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Ms. Linda E. Stiff
Internal Revenue Service
CC:PA:LPD:PR (REG-129916-07)
1111 Constitution Avenue, NW
Washington, D.C.

RE: Proposed Treasury Regulation 129916-07

Dear Ms. Stiff:

This letter is a response to requests for comments regarding proposed amendments to Treasury Regulation § 1.6011-4. The proposed regulations create a new concept to be reported under IRC § 6011 "patented transactions".

1. Identity of Person Making This Comment.

I am Peter K. Trzyna having an address of 195 North Harbor Dr. # 5403, Chicago, Illinois 60601-7540. My education includes a Master of Engineering and Applied Physical Sciences, 1989; Juris Doctor,1983; Master of Arts: Public Policy and Administration, 1979; and Bachelors of Science, 1975 - all from the University of Wisconsin, Madison. I have been a registered patent attorney since 1987 (Reg. No. 32,601), and my other admissions include the Wisconsin Bar, 1983 (Inactive since 1989), New York Bar, 1986, Washington D.C. Bar, 1988, and Illinois Bar 1996.

Since working on the litigation of *Paine, Webber, Jackson & Curtis, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dean Witter Reynolds, Inc.*, 564 F.Supp. 1358 (D.C. Del. 1983), my practice has been essentially directed to patent aspects of financial innovations, and I have been quoted on this subject in the NY Times, Wall Street Journal, AP, UPI, Financial Times, LA Times, Chicago Tribune, The Economist, Forbes, and many other publications. My publications of an academic nature include: "Legal Protections for Innovative Financial Products and Services," Peter K. Trzyna, *Financial Engineering: A Complete Guide to Financial Innovation*, John F.Marshall and Viputl K. Bansal, Ed. 1992; "Toward the Exclusive Right to Market Innovative Insurance Products: the Use of Intellectual Property Law in the Business of Insurance," Bruce Foudree (former Commissioner of Insurance for the State of Iowa) and Peter Trzyna, *Drake Law Review* Vol. 41, No. 4 (1992); "The *Alappat* Standard for Determining That Programmed Computers are Patentable Subject Matter," James Goodman, Todd Marlette, and Peter Trzyna *JPTOS* Vol. 76, No. 10, May 1994; "Toward a Fact-based Standard for Determining Whether Programmed Computers are Patentable Subject Matter," James Goodman, Todd Marlette, and Peter Trzyna *JPTOS* Vol. 77, No. 5, May 1995.

My experience includes work at law firms including Kenyon & Kenyon; Cadwalader, Wickersham & Taft, and Baker & McKenzie where I was a partner in the Chicago office. I am now a sole practitioner, and part of my work includes obtaining patents for clients; I also own, or am the majority owner of companies that own, numerous patents and patent applications, with millions of dollars of patent expenditures in each of the last few years. I am filing this comment personally and not on behalf of anyone else.

At the invitation of Group Director Winn Coggins of the U.S. Patent and Trademark Office (PTO), I was the guest speaker at the PTO's 2006 Business Methods meeting, which includes the subclassification of "Tax Strategies". After not quite a quarter of a century of work in the field of computer program-related inventions, especially those having utility in the financial and insurance industries, I have knowledge of the facts presented herewith and would so testify and elaborate if a public hearing were permitted, or if called upon to do so.

2. Overview.

As an overview, the proposed IRS regulations are unjustified, premised on a poor understanding of the law, would itself be bad law, and would also be bad policy. The proposed regulations are unnecessary for the enforcement of tax law, the prevention of tax shelters or abusive tax strategies, or the unobstructed rendering of tax advice by accountants and lawyers. They are inconsistent with US patent law and harass inventors in a select area of patent law (placing no penalty on infringers). Instead, if adopted, the proposed regulations will result in hours upon hours of expensive fees paid to lawyers and accountants by clients trying to understand if they fall into the vague reporting requirements. My recommendations, based on the discussion set forth below, are as follows:

Recommendations:

A. Withdraw the proposed § 1.6011 regulations in their entirety.

B. Assuming the above recommendation 1 is not adopted, amend the proposed language at §1.6011-4(b)(7)(ii)(F):

Tax planning method. The term *tax planning method* means any plan, strategy, technique or structure designed to affect Federal income, estate, gift, generation skipping transfer, employment, or excise taxes. A patent issued solely for tax preparation software or other tools to perform or model mathematical calculations or to provide mechanical assistance in the preparation of information returns is not a tax planning method.

