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**The Supreme Court's Opinions in
Bilski and the Future of
Tax Strategy Patents**

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The Supreme Court's Opinions in *Bilski* and the Future of Tax Strategy Patents

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Although patent law is far from the daily bread of tax professionals, most have watched with interest, and some concern, developments involving the eligibility of various tax strategies for patent protection. Now that the Supreme Court has spoken, it seems that not much has been settled at all and future litigation—and possibly legislation—can be expected.

The Supreme Court waited until the last day of the 2009-10 Term to issue its pronouncement on business method patents, *Bilski v. Kappos*, 2010-1 USTC ¶50481 (2010). It then came "not with a bang but a whimper."¹ Those who thought, based on statements in earlier opinions or the tenor of oral argument in *Bilski*, that the Court might find all business methods, including tax strategies, not to be patentable subject matter, were disappointed.

All the Justices agreed that patent protection did not extend to *Bilski*'s hedging strategy process claims because they involved only an abstract idea. All agreed as well that the Federal Circuit's machine-or-transformation test was not the sole test for patentability of a process, although they recognized that it was an important and useful test in many, perhaps even most, cases. They also declined to endorse the Federal Circuit's prior test for patentability, whether the invention produced a "useful, concrete and tangible result."

The five members of the majority, in an opinion by Justice Kennedy, read the patent law as leaving open "the possibility of some business method patents." At the same time, the opinion was quick to disclaim "broad patentability of such claimed inventions." But the majority failed to offer guidance on when an idea is an abstract idea or what the limits on business method patents might be.

Justice Stevens, joined by Justices Ginsburg, Breyer, and Sotomayor, concurred in the result, but would have held that methods of doing business were not patentable. Many have speculated that Justice Stevens started out writing the majority opinion, but lost Justice Scalia along the way.² Justice Scalia did not join two parts of Justice Kennedy's opinion, both of which expressed angst about the proper role of the patent law in today's "Information Age." He did join a separate concurrence by Justice Breyer summarizing areas of agreement of all the Justices. Thus, the Supreme Court came very close to holding that methods of doing business cannot be patented.³

After *Bilski*, the status of patents on tax strategies, as one type of business method patent, is no clearer than it was before the case was decided. Under the machine-or-transformation test, applications for tax strategy inventions that did not depend on computer software were clearly not patentable. Although it will depend on how the Patent

and Trademark Office (PTO), lower courts, and the Federal Circuit analyze and apply the term "abstract idea," the same result is likely, but not certain, to hold after *Bilski*.

Both before and after *Bilski*, the most difficult issues involve tax applications for tax strategies with claims that include use of computers or computer software, which many tax strategy patents already, or easily could, do. The PTO has issued thoughtful "Interim *Bilski* Guidance," but difficult issues remain when this guidance is applied to tax strategy patents. For those who believe that, as a matter of policy and practice, tax strategies should not be patented, *Bilski* underscores the need for legislation.

BACKGROUND: BUSINESS METHOD PATENTS

We as a nation encourage innovation. The Constitution itself provides: "The Congress shall have Power ... [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writing and Discoveries[.]" ⁴

Thomas Jefferson, one of the authors of the Patent Act of 1793, wrote that "ingenuity should receive a liberal encouragement." ⁵ Consistent with that belief and attitude, the Supreme Court has interpreted the patent laws broadly. In one case it spoke of Congress intending the 1952 Patent Act to encompass "anything under the sun made by man." ⁶ Many believe that a broad interpretation of the patent laws has contributed substantially to our country's economic success. As Nicholas P. Godici, the then-Commissioner for Patents, testified before the Senate Finance Committee in 2004: "The patent system has withstood the test of time. This is powerful evidence of the system's effectiveness in simultaneously promoting the innovation and dissemination of new technologies and the creation of new industries and jobs." ⁷

Section 101 of the Patent Act specifies the subject matter that may be patented: "Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefore, subject to the conditions and requirements of this title." ⁸

Supreme Court precedents have provided for three exceptions to this broad specification of patentable subject matter: "laws of nature, physical phenomena, and abstract ideas." ⁹ The statute further defines "process," the type of claim at issue in *Bilski*, as "process, art or method, and includes a new use of a known process, machine, manufacture, composition of matter or material." ¹⁰ Also, even if an invention comes within the categories of patentable subject matter, it must also be novel, ¹¹ nonobvious, ¹² and fully and particularly described ¹³ in order to be granted a patent.

For many years, the patentability of methods of doing business was uncertain at best. In 1869, the Patent Office declared: "It is contrary to the spirit of the patent law construed by the Office for years to grant patents for methods or analogous systems of bookkeeping." ¹⁴ In 1908, the Second Circuit wrote in *Hotel Security Checking Co. v. Lorraine Co.*, 160 F 467 (CA-2, 1908), that a "system of transacting business disconnected from the means for carrying out the system is not, within the most liberal interpretation of the term, an art," at a time when the statute used "art" rather than "process." "Art," however, had been interpreted by the courts "to be practically synonymous with process or method." ¹⁵

In 1998, the Federal Circuit decided *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F3d 1368 (CA-F.C., 1998), *cert. den.* ¹⁶ As described by the court, the invention at issue was a data processing system that allowed a number of mutual funds

to pool their assets into an investment portfolio organized as a partnership for tax purposes. The invention permitted the administrator to track all data required on a daily or annual basis for accounting, tax, and sale purposes for each partner.

The Federal Circuit rejected the district court's reliance on the business method exception to statutory subject matter and took the opportunity to "lay this ill-conceived exception to rest" because "business methods have been, and should have been, subject to the same legal requirements for patentability as applied to any other process or method." Patentability, the court explained, does "not turn on whether the claimed subject method does 'business' instead of something else." It described *Hotel Security Checking Co.* as relying not on a business method subject matter exception but on lack of novelty to hold the patent in that case invalid.

Moreover, in also rejecting the district court's conclusion that the patent in *State Street Bank* was not patentable because it was a mathematical algorithm, the Federal Circuit articulated its "useful, concrete and tangible result" test, at least for a machine that transforms data through a series of mathematical calculations. In *AT&T Corp v. Excel Communications, Inc.*, 172 F3d 1352 (CA-F.C., 1999), which was decided the next year and which involved an invention to aid long-distance carriers in providing differential billing treatment with multiple long-distance service providers, the Federal Circuit made clear that the same standards applied to process and machine claims under section 101: "[W]e consider the scope of §101 to be the same regardless of the form—machine or process—in which a particular claim is drafted."

