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# Tax Strategies Are Not Patentable Inventions

BY ANDREW A. SCHWARTZ



Andrew A. Schwartz

In the most recent issue of this Newsletter, E. Anthony Figg, the immediate past Section Chair, addressed certain policy concerns relating to patents on “tax strategies” and responded to the “quite negative” reactions of tax and estate-planning professionals “to the realization that tax preparation and planning methods represent

patentable subject matter.”<sup>1</sup>

This “realization” dates back to 2003, when the Patent Office awarded its first ever tax-strategy patent,<sup>2</sup> thereby tacitly expressing its view that tax strategies are eligible for patenting. The Office has since stated its view that tax strategies are a type of business method<sup>3</sup> and are therefore patentable under the authority of *State Street Bank & Trust Co. v. Signature Financial Group Inc.*<sup>4</sup>

But the issue of whether tax strategies meet the statutory requirements of the Patent Act has never been resolved by any court,<sup>5</sup> nor has it even been analyzed in the academic literature.<sup>6</sup> At a recent hearing of the Subcommittee on Select Revenue Measures of the House Ways and Means Committee on “issues relating to the patenting of tax advice,” for example, none of the witnesses (including the General Counsel of the USPTO and the Commissioner of Internal Revenue) questioned the patentability of tax strategies. Their testimony focused entirely on the policy implications of this new type of patent and on whether Congress should amend the Patent Act to exclude tax strategies from the scope of patentable subject matter.

This article suggests, however, that tax strategies cannot be patented, no matter how novel or nonobvious, because they are not “inventions” within the meaning of Section 101 of the Patent Act of 1952, as amended to date.

## I. The Invention Requirement

The Patent Act provides that a patent may issue for “any new and useful process” or product.<sup>7</sup> The Supreme Court has held that this language to include within its scope “anything under the sun made by man.”<sup>8</sup> But Congress did not, by enacting the Patent Act, give the Patent Office a blank check. To the contrary, Congress limited its authority by including a number of conditions and requirements for patentability, such as novelty, inventorship and nonobviousness.<sup>9</sup> One of these conditions is that only “inventions” may be patented.<sup>10</sup>

What is meant by the term “invention”? The defini-

tion provided in Section 100 of the Patent Act — “The term ‘invention’ means invention or discovery.”<sup>11</sup> — is not helpful. A leading legal dictionary’s entry for “invention” describes it as a “word impossible of definition.”<sup>12</sup> The Supreme Court, however, has not shied away from this challenge and has offered a clear and workable definition of the term “invention” from as far back as the late nineteenth century to as recently as the late twentieth century. To understand the court’s definition, however, requires a detour into the “law-of-nature” doctrine.

## II. The Law-of-Nature Doctrine and Its Corollary

As discussed above, “anything under the sun made by man” is eligible for patenting.<sup>13</sup> It is well settled that the converse is also true: anything that was *not* “made by man” may *not* be patented. This is referred to herein as the “law-of-nature doctrine.”<sup>14</sup>

Thus, a product of nature, such as “a new mineral discovered in the earth or a new plant found in the wild[,] is not patentable subject matter.”<sup>15</sup> The same can be said for laws of nature (gravity,<sup>16</sup>  $e=mc^2$ ),<sup>17</sup> natural phenomena<sup>18</sup> (volcanic eruptions, the tides), abstract scientific principles<sup>19</sup> (thermodynamics, quantum physics) and mathematical concepts and algorithms<sup>20</sup> (the Pythagorean theorem,<sup>21</sup> calculus, the Fourier series). All of these are referred to collectively herein as “laws of nature,” and they are all excluded from patentable subject matter under the law-of-nature doctrine.<sup>22</sup>

The “underlying notion” of the law-of-nature doctrine is that laws of nature have “always existed,” just waiting to be discovered by humankind.<sup>23</sup> Because laws of nature have always existed, it logically follows that they cannot be newly created by humans. Hence, they necessarily fail the anything-under-the-sun-made-by-man<sup>24</sup> test and are excluded from patentable subject matter for that reason.