To read as follows:

Tax planning method. The term *tax planning method* means any plan, strategy, technique or structure, other than those allowed specifically within the Internal Revenue Code and its accompanying regulations, primarily designed to reduce or defer Federal income, estate, gift, generation skipping transfer, employment, or excise taxes. Any patent claim issued for software or other tools to perform or model mathematical calculations or to provide mechanical assistance in the preparation of information is not a tax planning method.

C. Assuming the above recommendation 1 is not adopted, amend the proposed language at §1.6011-4(b)(7)(ii)(B):

Patent. The term *patent* means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. See §1.1235-2(a). The term *patent* includes patents that have been applied for but not yet granted.

To read as follows:

Patent. The term *patent* means a patent with at least one claim granted and issued under the provisions of title 35 of the United States Code. See §1.1235-2(a). The term *patent* does not include any foreign patent or patent application or any patent or claim in an application that is not yet granted by the United States Patent and Trademark Office.

3. Background

Reading the public record, it is easy to see that the proposed regulations are the result of a long lobbying campaign by the American Bar Association ("ABA"). Why has the ABA worked so hard to have these regulations put in place? While only the ABA itself can really answer the question, a logical explanation is that the ABA is working for the best interest of those major US corporations who are vigorously trying to limit the application and availability of patents. Although the turf may have changed, this battle between innovators and copycats has been fought since the beginning of the last century.

In the past few years, there has been extensive lobbying by large and established corporate interests (typically the infringers or copycats) to change patent laws to their favor. These changes are being vigorously fought by inventors and innovators. The best recent examples include current U.S. bills H.R. 1908 and S. 1145, and the proposed PTO rules that were enjoined by *Tafas v. Dudas; SmithKline Beecham Corp. v. Dudas*, No. 07 C 846 (E.D. Va. 2007). The ant-patent / pro-infringer fight has been taken to the Internal Revenue Service. If the IRS can be persuaded to make "tax patents" or other computer program-related inventions "reported transactions" under IRC § 6011 and the IRS casts its definitional tests as broadly as possible, then any patent that affects income taxation is a "reported transaction" under § 6011. That means that any such transaction in the financial services area is a reported transaction and as a result, inventors will face strong opposition to licensing their inventions. Indeed, with the IRS burden on inventors, and not infringers, non-inventors will be encouraged to duplicate the product simply by not having a patent and thereby avoiding the IRS reporting trap for the buyer.

So how did the ABA manage to create an impression that there is a need for these regulations? Below is brief summary of their suppositions.

1) The patent law permits a person to claim a patent on a tax process.

2) Legal and accounting practitioners will have to pay royalties on ERISA and tax advice.

3) A patent holder can avoid using confidentiality agreements thereby move freely under the radar screen of the other § 1.6011 rules.

4) There is a substantial threat to the Treasury from “tax patents”.

None of the above four suppositions are true. Each is discussed below

4. It is not true that the patent law permits a patent claim on a tax process.

Generally, the proposed IRS Rule is premised on a misunderstanding of the law Patentable subject matter is set forth in 35 U.S.C. Sec. 101 as any new and useful “process, machine, manufacture, or composition of matter”. Courts have interpreted “process” to have a special and highly developed definition that generally means a method of making, or a method of using, a machine, manufacture, or composition of matter. The PTO’s “Overview of Interim Guidelines for Subject Matter Eligibility,” makes it clear that one cannot patent abstract ideas, such as “legal rights,” and states that a patent claim may not preempt every “substantial practical application of an abstract idea.” Thus, one cannot obtain a patent with a claim (definition of the invention) on a tax process because a “tax process” is not patentable subject matter.