With the clear blessing of the Federal Circuit and its pronouncement of the "useful, concrete, and tangible result" as the appropriate test, applications for business method patents flooded the PTO. The petitioner's brief in *Bilski* states that in the ten years since *State Street Bank*, "the PTO has issued more than 15,000 patents classified in the 'business methods' technology group."¹⁷ This group "encompasses machines and their corresponding methods for performing data processing or calculation operations, where the machine or method is utilized in the 1) practice, administration, or management of an enterprise, or 2) processing of financial data, or 3) determination of the charge for goods or services."¹⁸ Over the years, and particularly since 2000, the PTO has implemented various initiatives to improve the quality of business method patents, such as hiring more examiners, instituting a second review, and expanding the databases searched to help determine whether an invention is novel and nonobvious.¹⁹

Nonetheless, dicta in Supreme Court opinions prior to *Bilski* suggested that at least some Justices had concerns about business method patents and the test the Federal Circuit had been applying to them. Concurring in *eBay Inc. v. MercExchange, L.L.C.*, 547 US 388, 164 L Ed 2d 641 (2006), Justice Kennedy, joined by Justices Stevens, Souter, and Breyer, wrote of the "potential vagueness and suspect validity" of the "burgeoning number of patents over business methods, which were not of much economic and legal significance in earlier times." Justice Breyer, joined by Justices Stevens and Souter, dissented from the dismissal of certiorari as improvidently granted in *Laboratory Corp. of America Holdings v. Metabolite Laboratories, Inc.*, 548 US 124, 165 L Ed 2d 399 (2006), and questioned the *State Street Bank* formulation of a "useful, concrete and tangible result" as a test for patentability: "But this Court has never made such a statement and, if taken literally, the statement would cover instances where this Court has held the contrary."

Thus, many wondered what would happen when the Court decided to hear *Bilski*, a case involving a business method patent.

BACKGROUND: TAX STRATEGY PATENTS

Many tax lawyers view the patent at issue in *State Street Bank*, the key Federal Circuit case for patentability of business methods, to be a tax strategy patent, because it was designed to enable participants to satisfy the income tax Regulations under Section 704 regarding allocations, capital accounts, etc., for partnership transactions. As one scholar aptly put it, "Boes, the inventor, was a software designer engaged to write a program executing the calculations required by the Regulations to the Internal Revenue Code." ²⁰

Processing of financial data, one of the key categories of business method patents for the PTO, often involves tax effects and considerations. To take one simple example, patents involving portfolio selection, analysis, and planning, which is a subclass of the business method class, can be expected to take into account tax holding period, to evaluate long-vs. short-term capital gain treatment on sale of a security.

The PTO not only considers tax strategies as a type of business method but also has established a special subclass for them. As of 7/31/10 there were 112 issued patents in that subclass. ²¹ (Patents frequently are listed in more than one subclass.) These patents cover a number of areas of tax practice—employee benefits, charitable giving, employee compensation, and financial products, to name a few. ²²

The best known tax strategy patent is probably the SOGRAT™ patent, ²³ which involved using stock options to fund a grantor retained annuity trust, an estate planning technique authorized by Section 2702. The holder of the patent sued a former Aetna CEO for infringement in 2006 over stock options worth an estimated \$28.5 million. The case settled in 2007. The settlement stated that "there are facts from which a trier of fact could conclude that the ... patent is not invalid and is not unenforceable," but that the "statement is not to be taken as an admission that the trier of fact would necessarily so conclude if the case were to be tried on the merits." ²⁴ The parties also agreed to enter "a confidential patent license and settlement agreement" that resolved their differences without any admission of liability by any party. ²⁵

The tax strategy patent in another case, *Fort Properties, Inc. v. American Master Lease, LLC*, 609 F Supp 2d 1052 (DC Calif., 2009), involved Section 1031 and tenancy-in-common interests. Fort Properties had filed a suit seeking a declaratory judgment that it was not infringing on defendant's patent. ²⁶ The patent had claimed to create an investment instrument out of tenancy-in-common interests in real property, called a "deedshare," which was alleged to be eligible for tax deferral under Section 1031.

The district court granted summary judgment for the plaintiff on the basis that the patent had been granted under the "useful, concrete and tangible result" test, which the Federal Circuit rejected in *Bilski*. Moreover, the court concluded, the patent failed to meet the Federal Circuit's *Bilski*'s "machine-or-transformation test." According to the court, none of the invention's claims were tied to a machine or apparatus, since the defendant had acknowledged during the patent application process that its invention need not be performed by a computer and relied in its brief on the transformation prong of the machine-or-transformation test. The court found that plaintiff had not transformed any article or thing; an arrangement of conceptual legal rights did not constitute transformation of an article, but only of "legal ownership interests in real estate." The district court granted summary judgment solely on the basis of the machine-or-transformation test, which the Supreme Court has now rejected as the exclusive test in its *Bilski* opinion. ²⁷

While some tax professionals support patenting of tax strategies, believing that innovation involving tax deserves patent protection in the same way as other financial innovations,²⁸ many professional tax groups have opposed tax strategy patents for both practical and policy reasons.²⁹ Many of the practical concerns go to the quality of tax strategy patents. They include the limited ability of PTO examiners to judge the novelty and obviousness of tax strategy patents, because of their lack of training and background in this area, the limited time examiners have to review applications, and their lack of access to tax authorities and databases. Others anticipate the impact on the profession itself, particularly the many difficult ethical questions that tax strategy patents raise.³⁰

The tax groups also have raised a number of policy considerations. Perhaps the key one is that all citizens are obliged to pay and report taxes they owe, and patents on tax strategies could privatize the tax system. The New York State Bar Association has explained: "The tax laws ... are perhaps unique in that they impose universal affirmative obligations of compliance on U.S. citizens and residents.... The tax law should be an open road, not a toll road."³¹ The AICPA has elaborated on this theme: "Patents on tax strategies may limit the ability of taxpayers to utilize fully interpretations of the law intended by Congress."³²

These groups further assert that granting a government monopoly in the form of a patent that undermines another key federal function—the collection of revenue—seems contradictory and thus raises fundamental questions about the appropriateness of such patents. Patents carry with them the appearance of federal government approval and the legal presumption of validity. Tax professional groups are concerned that taxpayers and others who consider employing tax strategy patents will rely on this appearance of government approval and the presumption of validity a patent, and therefore fail to evaluate carefully whether the underlying tax strategy actually works under the tax laws. If such is the case, the impact on federal tax revenue could be substantial. Thus, they argue, proliferation of tax strategy patents could undermine the efficacy of our tax laws and increase compliance burdens.

In response, members of the patent bar explain that many fields have had similar reactions when patents entered their area, that patents exist in other areas related to compliance with federal law, and that Congress has decided that the benefits of a broad definition of patentable subject matter and the encouragement of innovation outweigh the burdens patents impose.³³ "Careful application of the traditional requirements for patentability will eliminate virtually all of the criticisms that have been directed to patents on tax-related methods."³⁴ Patent lawyers ask for evidence that tax strategy patents have undermined collection of revenue or the efficacy of our tax laws.