Thus, the law-of-nature doctrine holds that laws of nature are not patent-eligible.<sup>25</sup>

But there is a vital corollary to the law-of-nature doctrine: while a law of nature may not itself be patented, an *application* of that law of nature “may well be deserving of patent protection.”<sup>26</sup> The Wright brothers’ airplane was able to fly because it exploited certain laws of physics that are inherent in the universe. Whereas the underlying laws of physics that kept the plane in the air were not patentable, the airplane itself clearly would be. Similarly, when presented with Samuel Morse’s patent on the telegraph,<sup>27</sup> the Supreme Court upheld the first seven of his claims, but rejected the last which claimed “the use of the motive power of the electric or galvanic current, which I call electro-magnetism, however developed for marking or printing [characters] at any distances.”<sup>28</sup>

This distinction between laws of nature and the appli-

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cation thereof — however difficult to make in a given case<sup>29</sup> — is closely related to that which separates engineers from scientists. Scientists use experiments to understand and describe laws of nature.<sup>30</sup> But engineers create machines and methods for applying those laws of nature for human benefit.<sup>31</sup> As discussed in the next section, the term “invention” refers to the work of engineers, not scientists.<sup>32</sup>

### III. Definition of “Invention”

From at least as early as the *Telephone Cases* (1888),<sup>33</sup> to as recently as *Diamond v. Diehr* (1981),<sup>34</sup> the Supreme Court has construed the term “invention,” for purposes of patentability, in a single, consistent fashion: an “invention” is anything made by man that uses or harnesses one or more “laws of nature” for human benefit.<sup>35</sup> This construction harmonizes well with the law-of-nature doctrine and its corollary.

A simple example of a patentable invention is the watermill,<sup>36</sup> which is a system of extracting power from a river and using it to run machinery. The river’s power, of course, comes from the natural force of gravity. Another example is the I-beam, a construction beam with a cross section that resembles an uppercase “I.” The I-beam is extremely strong, relative to its own weight, because it has a high “moment of inertia,” a natural phenomenon.

By way of contrast, a “perpetual motion” machine does not harness any known laws of nature, but rather violates them. A perpetual motion machine therefore cannot qualify as an invention, and the Patent Office regularly rejects patents for such devices.<sup>37</sup>

The earliest description of a patentable invention by the Supreme Court as something that employs laws of nature for human benefit appears to be in a colorful concurring opinion from the Morse telegraph case of 1853.<sup>38</sup> In his concurrence, Justice Grier described the difference between scientists (“philosophers,” as he calls them) and engineers:

The mere discovery of a new element or law or principle of nature, without any valuable application of it to the arts, is not the subject of a patent. But he who takes this new element or power, as yet useless, from the laboratory of the philosopher and makes it the servant of man; who applies it to the perfecting of a new and useful art or to the improvement of one already known, is the benefactor to whom the patent law tenders its protection.<sup>39</sup>

The first majority opinion taking this view came decades later in the *Telephone Cases* (1888),<sup>40</sup> a consolidated action of numerous suits brought by Alexander Graham Bell for infringement of his patent on the telephone. In upholding his broad fifth claim,<sup>41</sup> the Supreme Court explained that it was valid because it disclosed a method of harnessing a law of nature for human benefit: What made the telephone a patentable invention, said the court, was that “one of the forces of nature is employed [E]lectricity, left to itself, will not do what is wanted. The [invention] consists in controlling the force as to make it accomplish the purpose.”<sup>42</sup>

In the twentieth century, the court explained in *United*

*States v. Dubilier Condenser Corp.* (1933)<sup>43</sup> that “the act of invention...consists neither in finding out the laws of nature, nor in fruitful research as to the operation of natural laws,...but in discovering how those laws may be used or applied for some beneficial purpose, by a process, a device or a machine.”<sup>44</sup> Similar language was employed in the later cases of *Funk Bros. Seed Co. v. Kalo Inoculant Co.* (1948),<sup>45</sup> *Gottschalk v. Benson* (1972),<sup>46</sup> and *Diamond v. Diehr* (1981).<sup>47</sup>

In short, this clear and consistent body of Supreme Court case law establishes that the term “invention,” as used in all Patent Acts to date, encompasses anything made by man that uses or harnesses one or more “laws of nature” for human benefit.

