to evaluate a relevant patent?

b. Alternatively, is there a duty to consult an expert?

c. Can you disclaim expertise on the patent law?

d. If you conclude it is invalid or would not be infringed

1) What can/should you tell the client?

2) Can you disclaim liability for the costs of infringement litigation?

IV. Other Issues

A. Issues as to when a patent is used or infringement occurs -- When has a patented tax strategy been used (with permission) or infringed? The answer to this question will inform a number of issues. Does permitted use or infringement occur when the patented strategy is described and proposed to the client? When documents are drafted? When documents are signed? When the documents actually take legal effect, for example, in the case of a will, when the client dies? Or when the relevant tax return is filed? If the permitted use or infringement occurs only upon the documents taking legal effect or a return being filed, does the lawyer have a duty to monitor patent activity to assure the client periodically that the planning strategy has not been patented?

B. Unauthorized practice of law by non-lawyer patent holder – Is there some point at which a non-lawyer who obtains a patent with respect to a tax planning strategy and seeks to market the strategy is engaged in the unauthorized practice of law?