Members of Congress and other policymakers, however, have expressed concern about patents on tax strategies. A Subcommittee of the House Committee on Ways and Means held a hearing on the issue in 2006.³⁵ The House version of the Patent Reform Bill of 2007 in the 110th Congress included provisions making tax strategies unpatentable,³⁶ and Senators Baucus (D-Mont.) and Grassley (R-Iowa), leaders of the Senate Finance Committee, have also introduced a bill to prohibit patents on tax planning inventions.³⁷ Three bills to prohibit tax strategy patents have been introduced in the 111th Congress.³⁸ In September 2007, Treasury published Proposed Regulations that would add a new category of reportable transactions for patented transactions.³⁹

None of this legislation has passed, and the Proposed Regulations have not been finalized. There was a sense in the tax community that policymakers were waiting to see what the Supreme Court would do in *Bilski*. If the Court found business methods unpatentable or sharply limited their scope, there might be no need for legislation or Regulations on the topic of tax patents.

THE *BILSKI* CASE

Petitioners Bernard Bilski and Rand Warsaw filed an application to patent a process by which commodities dealers in the energy market could hedge against the risk of price changes. The method did not use a computer or any other machine to implement the method. Both the patent examiner and the Board of Patent Appeals and Interferences rejected the claims as not directed to patentable subject matter.

On appeal, after briefing and argument before a three-judge panel, the Federal Circuit on its own motion heard the case *en banc*. The court directed the parties to file supplemental briefs to address whether the "useful, concrete, and tangible result" test for patent eligibility as expressed in *State Street Bank* and reiterated in *AT&T Corp.* should be reconsidered or overruled. The patent bar attached a great deal of importance to the case; 38 amicus briefs were filed.⁴⁰ The opinion of the court by Chief Judge Michel and eight other judges concluded that the sole test for determining patent eligibility of a process under section 101 was a machine-or-transformation test.⁴¹

This two-part test asks of a claimed process whether (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing. The court's opinion also rejected its "useful, concrete and tangible result" test set forth in *State Street Bank*. The court concluded that petitioners' application did not meet its newly adopted machine-or-transformation test and thus was not patent eligible.

Judge Dyk, joined by Judge Linn, wrote a concurring opinion to demonstrate how the history of section 101 supported the majority's holding that Bilski's claim did not recite patentable subject matter. Judge Mayer dissented because he would find no application directed to a method of conducting business eligible for patent protection. Judge Rader dissented because he would have affirmed the rejection by the Board of Patent Appeals and Interferences of the application simply on the basis that it claimed an abstract idea. Only Judge Newman's dissent viewed Bilski's claims favorably. She saw the majority's limitation on the meaning of process "contrary to statute, precedent, and a negation of the constitutional mandate."

The Supreme Court granted certiorari. The petition for certiorari listed two questions: First, whether the Federal Circuit erred in establishing the machine-or-transformation test when precedents had permitted no exceptions to patentable subject other than laws of nature, physical phenomena, and abstract ideas. Second, whether the machine-or-transformation test, "which effectively forecloses meaningful patent protection to many business methods,"⁴² contradicts congressional intent because another provision of the patent law explicitly refers to "methods of doing or conducting business."⁴³

The case attracted enormous interest. Sixty-eight amicus briefs were filed and, astonishingly, 26 of them were filed in support of neither party. The briefs offered a variety of tests for process patents. Several, for example, argued that patent protection should be limited to technological methods.⁴⁴ One group of law professors suggested that for a claim applying science, nature, or ideas to be eligible, there must be invention in the application.⁴⁵ Even some briefs filed in support of the inventors argued that their invention did not qualify for patent protection.⁴⁶ The American Bar Association's brief in support of the respondent argued that petitioners claimed an abstract idea. It further explained that abstract ideas were those in which mental processes, such as human reasoning or judgment, are central, not ancillary, and thus, that abstract business methods, such as tax planning and retirement planning, may be unpatentable.⁴⁷ Many of the amicus briefs expressed concern about the role of patent law in the Information Age.

Some saw too much patent protection as blocking innovation; others too little protection as discouraging innovation.

The petitioners' brief argued that, in making the machine-or-transformation test the sole test for process patents, the Federal Circuit misread both the statutory language of section 101 and Supreme Court precedents. The petitioners also contended that Congress, by enacting section 273 as a defense to infringement of business method patent claims for those who had mistakenly thought such methods could not be patented, indicated its recognition of business methods as patentable subject matter. The machine-or-transformation test may have been appropriate for the Industrial Age, their argument continued, but is inadequate for the modern information-based economy. Petitioners acknowledged that abstract ideas cannot be patented, but emphasized that practical applications of them can be, and characterized Bilski's claims as such a practical application.

The government's brief interpreted "process" in light of not only its statutory context but also the historical scope and development of the patent law. Viewed against this background, "process" encompasses technological and industrial processes, including software and other modern technologies, but not methods of organizing human activity. According to the government, tying a patentable process to a machine or apparatus or to effecting a transformation of matter provides a framework for distinguishing methods that involve technology from those that do not. ⁴⁸

Moreover, the government argued, Congress's decision in section 273 to provide an affirmative defense to protect businesses using methods previously regarded as unpatentable does not suggest that it was *sub silentio* radically extending patent protection to nontechnological methods of organizing human behavior. Petitioners' method was a technique for organizing human activity untethered to technology, the government wrote, that also would preempt the abstract idea of hedging consumption risk.

At oral argument, the Justices expressed skepticism about business method patents. Within two minutes of the petitioners' argument, Justice Scalia asked Bilski's lawyer whether the patent law was designed for inventors like Lorenzo Jones, an old-time radio personality who came up with one impractical invention after another, and not someone like Dale Carnegie who wrote a book on how to win friends and influence people. Justice Ginsburg quickly chimed in to ask whether he would allow patentability of tax avoidance, estate plans, resisting a corporate takeover, or choosing a jury. Justice Sotomayor asked about patenting speed dating, Justice Breyer about his method of teaching antitrust law and keeping 80% of the students awake. Justice Scalia wondered why methods of training horses weren't patented as methods in the past. The Justices asked the petitioners' counsel to compare the issues of the Information Age to the issues involved in the patent for Bell's telephone or Morse's code.

When it was his turn to speak, the Deputy Solicitor General seemed focused on limiting the Court's opinion in the case. When Justice Sotomayor responded to his defense of the Federal Circuit's machine-or-transformation test by suggesting the Supreme Court hold all business methods unpatentable, the Deputy Solicitor General expressed concern about a sweeping holding that would eliminate patent protection for new machines, including programmed computers, useful to the operation of businesses.

When Chief Justice Roberts pushed him on a footnote in the government's brief that seemed to concede what the Chief Justice viewed as "the most tangential and insignificant use" of a computer might be sufficient to make the invention patentable

under the machine-or-transformation test, the Deputy Solicitor General defended the footnote as cautioning the court not to use *Bilski* to make decisions about the patentability of software innovations or medical diagnostic techniques. A long discussion about the software used to program the invention in *State Street Bank* followed.