It bears noting, further, that this definition of invention has apparently also achieved universal acceptance around the world. The few patent systems that define invention by statute have adopted this construction. The Japanese Patent Law, for example, defines invention as “a highly advanced creation of a technical idea *making use of a law of nature*.”<sup>48</sup> Similarly, the Patent Act of the Republic of Korea states that “‘invention’ means the highly advanced creation of a technical idea *using the rules of nature*.”<sup>49</sup> Continental Europe appears to endorse this view as well.<sup>50</sup> It appears that no one, ever, has questioned this understanding of the term “invention.”

### IV. Tax Strategies Are Not Inventions

A novel tax strategy — whether it “works” under current law or not — cannot be an invention. As explained above, for an innovation to qualify as an invention, it must be human-made and employ or harness a law of nature. But tax strategies do not employ any law of nature to reduce tax liability. Rather, they employ or exploit one or more “laws of man” to achieve that result.

Consider for example the SOGRAT method, which is claimed by the first tax-strategy patent issued by the Patent Office.<sup>51</sup> This “estate planning method for minimizing transfer tax liability” ostensibly minimizes transfer tax through the use of a grantor-retained annuity trust (GRAT) funded with stock options (SO). The patented SOGRAT method appears to employ 26 U.S.C. § 2702 of the Internal Revenue Code in a novel manner to reduce estate tax liability.

Assuming, arguendo, that the SOGRAT “works” as a matter of federal tax law, it works because it uses (or exploits) 26 U.S.C. § 2702 — a “law of man” — to benefit at least some humans (heirs and devisees). It does not have any interaction with the natural world and clearly does not harness any law of nature. It is therefore not a patentable invention under the definition established by the Supreme Court and described above.

The same can be said of any method, strategy, structure or technique to reduce or eliminate tax liability. All such tax strategies work — if they work — by harnessing statutes, regulations or common law, not any law of nature or natural phenomena. Tax strategies thus fall out-

side the scope of “inventions” patentable under the Patent Act and cannot be patented.<sup>52</sup>