There is no court law to the contrary, but the ABA has contended that *Ex parte CARL A. LUNDGREN*, Appeal No. 2003-2088 (BOPAI 2004) held that there is no "technological arts" test for patentability under US law, and thus it is possible to patent a tax strategy. However, the basis of the decision is that "technological arts" is a Patent Cooperation Treaty principle, not a principle under 35 U.S.C. Sec. 101. Nonetheless, pursuant to 35 U.S.C. Sec. 101, one cannot obtain a patent with a claim drawn to a tax strategy as recognized by the PTO’s Guidelines.

More particularly, any discussion of patents starts with the legal definition of what is patentable subject matter. There are four basic statutory requirements:

- Statutory Matter
- New
- Not Obvious
- Useful

In the past century, it has been widely held by the PTO and the patent bar itself that a “business method” per se is not patentable statutory matter. However, over the last decade or so, it has become clear that one can obtain a patent on a computer system (machine), an article of manufacture (e.g., code on a disk), a composition of matter (e.g., a chemical) or method of making or using any of them. Obtaining a patent on a computer system efficiently supports a financial innovation is an idea that has been pursued for at least a decade prior to Merrill Lynch obtaining three patents for software to perform the CMA account structure in 1981 and 1982. Merrill Lynch also succeeded in collecting royalties from the other retail investment banking firms for a license to its patents.

This is a fundamental idea in patent law: In exchange for disclosing the best mode for making and using an invention, one receives a limited-term exclusive right to make, use, and sell the invention. The reward of royalties is the trade for the disclosure (and of course, the IRS dissuading disclosure - by dissuading patents - is a misdirected policy because it undermines disclosure). On the other hand, by providing a patent-based incentive to innovate and disclose, any computer system that is "useful" will have a profit for someone and that profit will attract a tax, and that tax must be paid.

Despite cries to the contrary, obtaining a patent on a computer system having utility in the financial industry (and other industries) is an idea that is decades old and well in line with a unitary patent system that applies the same rules and standards in a technology-neutral manner.

A noteworthy case regarding "business methods" was *State Street v. Signature,* 149 F.3d 1368 (Fed. Cir. 1998) ("State Street" or "State Street case"). The decision in this case has been misrepresented by many writers, including the ABA. The decision is only 14 pages long and should be read by those working on the § 6011 proposed regulations. The State Street decision was a unanimous "in banc" pronouncement to the patent bar and to PTO as to what qualifies as patentable statutory subject matter. The claims were drawn to a machine - not to a business method or tax strategy or process of any kind.

To briefly summarize, Signature was the inventor of "Hub and Spokes" computer architecture to be used in the administration, book accounting, regulatory reporting, and tax accounting for mutual funds that are pooling assets. Signatures patent, U.S. Patent No. 5,193,056 ("'056"), has one independent claim that begins:

> 1. A data processing system for managing a financial services configuration of a portfolio…

All other dependent claims thereby become "data processing system" claims. In other words, the State Street case is about whether or not a particular "data processing system" is patentable subject matter.

State Street's argument was that the '056 was invalid because:

- It claimed a "law of nature, natural phenomena and/or an abstract idea" all of which the Supreme Court had previously held as not patentable subject matter; and/or
- It fell into a judicially created "business method" exception to statutory subject matter.

The court held that the Signature patented a data processing system that met the definition of patentable subject matter of being in the Sec. 101 statutory class of "a machine." The fact that the invented machine uses "Mathematical Algorithms" (i.e., laws of nature) or otherwise incorporates a "business method", does not mean a useful invention within Congress's specified statutory class cannot exist. Signature's data processing system created "a useful, concrete, and tangible result" as a machine.

To be very clear, the State Street decision said that the "business method" argument cannot be used to invalidate Signature's patent claims directed to an apparatus. On the other hand, the court was careful to point out that their decision did not mean that "business methods" alone are patentable subject matter. The court sited two prior court cases where business methods or processes were judged not patentable subject matter:

- A business method of a "how a salesman should best handle respective customers";
- "A 'system' for aiding a neurologist in diagnosing patients."

It is not correct to conclude that the State Street case holds that business methods per se are patentable subject matter. What the case does hold is that a data processing system is patentable subject matter even if it incorporates a business method or a mathematical algorithm – assuming the other requirements – novel, not obvious, and useful – are met. Accordingly, there is no court precedent which permits a patent on a tax process.