The Supreme Court's Opinion

Justice Kennedy, writing for the majority, first rejected the Federal Circuit's machine-or-transformation test as the sole test for what constitutes a patentable process, although it remained "an important and useful clue." To reach his conclusion about the broad meaning of process, he looked not only to the statutory definition but also "to ordinary, contemporary, common meaning."⁴⁹

In a section of the opinion that Justice Scalia did not join and thus represented only a plurality of the Court, Justice Kennedy worried about impact of the machine-or-transformation test on the Information Age: "As numerous *amicus* briefs argue, the machine-or-transformation test would create uncertainty as to the patentability of software, advanced diagnostic medicine techniques, and inventions based on linear programming, data compression, and the manipulation of digital signals."

The majority concluded that "process" in section 101 did not categorically preclude "business methods" as patentable subject matter. For this holding, it relied in part on common meaning and in part on another provision of the patent law. According to Justice Kennedy, this provision—section 273—acknowledged that there may be some business method patents by permitting a special defense of prior use to a claimed infringement of a business method. At the same time, however, "it does not suggest broad patentability of such claimed inventions."

Justice Kennedy went on, in another section that Justice Scalia did not join, to express a number of concerns about business method patents: "[S]ome business method patents raise special problems in terms of vagueness and suspect validity." As a limiting principle, Justice Kennedy urged recourse to the Supreme Court's precedents on the unpatentability of abstract ideas. He called attention to the critical roles served by the requirements of novelty, nonobviousness, and full and particular description in "adjusting the tension, ever present in patent law, between stimulating innovation by protecting inventors and impeding progress by granting patents when not justified by the statutory design."

In the last part of the opinion, Justice Kennedy, again writing for the majority, turned to the *Bilski* invention. "Rather than adopting categorical rules that might have wide-ranging and unforeseen impacts, the Court resolves this case narrowly on the basis of this Court's decisions in *Benson*, *Flook*, and *Diehr*, which show that petitioners' claims are not patentable processes because they are attempts to patent abstract ideas."

In *Gottschalk v. Benson*, 409 US 63, 34 L Ed 2d 273 (1972), the Court had found an application to patent an algorithm to convert binary-coded decimal numerals into pure binary code was not a patentable process but an unpatentable abstract idea because allowing the patent "would wholly pre-empt the mathematical formula and in practical effect would be a patent on the algorithm itself."

Parker v. Flook, 437 US 584, 57 L Ed 2d 451 (1978), found not patentable a procedure that relied on a mathematical algorithm to monitor conditions during the catalytic conversion process in the petrochemical and oil-refining industries. As later explained in *Diamond v. Diehr*, 450 US 175, 67 L Ed 2d 155 (1981), "*Flook* stands for the proposition

that the prohibition against patenting abstract ideas 'cannot be circumvented by attempting to limit the use of the formula to a particular technological environment' or adding 'insignificant postsolution activity.'" ⁵⁰

In contrast, *Diehr* permitted patenting of a process that used a mathematical formula in molding raw, uncured synthetic rubber because the formula was applied to a known structure or process. That is, the claim was not "an attempt to patent a mathematical formula, but rather [was] an industrial process for molding of rubber products."

The petitioners' application in *Bilski*, according to Justice Kennedy, could be disposed of based on these precedents. Two of the claims dealt with the concept of hedging, an unpatentable abstract idea, like the algorithms in *Benson* and *Flook*. The other claims gave examples of the hedging in the commodities and energy markets, but as *Flook* established, limiting an abstract idea to a field of use or adding token post-solution components did not make the concept patentable. Thus, the Court did not have to define further what constitutes a patentable process.

In the last paragraph before the one-sentence affirmation of the Court of Appeals, the majority played Lucy to the Federal Circuit's Charlie Brown. Having already pulled the football away by rejecting the exclusivity of the machine-or-transformation test, it did so again by cautioning that "nothing in today's opinion should be read as endorsing interpretations of §101 that the ... Federal Circuit has used in the past," and then cited to occurrences of the "useful, concrete and tangible result" test. ⁵¹ But it then went on to ask the Federal Circuit to try to kick the ball again, pleading with the court of appeals to do what it declined to do itself—develop some other test for limiting business method patents. It speculated that the court of appeals turned to exclusive use of the machine-or-transformation test "because its case law had not adequately identified less extreme means of restricting business method patents, including (but not limited to) application of our opinions in *Benson*, *Flook*, and *Diehr*. In disapproving an exclusive machine-or-transformation test, we by no means foreclose the Federal Circuit's development of other limiting criteria that further the purpose of the Patent Act and are not inconsistent with its text."

The concurring opinions. Justice Stevens, joined by Justices Ginsburg, Breyer, and Sotomayor, concurred in the result, in an opinion almost three times as long as Justice Kennedy's. The concurring Justices agreed that the machine-or-transformation test, although reliable in most cases, was not the exclusive test for a patentable process. The opinion rejected, however, the majority's reliance on the ordinary meaning of "process" to understand the term in section 101.

Such an approach, Justice Stevens continued, "would render §101 almost comical," making patent-eligible processes "for training a dog, a series of dance steps, [or] a method of shooting a basketball." His opinion criticized the majority for "never provid[ing] a satisfying account of what constitutes an unpatentable abstract idea." Nonetheless, Justice Stevens agreed that the petitioners sought to patent an abstract idea.

More fundamentally, however, Justice Stevens would have held that "a general method of engaging in business transactions" is not patentable as a process under §101. He undertook an extensive examination of the history and purpose of American patent law to conclude that it does not call for the patenting of business methods. He drew on a wide array of academic literature to point out the issues raised by patents on business methods:

- The danger of stifling progress rather than promoting it.
- The presence of sufficient incentives for business innovation through the competitive market without the need for patent protections.
- The question of whether patents might inhibit competition, research, and the free exchange of information.
- The cost to business of both the fear of patent infringement and of patent searches, magnified by the potential vagueness of business method patents.

"[P]atents on business methods are patents on business itself," he concluded. "Therefore, unlike virtually every other category of patents, they are by their very nature likely to depress the dynamism of the marketplace."

Justice Breyer also wrote a short opinion concurring in the judgment. In Part I of his opinion, he agreed with Justice Stevens that a general method of engaging in business transactions should not be patentable. Part II, which Justice Scalia joined, delineated four points of agreement, in addition to agreement that the claims at issue in *Bilski* were unpatentable abstract ideas, between the opinion of the Court and Justice Stevens's concurrence:

- (1) Section 101 is broad but not without limit.
- (2) The machine-or-transformation test has repeatedly proved to be a helpful test for what is a patentable process.
- (3) The machine-or-transformation test has never been the sole test for determining patentability.
- (4) It is not the case that anything which produces a "useful, concrete, and tangible result" is patentable.⁵²

BILSKI AND THE FUTURE OF BUSINESS METHOD PATENTS

While *Bilski* did not categorically reject business methods as patentable subject matter and clearly stated that the machine-or-transformation test cannot be the sole test for such patents, it neither suggested that such patents are to be granted freely nor rejected the machine-or-transformation test completely. It is an opinion in search of standards, and to a large extent, these standards will need to be supplied by others, in the first instance by the PTO in applying its understanding of the case and then by the district courts and, in particular, the Federal Circuit.