## Endnotes

1. E. Anthony Figg, *Keeping Current with the Chair*, 24 ABA IPL NEWSLETTER, Summer 2006, at 3.
2. U.S. Patent No. 6,657,790 (filed Dec. 1, 1999; issued May 20, 2003) (for an “estate planning method for minimizing tax liability”).
3. The Patent Office recently established a new “Tax strategies” subclass (705/36T) within the “Business Practice” class (705). See <http://www.uspto.gov/go/classification/uspc705/sched705.htm>; see also *Issues Relating to the Patenting of Tax Advice: Hearing before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 109th Cong. (2006) (statement of James Toupin, General Counsel, U.S. Patent and Trademark Office) (testifying as to “business method patents concerning tax strategies”).
4. 149 F.3d 1368 (Fed. Cir. 1998).
5. There is one currently pending case that appears to present the question. See *Wealth Transfer Group v. Rowe*, No. 06 Civ. 24 (D. Conn. filed Jan. 6, 2006).
6. But see Andrew A. Schwartz, *The Patent Office Meets the Poison Pill: Why Legal Methods Cannot Be Patented*, 20 HARV. J.L. & TECH. (forthcoming 2007) (explaining why legal methods, including tax strategies, are not patentable).
7. 35 U.S.C. § 101 (2005).
8. *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980) [hereinafter *Chakrabarty*].
9. 35 U.S.C. § 101 (2005) (“...subject to the conditions and requirements of this title”); cf. *Bonito Boats Inc. v. Thunder Craft Boats Inc.*, 489 U.S. 141, 151 (1989) (“[I]mplicit in the Patent Clause itself [is the understanding] that free exploitation of ideas will be the rule, to which the protection of a federal patent is the exception”).
10. See, e.g., 35 U.S.C. § 101 (2005) (“Inventions [are] patentable”); *id.* § 102(a)-(e) (2002) (“the invention”); *id.* § 103(a) (2004) (same).
11. See *id.* § 100(a) (2005).
12. BALLANTINE’S LAW DICTIONARY.
13. *Chakrabarty*, *supra* note 8, at 309.
14. See generally *Diamond v. Diehr*, 450 U.S. 175, 187-88 (1981) (collecting Supreme Court cases) [hereinafter *Diehr*].
15. *Chakrabarty*, *supra* note 8, at 309 (“The laws of nature...have been held not patentable.”) (collecting Supreme Court cases).
16. *Parker v. Flook*, 437 U.S. 584, 598 (1978) (Stewart, J., dissenting) (“A patent could not issue...on the law of gravity. ...”).
17. *Chakrabarty*, *supra* note 8, at 309 (“Einstein could not patent his celebrated law that  $E = mc^2$ ; nor could Newton have patented the law of gravity”).
18. *Funk Bros. Seed Co. v. Kalo Inoculant Co.*, 333 U.S. 127, 130 (1948) (“patents cannot issue for the discovery of the phenomena of nature”).
19. *Mackay Radio & Tel. Co. v. Radio Corp. of Am.*, 306 U.S. 86, 94 (1939) (“a scientific truth or the mathematical expression of it, is not patentable invention”); *Le Roy v. Tatham*, 55 U.S. (14 How.) 156, 175 (1853).
20. *Flook*, *supra* note 16, at 589 (“an algorithm or mathematical formula, is like a law of nature” and, hence, is not patentable).
21. *Id.* at 590 (“the Pythagorean Theorem would not have been patentable”).
22. See generally *Lab. Corp. of Am. Holdings v. Metabolite Labs. Inc.*, 126 S. Ct. 2921, 2925 (2006) (Breyer, J., dissenting).
23. *Flook*, *supra* note 16, at 593 n.15. See generally *Gottschalk v. Benson*, 409 U.S. 63, 67 (1972); *Le Roy*, 55 U.S. 156, 175 (1852) (“A principle, in the abstract, is a fundamental truth; an original cause; a motive; these cannot be patented, as no one can claim in either of them an exclusive right. Nor can an exclusive right exist to a new power, should one be discovered in addition to those already known.”); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW*, 294-333 (2003).
24. *Chakrabarty*, *supra* note 8, at 309 (emphasis supplied).
25. See Patent and Trademark Office, *Examination Guidelines for Computer-Related Inventions*, 61 Fed. Reg. 7478, 7481 (Feb. 28, 1996) (“The subject matter courts have found to be outside the four statutory categories of invention is limited to abstract ideas, laws of nature and natural phenomena”).
26. *Diehr*, *supra* note 14, at 175, 187; *Funk Bros.*, *supra* note 18, at 130 (“If there is to be invention from [the] discovery [of a natural law], it must come from the application of the law to a new and useful end.”); *Mackay Radio*, *supra* note 19, at 94 (“While a scientific truth or the mathematical expression of it, is not patentable invention, a novel and useful structure created with the aid of knowledge of scientific truth may be.”); *De Forest Radio Co. v. General Electric Co.*, 83 U.S. 664, 684-85 (1931) (“It is method and device which may be patented and not the scientific explanation of their operation.”); *O’Reilly v. Morse*, 56 U.S. 62, 132-33 (1853) (opinion of Grier, J.); *State Street*, 149 F.3d at 1374 (Fed. Cir. 1998) (“a process, machine, manufacture or composition of matter employing a law of nature, natural phenomenon or abstract idea is patentable subject matter even though a law of nature, natural phenomenon or abstract idea would not, by itself, be entitled to such protection”) (collecting Supreme Court cases).
27. See *O’Reilly*, *supra* note 26, at 132.
28. *Id.* at 112.
29. *Flook*, *supra* note 16, at 589 (the “line between a patentable ‘process’ and an unpatentable ‘principle’ is not always clear”).
30. Encyclopaedia Britannica defines “science” as the “pursuit of knowledge covering general truths or the operations of fundamental laws.”
31. Encyclopaedia Britannica defines “engineering” as “the application of science to the optimum conversion of the resources of nature to the uses of humankind.”
32. Cf. *Gottschalk v. Benson*, 409 U.S. 63, 67 (1972) (“Phenomena of nature, though just discovered,...are not patentable, as they are the basic tools of scientific...work”).
33. *Dolbear v. American Bell Tel. Co.*, 126 U.S. 1 (1888).
34. *Diehr*, *supra* note 14, at 175, 188 n.11.
35. Of course, any such invention would only be patentable if it were new, useful, nonobvious, not subject to a statutory bar and directed to statutory subject matter.
36. See *Slater’s Mill*, 67 Roosevelt Ave., Pawtucket, R.I. (first operational textile mill in the United States; est. 1793).
37. See *Tol-O-Matic Inc. v. Proma Product-und Marketing Gesellschaft M.b.H.*, 945 F.2d 1546, 1552 (Fed. Cir. 1991) (“Section 101 has...been interpreted to exclude devices deemed to be scientifically impossible, such as perpetual motion machines.”).
38. *O’Reilly*, *supra* note 26, at 62.
39. *Id.* at 132-33 (Grier, J., concurring) (emphasis supplied).
40. *Dolbear*, *supra* note 33.
41. Bell’s fifth claim read, “(5) The method of and apparatus for transmitting vocal or other sounds telegraphically, as herein described, by causing electrical undulations, similar in form to the vibrations of the air accompanying the said vocal or other sounds, substantially as set forth.” *Id.* at 1.
42. *Dolbear*, *supra* note 33, at 532.
43. 289 U.S. 178 (1933).
44. *Id.* at 187.
45. 333 U.S. 127, 130 (1948) (One “who discovers a hitherto unknown phenomenon of nature has no claim to a monopoly of it which the law recognizes. If there is to be invention from such a discovery, it must come from the application of the law of nature to a new and useful end.”).
46. 409 U.S. 63, 67 (1972) (quoting *Funk Bros.*, *supra* note 18, at 130).
47. 450 U.S. 175, 188 n.11 (1981) (quoting *Funk Bros.*, *supra* note 18, at 130).
48. Japan Patent Law of 1959, Ch. 1, Art. 2(1) (emphasis supplied).