Now, let us make an assumption that a tax process claim – independent of any sec. 101 statutory class of patentable subject matter – is somehow issued in a patent. The PTO, like anyone else, is not infallible – strange patents have been issued, including a series of patents on perpetual motion machines. But if one were to attempt to enforce a tax process patent claim, presumably no competent patent attorney would take them seriously, and if litigation ensued, there likely would be Rule 11 problems from asserting a patent claim clearly allowed in error.

More so, the owner of the patent cannot succeed unless the claimed invention meets all criteria for a patentable invention. Thus, ignoring "statutory subject matter" and "useful" for the moment, the tax process patent must be "new" and "not obvious" (35 U.S.C. Secs. 102 and 103). Courts consistently hold that the existence of "prior art" has its feet set in both being not "novel" and being obvious. In other words, proving the existence of prior art has been a typical means of invalidating a patent. An old unpublished Ph.D. thesis sitting in the stacks of a university library has been treated as prior art. Accordingly, if a tax process patent claim was to be found in a patent, the claim would promptly succumb to the prior art of the published Internal Revenue Code and its published regulations. What is new and not obvious about following IRS regulations? Answer: nothing.

Accordingly, a tax process is not patentable subject matter. If a patent were to issue with claims on a tax process alone, it would not survive a challenge in patent court. Further, if the tax process patent claim was coupled with a computer system to meet patentable subject matter requirements, it would presumably be obvious.

Finally, assume that one is able to obtain issuance of a patent claim directed to a new and unobvious computer system that in some way constitutes a tax abuse. This would run afoul of the "useful" requirement of 35 USC Sec. 101.

5. It is not true that the patent law would require legal and accounting practitioners to pay royalties on ERISA and tax advice.

Patent law professionals find the above assertion bizarre, but nonetheless it was the proposition the ABA presented to accountants and lawyers in their teleconference on June 14, 2007. To be accurate, the title to the conference read:

"Do You Have to Pay a Royalty on Your ERISA and Tax Advice?"

The ABA conference conclusion, of course, was that practitioners are at serious risk of having to pay royalties for rendering ERISA and tax advice. Somehow, the ABA forgot the Supreme Court's rule that "laws of nature, natural phenomena, and abstract ideas" are not patentable subject matter. ERISA and tax advice are "abstract ideas" and as such, are not patentable subject matter (see above). The ABA is just engaging in bombastic rhetoric to stir up anti-patent sentiment. However, computer-program related inventions that prepare complex accounting and tax computations and which meet the thresholds of novel, not obvious, and useful, on the other hand, are patentable subject matter - and are not subject to the IRS proposed regulations. Reconciling the ABA preposition with the tax preparation extemption of the ptoposed IRS rule is not an easy task.

The proposed regulations readily admit that patented tax return preparation software patents should fall outside the definition of a tax planning method. What logic exempts a computer system adapted for tax return preparation but includes for example, a computer system adapted to compute a company's book balance sheet and income statement, a tax balance sheet and income statement and a reconciliation of the two? Why is not the "Hub and Spoke" computer system equally exempt? The fact is that computer program-related inventions are not a culprit of tax evasion and patent claims. Accordingly, any patent claim on a computer system should all fall outside the definition of a tax planning method.

To be even clearer, the Signature "Hub & Spoke" patent, for example, in no way prevents one from rendering legal advice about using investment partnerships made up of mutual funds. The patent extends only to the claim requirements, which generally pertain to a computer architecture adapted to carry out specific automated computations of book and tax values on real time basis to enable mutual funds to combine resources and still meet their SEC, GAAP and tax reporting requirements. Unfortunately, the ABA constantly obfuscates this significant difference and attempts to meld software patents into a stand alone business method or tax strategy patent.

6. It is not true that the patent law permits avoiding confidentiality agreements so as to move freely under the radar screen of the other § 1.6011 rules.

After its campaign to make legal and accounting professionals feel threatened by "tax patents", the ABA has attempted to convince the Treasury that the US government is at risk of loosing tax revenues due to tax schemes that are buried in "tax patents". Their argument is as follows.