At times, the majority opinion seemed eager, almost desperate, for the Federal Circuit to try again to articulate some standards as to patentability, that is, to do what the Court itself was unwilling or unable to do. It asked the Federal Circuit to be masochistic enough to risk again the rejection the Court has given to its every attempt to do so. In one of the sections that Justice Scalia did not join, Justice Kennedy worried about floods of business method patent applications that might "put a chill on creative endeavor and dynamic change."

Justice Kennedy continued in a sentence that piled qualification upon qualification: "Indeed, if the Court of Appeals were to succeed in defining a narrower category or class of patent applications that claim to instruct how business should be conducted, and then rule that the category is unpatentable because, for instance, it represents an attempt to patent abstract ideas, this conclusion might well be in accord with controlling precedent."⁵³ That is, not only did the Court ask the Federal Circuit to try to develop a general test for the patentability of business methods, it also asked that the Federal Circuit develop

tests specifically for the concept on which the Court relied to reject Bilski's patent—an attempt to patent abstract ideas.⁵⁴

To take on this challenge and address the meaning of "abstract ideas," the Federal Circuit might well revisit its opinion in *In re Comiskey*, 554 F3d 967 (2009).⁵⁵ The patent application there claimed a method and system for mandatory arbitration, involving legal documents such as wills or contracts. In trying to understand the meaning of an abstract idea, the Federal Circuit's opinion quoted the Supreme Court's language from *Benson* that "[p]henomena of nature, though just discovered, *mental processes*, and abstract intellectual concepts are not patentable, as they are the basic tools of scientific and technological work" (emphasis by the Federal Circuit). It concluded:

"It is thus clear that the present statute does not allow patents to be issued on particular business systems—such as a particular type of arbitration—that depend entirely on the use of mental processes. In other words, the patent statute does not allow patents on particular systems that depend for their operation on human intelligence alone, a field of endeavor that both the framers and Congress intended to be beyond the reach of patentable subject matter. Thus, it is established that the application of human intelligence to the solution of practical problems is not in and of itself patentable."

Such a principle seems far more certain than the Supreme Court's bald assertion that Bilski's hedging is an abstract idea, particularly when so many patents for hedging have been issued.⁵⁶

Even though *Comiskey* came to the Federal Circuit on a motion for summary judgment, the court remanded two of Comiskey's claims, along with dependent claims, back to the PTO because they recited use of a machine, such as an arbitration database. This aspect of *Comiskey* heightens another aspect of *Bilski*—the limits of the machine-or-transformation test. The Supreme Court did not reject this test, but simply said that it was not the sole test. What is sufficient to bring a claim within this test? When is use of a machine no more than insignificant "extra-solution" activity—that is, activity which is not central to the purpose of the invention and which does not impose a meaningful limitation on the claim?⁵⁷

The government's brief in *Bilski* rightly stated that petitioners' claims "might satisfy the machine-or-transformation definition if they involved a machine implementation central to the process of hedging."⁵⁸ The examples the brief offered of activity that would have rendered Bilski's invention patentable, however, seemed trivial—conducting the hedging transactions online, using a computer network to identify counterparties and initiate the transaction, and a microprocessor to calculate the fixed purchase price.

In the *Bilski* oral argument, Chief Justice Roberts pressed the Deputy Solicitor General on this point: "But if you look at your footnote, that involves the most tangential and insignificant use of a machine. And yet you say that might be enough to take something from patentability to not patentable."⁵⁹ Should Comiskey's claims involving the use of a machine come back to the Federal Circuit after remand to the PTO, perhaps we will get some guidance from the appellate court on what is and is not a sufficient use of a machine.

The PTO, of course, must make the determination of patentability in the first instance, and it has announced interim guidance in light of the Supreme Court's decision ("*Interim Bilski Guidance*").⁶⁰ The PTO invited comments not only on its Interim *Bilski* Guidance but also asked more generally for examples of two categories of claims:

- (1) Those that do not meet the machine-or-transformation test but "nevertheless remain patent-eligible because they do not recite an abstract idea," and
- (2) Those that meet the machine-or-transformation test "but nevertheless are not patent-eligible because they recite an abstract idea."

The Interim *Bilski* Guidance offered a number of factors for examiners to consider in making a prima facie case for rejecting an application on the basis of its being an abstract idea.

The PTO noted that, although the guidance represents a change in existing examination process, it did not expect complexity to increase for most examiners in determining subject matter eligibility because examiners seldom encounter claims that implicate the abstract idea exception. Moreover, it asserted that "[t]o date, no court, presented with a subject matter eligibility issue, has ever ruled that a method claim that lacked a machine or transformation was patent eligible," although it acknowledged, of course, that *Bilski* allowed for such a possibility.

The Interim *Bilski* Guidance emphasized that examiners "should avoid focusing on issues of patent-eligibility under §101 to the detriment of considering an application for compliance with §§102 [novelty], 103 [nonobviousness] and 112 [fully and particularly described], and should avoid treating an application solely on the basis of patent eligibility under §101, except in the most extreme case." In fact, "[s]ections 102, 103 and 112 are typically the primary tools for evaluating patentability, unless the claim is truly abstract."

For business method patents, the Interim *Bilski* Guidance listed a number of factors for examiners to consider in determining whether the claimed invention, viewed as a whole, would satisfy the machine-or-transformation test or provide evidence that the abstract idea has been practically applied.⁶¹ Key factors included an involvement of a machine or transformation and whether or not the invention was more than a mere statement of a concept. Additional factors included particularity, observable and verifiable performance of steps, and whether a concept was disembodied or implemented in some tangible way.

The guidance provided examples of general concepts. The examples included but were not limited to "basic economic practices or theories" (e.g., hedging, insurance, financial transactions, marketing.) These, in turn, included: basic legal theories (e.g., contracts, dispute resolution, rules of law); mathematical concepts (e.g., algorithms, spatial relationships, geometry); mental activity (e.g., forming a judgment, observation, evaluation, or opinion); interpersonal interactions or relationships (e.g., conversing, dating); teaching concepts (e.g., memorization, repetition); human behavior (e.g., exercising, wearing clothing, following rules or instructions); instructing "how business should be conducted."⁶²

The Interim *Bilski* Guidance pointed to *Ferguson v. Kappos*, a case that involved instruction on how business should be conducted, for further understanding of the abstract idea exception to patentability. The Guidance attached significance to the Supreme Court's denial of certiorari in *Ferguson* the day after the *Bilski* decision while at the same time granting, vacating and remanding two other Federal Circuit section 101 cases: "Although the Federal Circuit had applied the machine-or-transformation test to reject Ferguson's process claims," the notice suggested, "the Supreme Court's disposition of *Ferguson* makes it likely that the *Ferguson* claims also run afoul of the abstract idea exception." In fact, the *Ferguson* petition for certiorari conceded the issue when it described the claims, which involved product marketing,⁶³ as reciting business methods not tied to a machine, and as being abstract ideas.⁶⁴ Nonetheless, it would seem that

after *Bilski* a pure or naked method for doing business will as a practical matter be difficult to qualify as patent-eligible, as Justice Stevens desired.