49. Republic of Korea Patent Act, Ch. 1, Art. 2(1) (emphasis supplied).

50. *See, e.g.*, JOSEF KOHLER, *LEHRBUCH DES PATENTRECHTS* § 5(III), at 23 (1908) (“An invention, in a technical sense, is a new creation characterized by human ingenuity invoking the forces of nature.”) (original German: “Die Erfindung im technischen Sinne ist aber eine solche Neuschöpfung, welche eine Ueberwindung der Naturkräfte durch den menschlichen Geist enthält.”).

51. U.S. Patent No. 6,567,790 (filed Dec. 1, 1999; issued May 20, 2003).

52. By contrast, an innovative business method would appear to be a patent-eligible “invention” under the definition established by the Supreme Court and examined herein. First, many business method patents improve economic efficiency in some manner, for example, by reducing transaction costs. *See, e.g.*, U.S. Patent No.

5,960,411 (filed Sept. 12, 1997; issued Sept. 28, 1999) (Amazon.com’s “1-click” method of selling merchandise over the Internet). This seems highly analogous to a mechanical method of increasing energy efficiency by reducing friction and should be treated in the same way. Second, a fair number of business method patents are practical applications of algorithms or pure mathematics and are patentable under the corollary to the law-of-nature doctrine. The “Black-Scholes” options-pricing model, for instance, is a differential equation that provides a value for a stock option, premised on the assumption that the underlying stock price evolves according to Brownian Motion. The model is not itself patentable under the law-of-nature doctrine, because it is pure mathematics. But a patent could properly issue for a novel and useful business method that employed Black-Scholes. *See generally Schwartz, supra* note 6.

## e-Bay Effect

(continued from page 21)

able to them. (*See* 126 S. Ct. at 1840).

79. *Id.*

80. *Id.* (quoting *Honeywell Int’l, Inc. v. Universal Avionics Sys. Corp.*, 397 F. Supp. 2d 537, 547 (D. Del. 2005)).

81. 2006 WL 2385139, at \*1 (E.D. Tex. Aug. 16, 2006)

82. *Id.* at \*5.

83. *Id.* at \*6.

84. *Id.*

85. 2006 WL 2398681, at \*1 (E.D. Tex. Aug. 17, 2006)

86. *Id.*

87. On October 4, 2006, the Federal Circuit reversed the district court’s denial of Echostar’s request for a stay of the permanent injunction. This stay will be in place while the appeal is pending.

88. 2006 WL 2398681, at \*5.

