Estate & Succession Planning Corner

By Lawrence I. Richman

The End of Tax Strategy Patents?

In our January-February 2007 column we discussed a disturbing development for tax practitioners: the growth of the tax strategy patent industry.[1] In that column, we reviewed how for a patent to issue an innovation be "nonobvious" such that it would not be an improvement that would be obvious to a person having ordinary skill in the pertinent art.[2] We also explained how the Court in *State Street Bank and Trust Co. v. Signature Financial, Inc.*[3] created the right to patent business methods. *State Street* approved the patentability of a business method system for computerized mutual fund pooling under Section 101 of the Patent Act. That section of the statute allows the issuance of patents to whomever "invents or discovers any new and useful process, machine, manufacture or composition of matter, or any new and useful improvement thereof…"[4]

While many tax practitioners probably gave little heed to the Patent Office allowing patents for tax strategies as just another business method patent, practitioners did take note of the litigation in *Wealth Transfer Group LLC v. John W. Rowe*,[5] which involved patent 6,567,790, also known as the SOGRAT patent. That patent was for a Grantor Retained Annuity Trust (a "GRAT") to which stock options and possibly other assets would be transferred. The "invention" minimized transfer taxes by "(1) calculating an optimum annuity percentage to reduce the value of the taxable gift, and (2) minimizing estate taxes through use of the GRAT. The … invention also determines the length of the term of the GRAT, beginning and end of year asset value, and the form of payment of the annuity each year based on either estimated or actual input variables as selected by the user."[6]

The SOGRAT patent seemed to tell tax practitioners that the PTO standard for granting a tax strategy patent was that the strategy produce a useful result such as tax savings. The fact that the so-called invention seemed obvious or was little more than a dressed-up

Lawrence I. Richman is a Partner with Neal Gerber & Eisenberg in Chicago.

thought process appeared not to be relevant.

The recent decision of the Court of Appeals for the Federal Circuit in *In re Bilski*[7] marks a halt in the approval of patents for thought-based processes. In *Bilski* the Federal Circuit required that in order for a process to be patent eligible that "it transform a particular article into a different state or thing."[8] By making transformation of an article to a different state or thing, the critical test of the patentability of a process that does not involve a particular machine the *Bilski* court iterated a bright line that any tax strategy patent should find difficult to cross.

Bilski, however, is not a tax strategy patent case. Rather, it involves a patent application for a method of using hedging contracts to reduce the risk that a commodity's wholesale price might change. The process provides for a set of hedging transactions at another price when a commodity seller makes a sale at a fixed price. The *Bilski* patent application claimed as follows:

> "A method for managing the consumption risk costs of a commodity sold by a commodity provider at a fixed price comprising the steps of:
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> (a) initiating a series of transactions between said commodity provider and consumers of said commodity wherein said consumers purchase said commodity at a fixed rate based upon historical averages, said fixed rate corresponding to a risk position of said consumer;
>
> (b) identifying market participants for said commodity having a counter-risk position to said consumers; and
>
> (c) initiating a series of transactions between said commodity provider and said market participants at a second fixed rate such that said series of market participant transactions balances the risk position of said series of consumer transactions…

In essence, the claim is for a method of hedging risk in the field of commodities trading."[9] The process involves neither calculation of hedging prices nor computers to implement the strategy. In September 2006, the PTO ruled the method as not being patentable subject matter. The ruling was then appealed to the Federal Circuit where the ruling of the PTO was affirmed.

It is the absence of any technology or machine as an integral part of the *Bilski* patent application that makes the *Bilski* decision so important to tax practitioners. In issuing its ruling, the *Bilski* court stated "We hold that the Applicants' process as claimed does not transform any article to a different state or thing. Purported transformations or manipulations simply of public or private legal obligations or relationships, business risks, or other such abstractions cannot meet the test because they are not physical objects or substances, and they are not representative of physical objects or substances…As discussed earlier, the process as claimed encompasses the exchange of only options, which are simply legal rights to purchase some commodity at a given price in a given time period."[10]

By rejecting the approach taken in tax patent strategy patents which focus on (1) whether the patent seeking process produces useful, concrete and tangible results and (2) whether the tax patent involves physical steps, the *Bilski* court clearly demonstrates that more than a mental and mathematical process is required for a process patent to issue. Read narrowly, however, the decision would seem to apply only to those tax strategy patents based upon pure mental process that do not require technology such as a specific computer program.

It is hard to envisage how a tax strategy could be seen as transforming an article into a different state or thing, although one would expect that future tax patent strategy applications will seek to either tie the application of the strategy to a specific computer program or explain how transforming the tax strategy is. Future decisions should help fill in the details. In the interim, *caveat* patent-seeking tax practitioner.

Endnotes

1 Lawrence I. Richman, Estate & Succession Planning Corner, *Tax Strategy Patents,* J. Passthrough Entities, Jan.–Feb. 2007, at 9.
2 Patent Act of 1952, 35 USC §103.
3 *State St. Bank & Trust Co. v. Signature Fin. Group*, CA-FC, 149 F3d 1368 (1998).
4 35 USC §101.
5 *Wealth Transfer Group LLC v. John W. Rowe,* Dkt. No. 3:06-CV-00024 (ANT)(D. Conn.).
6 United States Patent 6,567,790, USPTO Patent Full-Text and Image Database at page 6.
7 *In re B.L. Bilski*, CA-FC, 2008-2 USTC ¶50,621.
8 *Id.,* at 13.
9 *Id.,* at 2.
10 *Id.*, at 28.