At the same time, the Interim *Bilski* Guidance should give solace to both the computer and financial industries in that the factors indicate that a particular computer implementation is likely to be patent-eligible. The Interim *Bilski* Guidance speaks of "[i]ntegral use of a machine or apparatus to achieve performance of the method" as weighing toward eligibility.⁶⁵

It also refers to transformation to a different function or use as a positive factor. The Interim *Bilski* Guidance explicitly provided that it supplemented the 2009 Interim Examination Instructions for Evaluating Subject Matter Eligibility under 35 U.S.C. section 101. Those Interim Examination Instructions stated: "[T]ransformation of electronic data has been found when the nature of the data has been changed such that it has a different function or is suitable for a different use."⁶⁶ The Interim *Bilski* Guidance also gave examples of when use of computers will not be adequate, that is, when such use will be only nominal or insignificant. The two instances it offered were a data-gathering step and a field-of-use limitation.

Thus, we now know that *Bilski* allows for the possibility that some business methods constitute patentable subject matter under section 101; that the "useful, concrete and tangible" test of *State Street Bank* will no longer be used; that in many, probably most, cases, business methods will be patentable, if at all, under the machine-or-transformation test, but that it is not the sole test for patentability (and thus there may be some other basis or bases as well); and that abstract ideas are not patentable.

Like the rest of us, the PTO would like to know what are examples of claims that fail the machine-or-transformation test but are nonetheless patent-eligible because they are not abstract ideas. Under *Bilski*, the PTO must allow for the possibility, but seems skeptical that any such inventions exist. *Bilski* clearly gives inventors an incentive to make their claims as concrete, specific, and limited in scope as possible and, whenever possible, to satisfy the machine-or-transformation test, to avoid any PTO examiner or court from concluding that their claims are no more than statements of abstract ideas or fundamental principles.

BILSKI AND THE FUTURE OF TAX STRATEGY PATENTS

Tax strategy patents are likely to provide a rich testing ground for determining whether it is possible for an invention that does not meet the machine-or-transformation test to nonetheless be patent-eligible because it is a practical application of an abstract idea. Take, for example, the invention at issue in *Fort Properties, Inc.*, which is currently on appeal to the Federal Circuit.⁶⁷

The patented "deedshares" in *Fort Properties* were intended to provide a "guaranteed steady income stream," be "readily transferable, readily alienated," and "suitable for identification as replacement property" under Section 1031.⁶⁸ To accomplish this end, aggregated properties were made subject to at least one master agreement and title to the property was then divided into tenant-in-common deeds and, in a preferred embodiment, the property was subject to a master lease, which included a put/call arrangement. At the time of the district court case, the defendant argued that the invention satisfied the transformation prong of the machine-or-transformation test.

Does this invention claim patent-eligible subject matter in a post-*Bilski* world? If the Federal Circuit applies its *Comiskey* definition of mental processes, the claims in the

deedshare patent would be claiming only an abstract idea. Such is the likely outcome as well under the PTO Interim *Bilski* Guidance, but, as with any multi-factor test, the result is less certain. In part, the uncertainty arises because the guidance appears to permit testing the factors listed under both "transformation" and "general concept."

Under the Interim *Bilski* Guidance, the key factor under "transformation" is whether "performance of the claimed method involves a transformation of a particular article." The Interim *Bilski* Guidance also lists as a factor the "nature of the article transformed, i.e., whether it is an object or substance, weighing toward eligibility, compared to a concept such as a contractual obligation or mental judgment, which would weigh against eligibility." That is, under this guidance, transformation need not be of an object or substance, although that is preferable. Another factor is the "type or extent of change," such as "having a different function or use."

While the nature of the article being transformed in *Fort Properties* is a contractual obligation, which weighs against eligibility, the inventor of the deedshare patent would argue that all the other factors weigh in favor of eligibility. The transformation of legal obligations and relationships, which is what the deedshare patent addresses, involves a very particular kind of ownership, and transforms the interest in land to a different function and use so that it is a practical application of legal concepts. As the Summary of the Invention explains, a "deedshare" represents a "new type of investment instrument," one that "represents both a tenant-in-common interest in real estate, and provides the divisibility and liquidity of a traditional security, such as a bond," so that they "provide a guaranteed steady income stream, are readily transferable, readily alienated, and are suitable for identification property under IRC §1031." We have factors going in both directions and do not have any indication of how to weigh them.

At the same time, many, but not all, of the factors listed in the Interim *Bilski* Guidance for "general concept" suggest that the invention is an abstract idea rather than an application of an abstract idea. The Interim *Bilski* Guidance states that a "general concept" could "also be recognized in such terms as "a principle, theory, plan or scheme" and its presence "can be a clue that the claim is drawn to an abstract idea."

The Interim *Bilski* Guidance specifies basic legal theories, including contracts and rules of law as examples of general concepts. Additional factors relating to a general concept include whether it effectively grants a monopoly over the concept, whether it covers both known and unknown uses of the concept, whether it would cover all solutions to a particular problem, whether the concept is implemented in some tangible way, and whether the performance of the process is observable and verifiable.

The Quick Reference Sheet included in the Interim *Bilski* Guidance puts these criteria in quite different terms, with language such as whether the claim "is more than a mere statement of a concept," whether it "describes a particular solution to a problem to be solved" and "whether the claim implements the concept in some tangible way." The deedshare patent sets out to solve a particular set of problems related to investment in real estate. It also states, however, that its claims are intended to cover all "changes and modifications that fall within the true spirit and scope of the invention," and thus it would seem to be claiming a monopoly over this particular legal concept, including both known and unknown uses of the legal concept, although not over all investments in real estate or over all uses of Section 1031. The legal concept is implemented only through legal documents, not through an apparatus or machine. Again, we have factors going in both directions, although more that seem to go toward ineligibility.

It is significant, however, that the Interim *Bilski* Guidance directs examiners to consider the claim as a whole. In *Fort Properties*, the claim as a whole involves, as the district court has stated, only the "transformation or manipulation of legal obligations and relationships," specifically, "legal ownership interests in real estate." Thus, it would seem that, ultimately, under the Interim *Bilski* Guidance the deedshare claims are abstract ideas. Nonetheless, we must hope that the Federal Circuit will give further guidance regarding the meaning of "abstract idea" in the context of tax strategy patents and do so in a manner that the PTO will be able to incorporate into its guidance on subject matter eligibility.

As discussed in the preceding section, tax strategies that use computer software for anything but the most insignificant activity, such as data storage, are likely to be deemed patentable under section 101. All eight of the patents that were granted in June or July of 2010 and listed in the tax strategy subclass "focused on use of a computer as an essential element"⁶⁹ of the claimed invention.⁷⁰ To avoid the possibility of rejection as an abstract idea, applications for tax strategy patents will likely be drafted to include computer software as a significant aspect of the invention. The goal will be to pass the machine-or-transformation test, which the Supreme Court has approved as a test, simply not as the exclusive test.