First, a patent owner can market its tax scheme without a confidentiality agreement if the scheme inventor can rely on patent law to reserve the scheme for its exclusive use. Otherwise, if the scheme inventor attempts to market his product under a confidentiality agreement, he will fall into the trap of §1.6011-4(b) (3) (ii). Accordingly, with a patent the scheme will be undetected. A further closure to this ABA argument is that the '056 patent failed to appear on the PTO list of issued patents and published patent applications called Class 705/36T. The longer version of the PTO's class and subclass is:

> **Class 705**: Data Processing: Financial, Business, Practice, Management, Cost Determination:
>
> > **36T**: Tax Strategies.

The fact that the '056 patent is not on the list seems to cause the ABA grave concern. What other vicious patents are hidden from view from the IRS and tax practitioners?

The short answer is, none. The answer is none for two reasons. First the Class 705/36T list has little utility to the world at large. The list is compiled by a computer system that looks for keywords in a patent application, and the machine makes the classification. Patent lawyers would be hard pressed to try to second guess the PTO software (or its updates). Until the current proposed regulations under §1.6011, outside of the PTO, no one cared about or paid any attention to this list.

No patented tax avoidance systems appear have been cited to justify the proposed IRS rule. Many patent applications are classified by the software that puts them in the subclass by the keyword searching, but on reading the patent claims, one sees references to such as relational databases and other computer systems, methods for making and using them, and occasionally to code on a disk. There is no patent cited in the rulemaking proceeding that is a patent on a tax avoidance scheme so as to drive the IRS concern. Instead, the proposed IRS rule would impose enormous burdens on the inventors and owners of patents on other subject matter that happens to be subclassified there.

The real reason that no patents are hidden from view is that the PTO website is a wide open book. Without charge, anyone – including an IRS employee – can log onto the PTO website (www.uspto.gov) and search patents issued and patent applications published. The PTO search tool is very sophisticated. It allows a search of PTO published materials using single or multiple criteria. For example, a search can be done by inventor name, owner name, key words (e.g. tax, income tax, tax strategy, ERISA benefit, tax savings, etc) application date, issue date, on and on. It is an extraordinary comprehensive search engine. The "PAIR" part of the system allows a user to track an application from beginning to end. In a fraction of the time and energy spent by the IRS on drafting these proposed regulations, an IRS staffer could have long ago identified all "tax strategies" it though to be offensive and buried in patents. If it were to undertake such an exercise, the IRS might be surprised how little there is to pursue.

Of course, if the IRS were to find a tax shelter in its review of patents and published patents, it has a tool under §1.6011-4(b) (2) to create a "listed transaction" which thereafter becomes a "reportable transaction" under the regulations.

Presently, the IRS can review all patents and published applications and decide which ones seem abusive, and go after them. Doing anything to discourage patents will drive information about the developments underground, making it more difficult for the IRS to find. Patent law provides, in exchange for a complete disclosure of the best mode of making and using an invention, an exclusive right for a limited term to make, use, and sell an invention. The proposed IRS rule makes it so burdensome that none would want to disclose, so as to punish disclosure, e.g., in a patent application.

One ABA argument has been that "tax patents" can avoid detection if they elect not to be published. What is not mentioned is that until the 1999 Act, patents applied for before the act are not enforceable until the patent issues. Also, the length of time from submission of an application to patent issuance for a Class 705 Data Processing application averages about 5-7 years. That is longer than many product life cycles today – even tax shelters.

Under the current patent law, it is assumed (but not yet tested) that infringement activity can begin with the publication date of the application, after notice to the infringer and after issuance of claims substantially the same as in the notice. As a practical matter, relatively few patent applications today are not published. In the Class 705 arena, it would be extraordinarily rare to find an unpublished patent application whose filing date before after 1999.

It is equally important to note that a patent application filed and published does not equal a patent issued. Indeed, the PTO in the past few years has made life very difficult for applicants falling into the 705 Class. Since the April 30, 2007 *KSR International v. Teleflex Supreme Court* decision regarding "not obvious", the PTO seems to find just about all software functions "obvious". Over the last year, in the so called "Business Methods" class, less than 1 in 5 applications result in a patent. When patents do issue, the claims are often very different than they were in the original applications. It is also important that the Treasury recognize that patents normally have many different claims – each individual claim that must be considered. Thus, a patent in class 705/36T may have claims directed to a relational database system, an apparatus, etc. In any case, since allowed claims in a patent define the application and scope of the invention, it is premature for any authority (tax or otherwise) to judge any patent matter until there is a patent, when the individual patent claims are finally determined.