89. *Id.* at \*6.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. 2006 U.S. Dist. LEXIS 59212, at \*1 (W.D. Mich. Aug. 22, 2006)

95. 2006 WL 2516568, at \*1 (S.D.N.Y. Aug. 29, 2006)

96. *Id.* at \*12.

97. *Id.* at \*9.

98. *Id.* at \*10. Additionally, the court found that since there were no other competing products on the market, but for plaintiff’s and defendants’ products, “[c]ompetition from defendants would likely lead to significant price erosion [for Canon].” *Id.* Thus, “absent injunctive relief, Canon will continue to lose sales and market share to defendants.” *Id.* The court also noted that, even if damages could be adequately calculated based on infringing sales, damages relief would likely not be adequate since defendants operations are located in various places throughout the world, and that “attaching assets sufficient to satisfy a money judgment would be exceedingly difficult.” *Id.*

99. *Id.* at \*11-\*12

100. *Id.* at \*12.

101. 2006 WL 2570614 at \*1 (W.D. Okla. Sept. 5, 2006)

102. *Id.* at \*6.

103. *Id.* at \*1. 35 U.S.C. § 284 provides for the award of treble damages in certain cases.

104. *Id.* at \*5.

105. *Id.*

106. *Id.*

107. *Id.* at \*6. One wonders whether the district court’s decision denying permanent injunctive relief here would have been different, had Scimed actually been a party to this suit. Since Scimed was actually using the patented technology, perhaps the Court would have been more likely to issue an injunction against Cordis,

since the harm to Scimed would have been more easily realized.

108. 2006 WL 2735499, at \*1 (D. Minn. Sept. 25, 2006)

109. *Id.*

110. *Id.* at \*1-\*2.

111. *Id.* at \*2.

112. *Id.*

113. Civil Action No. 2:02cv02873, Docket No. 294 (W.D. Tenn. Sept. 28, 2006)

114. Docket No. 294, at 6-7.

115. *Id.* at 10.

116. 2006 U.S. Dist. LEXIS 73366 at \*1 (E.D.N.Y. Sept. 28, 2006)

117. *Id.* at \*13-\*14.

118. *Id.* at \*14.

119. 2006 WL 3000134, at \*1 (W.D. Wash. Oct. 19, 2006)

120. 2006 WL 3000134 at \*4.

121. *Id.*

122. 2006 WL 3253450, at \*1 (D. Neb. Nov. 8, 2006)

123. *Id.* at 4-5.

124. 2006 WL 3446144, at \*1 (N.D. Ill. Nov. 29, 2006)

125. 2006 WL 3446144, at \*4

126. *Id.* at \*5.

127. *Id.*

128. The Eastern District of Texas is the jurisdiction with the most decisions: 4. (*See, z4; Finisar; Paice; and TiVo* cases discussed above).

129. *See, e.g., z4; Finisar; Paice; and Voda.*

130. Note, however, that the district court in *TiVo* stated that the fact *TiVo* sought to license their patented technology was not conclusive that no irreparable harm would occur absent an injunction. 2006 WL 2398681 at \*6. *But see, Paice* (where seeking a license contributed to court’s decision to deny injunction).

131. *See, e.g., Wald; Telequip; Christiana; TiVo; American Seating; Canon; 3M; Smith & Nephew; and Black & Decker.*

132. *eBay Inc.*, 126 S. Ct. at 1840.

133. *Id.*

134. *Id.* at 1840-41.

135. Although vacated by the Supreme Court, the Federal Circuit’s opinion in *eBay* took a much friendlier approach to “patent trolls” seeking injunctive relief, stating that “[i]njunctive relief is not reserved for patentees who intend to practice their patents, as opposed to those who choose to license.” *eBay Inc.*, 401 F.3d at 1339. Thus, it will be interesting to see how the Federal Circuit deals with the issue of injunctive relief by a “patent troll.”

136. One alternative to injunctive relief is to seek an exclusion order from the International Trade Commission (“ITC”) under section 337 of the Tariff Act. 19 U.S.C. § 1337(d). Exclusion orders operate similar to injunctions by prohibiting the importation into the U.S. of infringing products. Note, however, that an exclusion order cannot protect a patentee whose patent is being infringed solely by actions within the U.S. In addition, the ITC cannot grant monetary damages relief.