Those who object to the patenting of tax strategies as a matter of policy wish to ensure that no patents are granted with claims that "make law-abiding taxpayers vulnerable to patent infringement suits because they engage in a lawful transaction that qualifies for favorable tax treatment."⁷¹ In contrast, claims limited to a particular computer implementation of a tax strategy and which permit other implementations seem less troubling on the policy grounds that have been articulated.⁷²

It may be that over time, case law and PTO guidelines in connection with the interpretation and application of both "abstract ideas" and the "machine-or-transformation test" will make these distinctions.⁷³ The Interim *Bilski* Guidance appears to move in this direction. Nonetheless, any such development will be slow and uncertain. Many who are concerned about tax strategy patents believe that the Court's failure to provide any meaningful guidance in *Bilski* demonstrates that legislation is needed.

Achieving passage of any legislation prohibiting tax strategy patents will not be easy. Patent laws, even if they affect tax, are under the jurisdiction of the Judiciary Committees in the House and the Senate, not the tax-writing committees. These committees have struggled without success to reach agreement on questions of broader patent reform for the past several sessions. Tax strategy patents represent a tiny fraction of business method patents, much less of all patents. Thus, for the patent community, the issue is not a pressing one. To many in the patent bar, it is also not an appropriate one; the patent bar in general objects to making exceptions to patentability under section 101.⁷⁴

As is often the case in drafting legislation, defining key terms appropriately will be challenging. The goal is to exclude from patentability even those tax strategy patents that make some use of software but to continue to permit both patents on financial products in which tax issues are peripheral and patents on technology that may be the subject of tax incentives, such as a hybrid car. In the course of these efforts, it also will be important that any tax strategy prohibition does not affect patents on tax preparation software. The AICPA has taken the lead in this legislative effort and continues to work on these issues.⁷⁵

CONCLUSION

Many thought that the Supreme Court in *Bilski* would eliminate or sharply limit business method patents, including patents on tax strategies. The Court did not do so. It left us with one new certainty, that under current law business method patents are not categorically prohibited, and with uncertainties about the meaning of unpatentable abstract ideas and the reach of the machine-or-transformation test. If legislation regarding tax strategy patents is not enacted, these uncertainties in the context of tax strategy patents will persist for some time.

Practice Notes

Tax strategies that use computer software for anything but the most insignificant activity, such as data storage, are likely to be deemed patentable under 35 U.S.C. section 101. All eight of the patents that were granted in June or July of 2010 and listed in the tax strategy subclass "focused on use of a computer as an essential element" of the claimed invention. To avoid the possibility of rejection as an abstract idea, applications for tax strategy patents will likely be drafted to include computer software as a significant aspect of the invention. The goal will be to pass the machine-or-transformation test, which the Supreme Court has approved as a test, simply not as the exclusive test.

¹

T.S. Eliot, "The Hollow Men." See also Ambrogi, "*Bilski*'s Lesson: Avoid Abstraction," available at www.jdsupra.com/post/documentViewer.aspx?fid=c9b8c3d7-6e5a-4f6d-87fc-466b7b861ad4L.

²

See Magliocca, "The Bottom-Line of *Bilski*" (6/28/10), available at www.concurringopinions.com/archives/2010/06/the-bottom-line-of-bilski.html#comments; Schwartz, "Justices Take Broad View of Business Method Patents," New York Times, 6/28/10, available at www.nytimes.com/2010/06/29/business/29patent.html?_r=1&src=busln&scp=3&sq=Bilski&st=cse; Goldstein, "Business Method Patents Nearly Bite the Dust" (7/6/10), available at www.scotusblog.com/2010/07/business-method-patents-nearly-bite-the-dust/.

³

Elena Kagan, Justice Stevens's successor, was Solicitor General at the time of the case and signed the government's brief, which defended the machine-or-transformation test. She is known for her ability to bring factions together and, perhaps, if given the opportunity in some future Supreme Court case, she would, as a Justice, be able to articulate narrow limits for business method patents that would satisfy both those who joined the majority and the minority in *Bilski*.

⁴

Article I, Section 8, Clause 8.

⁵

Diamond v. Chakrabarty, 447 US 303, 65 L Ed 2d 144 (1980) (quoting 5 *Writings of Thomas Jefferson* 75-76 (Washington ed., 1871)).

⁶

Id. The case held a man-made microorganism to be patentable. The Supreme Court, however, did not quote the full sentence from the legislative history. In context, the phrase in fact suggests that Congress intended to limit rather than expand the breadth of patents: "A person may have 'invented' a machine or a manufacture, which may include anything under the sun that is made by man, but it is not necessarily patentable under section 101, unless the conditions of the title are fulfilled." H. Rep't No. 1923, 82d Cong., 2d Sess. 6 (1952), quoted by Brief Amici Curiae of Professors Peter S. Menell and Michael J. Meurer in Support of Respondent, page 21.

⁷

Statement of Nicholas Godici, Commissioner for Patents, U.S. Patent and Trademark Office, before the Senate Committee on Finance Hearing on "Bridging the Tax Gap"

(7/21/04), 2004 TNT 141-52.

[8](#)

35 U.S.C. section 101.

[9](#)

See note 5, *supra*.

[10](#)

35 U.S.C. section 100(b).

[11](#)

35 U.S.C. section 102.

[12](#)

35 U.S.C. section 103.

[13](#)

35 U.S.C. section 112.

[14](#)

Ex parte Abraham, 1869 C.D. 59.

[15](#)

H. Rep't No. 1923, *supra* note 6 (explaining substitution of "process" for "art" in section 101 of the 1952 Patent Act).

[16](#)

The Federal Circuit is the only federal appellate court to hear patent cases. See the Federal Circuit Act of 1982, P.L. 97-164 (4/2/82). It hears appeals both from the Board of Patent Appeals and Interferences (28 U.S.C. section 141) and from the district courts (28 U.S.C. section 1295).

[17](#)

Brief for Petitioners, page 36.

[18](#)

"A USPTO White Paper: Automated Financial or Management Data Processing Methods (Business Methods)," page 5, available at www.uspto.gov/patents/resources/methods/whitepaper.pdf.

[19](#)

Id. The second review was eliminated in 2008. See Crouch, "The Business Method Patent Arts Units," available at www.patentlyo.com/patent/2010/07/business-method-patents.html.

[20](#)

Raskind, "The *State Street Bank* Decision: The Bad Business of Unlimited Patent Protection for Methods of Doing Business," 10 Fordham Intell. Prop. Media & Ent. L.J. 61 (1999), page 86 (footnote omitted). See also Joint Committee on Taxation, "Background and Issues Relating to the Patenting of Tax Advice," JCS-31-06 (7/12/06), page 18.