Also, as a practical matter it is unheard of for a party to take a license of patent application, as this could constitute "patent misuse," resulting in unenforceability of the patent that issues from such an application.

In sum, It is not true that the patent law permits avoiding confidentiality agreements to move freely under the radar screen of the other § 1.6011 rules. More so, no rational businessman would do so – it is simply too hard to get a patent and there is a high probability that any given application will be denied.

7. It is not true that the patent law creates a substantial threat to the Treasury from "tax patents."

This fourth justification for the §1.6011 proposed regulations is a corollary to the third ABA supposition. In other words, the tax shelter stealth bombers will be flying undetected by IRS radar on patent wings to raid the US Treasury. Given the ready access via PTO website to published applications and granted patents, there is no foundation for such an alarm. Still, one could reasonably ask for empirical evidence that tax shelters are hidden in the claims of so called "tax patents".

Since the ABA mischaracterized the State Street case as involving a tax strategy patent, that patent deserves scrutiny. First, the patent claims are strictly limited to "a data processing system," so there is no "process" patent whatsoever. Second, the "Hub and Spoke" machine enabled users to link mutual funds to a single investment pool, thereby achieving economies of scale and fulfilling timely tax, financial, and regulatory reporting obligations. A partnership tax entity acted as the "Hub" and thereby avoided taxation at the "Hub" and the "Spoke". (As Regulated Investment Companies, mutual funds or the "Spokes" pass on their tax obligation to shareholders.) It is hard to imagine how any tax practitioner would characterize this application of a partnership as other than plain vanilla tax planning. It is not a tax shelter – it is a common and ordinary choice of an entity that is allowed by the Internal Revenue Code and performed every day by persons making choices of the type of entity to employ for a business. Why is that the ABA wants the '056 patent classified as a reported transaction under IRC § 6011? The only plausible explanation is that ABA simply wants to use the Internal Revenue Code to fight the use of patents in the financial services market. To anyone else, it should be apparent that the "Hub and Spoke" software enables users to make investments and receive reports that, prior to the invention, could not be performed timely and efficiently.

Other than the ABA's implication of a tax shelter hiding behind the '056 patent, what other concrete examples of patented tax processes are there? On July 13, 2008, 10 years will have passed the landmark State Street Court of Appeals decision. Surely, if there is a problem, it will have manifested itself in the past decade. Ignoring the fact that any tax process patent claim is unlikely to stand up against the "prior art" doctrine, how many tax process patents have actually slipped through the hands of the patent examiners? A review of the patents granted and listed on the PTO list Class 705:36T would be a good place to start to see how many, if any, such patent claims actually exist.

Further, it is not apparent how ownership of a non-US patent or application can have relevance in the US. Adding this provision to the proposed IRS rule is mere harassment.

The rule appears to be anti-patent, at least because it places burden on patent applicant but not on an infringer, unless the IRS intends that its reporting requirement would constitute an essentially forced admission of patent infringement.

As to patents on computer program-related inventions, I respectfully submit that it is not the business of the Treasury to determine if a particular software program is eligible for a patent, or to burden those it wishes to encumber to dissuade patenting.

I agree with Stephen Schreiner, of Hunton & Williams, who is quoted as follows: "A special rule for tax patents would run counter to the unitary nature of the U.S. patent system, which generally applies the same rules and standards in a technology-neutral manner… Even in the case of life-saving medical procedures, patents can be granted and are enforceable with only limited exception." in "Increased Awareness of Tax Patent Risks Needed, Practitioners Say".

It is for Congress to establish a uniform patent law. Interpretation and implementation are for the PTO and ultimately, the federal courts.

Stated differently, the IRS has no obligation, capability, or reason to concern itself with patent claims drawn to computer program-related inventions.

8. Request for a Public Hearing.

Given the considerable misunderstandings and myths in the area of patent law and taxes, a public hearing is requested on the above named proposed regulations.

Sincerely,

Peter K. Trzyna