[21](#)

Search of term "ccl/705/36T" at patft.uspto.gov/netahtml/PTO/search-adv.htm. Not all patents that have tax implications are necessarily categorized in that subclass; they may be classified in any number of other subclasses. Classification depends on how the application describes the invention, decisions made by the examiner, errors, and other reasons. For example, Patent No. 6,766,303 (filed 10/15/01, issued 7/20/04) (method for hedging one or more liabilities associated with a deferred compensation plan) was at one time listed in subclass 36T (see "USPTO Issues Patent for Method for Hedging Deferred Compensation Liabilities," 2007 TNT 78-87); it now is listed only in subclass 36R (portfolio selection, planning, and analysis). It has a lengthy discussion of tax consequences in its description, but no reference to tax or the Internal Revenue Code in its claims. The PTO also has established another subclass specifically for "Tax Preparation or Submission," which is described as "subject matter drawn to a computerized arrangement for determining or submitting a tax or tax form to a governmental entity." Tax professional organizations have been less concerned about patents in this tax preparation category.

[22](#)

See, e.g., U.S. Patent No. 7,620,593 (filed 6/22/02, issued 11/17/09) (method for capital creation for a tax-exempt organization); U.S. Patent No. 7,337,141 (filed 4/19/02, issued 2/26/08) (hedging employee stock options); U.S. Patent 7,219,079 (filed 8/12/02, issued 5/15/07) (convertible financial instrument with contingent payment).

[23](#)

U.S. Patent No. 6,567,790 (filed 12/1/96, issued 5/20/03).

[24](#)

Wealth Transfer Group LLC v. Rowe, Docket No. 3:06-cv-00024-AWT (DC Conn.), Consent Final Judgment Regarding Settlement (on file with author).

[25](#)

Id.

[26](#)

U.S. Patent 6,292,788 (filed 12/3/98, issued 9/18/01) (method and investment instruments for performing tax-deferred real estate exchanges).

[27](#)

As discussed in more detail in the text, below, the case is currently on appeal to the Federal Circuit: Fort Properties, Inc. v. American Master Lease, LLC, Fed. Cir. No. 07-365, 2009-1242.

[28](#)

See Lederman, "Tax-Related Patents: A Novel Incentive or an Obvious Mistake?," 105 JTAX 325 (December 2006).

[29](#)

See "AICPA Urges Congress to Legislate Against Tax Patents," 2007 TNT 45-22; "NYSBA Says Applying Patent Law to Tax Advice Could Cause Problems," 2006 TNT 160-18; "Texas State Bar Passes Resolution on Patents of Tax Planning Methods," 2007 TNT 39-43.

[30](#)

See Lang, "Patented Tax Strategies, Ethics, and Circular 230: Protecting Yourself, and Your Client," 50 Tax Mgt. Memo. No. 14 (7/6/09), page 275.

[31](#)

See "NYSBA Says Applying Patent Law to Tax Advice Could Cause Problems," *supra* note 29.

[32](#)

See "AICPA Urges Congress to Legislate Against Tax Patents," *supra* note 29.

[33](#)

See Figg, "Should the Patent Laws Exempt Certain Innovations from Patent Eligibility?," ABA IPL Newsletter, Summer 2006.

[34](#)

Id.

[35](#)

See "Hearing on Issues Relating to the Patenting of Tax Advice," Subcommittee on Select Revenue Measures of the Committee on Ways and Means, 109th Cong., 2d Sess. (7/13/06), available at waysandmeans.house.gov/Hearings/transcript.aspx?NewsID=10219. The author was among those testifying at this hearing.

[36](#)

H.R. 1908, 110th Cong., 1st Sess. Other legislation that would have affected tax patents introduced in 2007 included H.R. 2365, which would have limited damages and other remedies with respect to tax patents, and S. 681, which would have prohibited them.

[37](#)

S. 2369.

[38](#)

H.R. 2585, S. 506, and H.R. 1265.

[39](#)

Prop. Reg. 1.6011-4(b)(7) (REG-129916-07, 72 Fed. Reg. 54615 (9/26/07)).

[40](#)

See Argument Preview at www.scotuswiki.com/index.php?title=Bilski_v.Kappos.

[41](#)

In re Bilski, 545 F3d 943, 2008-2 USTC ¶150621 (CA-F.C., 2008).

[42](#)

Petition for Writ of Certiorari, page i.

[43](#)

35 U.S.C. section 273, known as the First Inventor Defense Act, protects those accused of infringing for "a method of doing or conducting a business" if they have reduced the subject matter to practice and have commercially used the subject matter at least a year before the filing date of the allegedly infringed patent, whether or not the subject matter is "accessible to or otherwise known to the public."

[44](#)

See, e.g., Brief Amicus Curiae of International Business Machines Corporation in Support of Neither Party, Brief of Entrepreneurial and Consumer Advocates Amici Curiae in Support of Respondent, Brief Amici Curiae of Professors Peter S. Menell and Michael J. Meurer in Support of Respondent.

[45](#)

Brief of Eleven Law Professors and AARP as Amici Curiae in Support of Respondent.

[46](#)

See, e.g., Brief of Amicus Curiae John Sutton in Support of Petitioners.

[47](#)

The author as a member of the ABA Tax Section had a role in reviewing the ABA brief and offering comments on it for its authors' consideration.

[48](#)

The brief for respondent stated that in the years following *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F3d 1368 (CA-F.C., 1998), *cert. den.*, the PTO sometimes issued patents for marketing strategies, tax-avoidance, and estate planning methods. A footnote listing examples included U.S. Patent No. 6,292,788 ("Methods and Investment Instruments for Performing Tax-Deferred Real Estate Exchanges") and U.S. Patent No. 6,567,790 ("Establish and Managing Grantor Retained Annuity Trusts Funded by Nonqualified Stock Options"). Brief for Respondent, page 41 and fn. 20. The brief continued: "Because these methods do not concern a particular machine or effect a transformation of matter, they are not patent-eligible 'processes' under a proper understanding of Section 101."

[49](#)

Quoting *Diamond v. Diehr*, 450 US 175, 67 L Ed 2d 155 (1981).

[50](#)

An activity is "postsolution" if it occurs after or outside what the invention claims to achieve.

[51](#)

Citing to *State Street Bank*, *supra* note 48, and *AT&T Corp v. Excel Communications, Inc.*, 172 F3d 1352 (CA-F.C., 1999).

[52](#)

Justice Breyer quoted from Judge Mayer's dissent in the Federal Circuit's decision in *Bilski* to list patents ranging "from the somewhat ridiculous to the truly absurd," such as a "method of training janitors to dust and vacuum using video displays" and a "system for toilet reservations."

[53](#)

In its recently announced interim guidance, the PTO quoted this language, requested comments, and asked, "Do any such 'categories' exist? If so, how does the category itself represent an 'attempt to patent abstract ideas'?" See "Interim Guidance for Determining Subject Matter Eligibility for Process Claims in View of *Bilski v. Kappos*," 75 Fed. Reg. 43,922 (7/27/10) available at

www.uspto.gov/patents/law/exam/bilski_guidance_27jul2010.pdf.

[54](#)

Justice Kennedy also took refuge in the fact that a claimed invention also must be novel, nonobvious, and fully and particularly described to receive patent protection.

[55](#)

The Federal Circuit frequently cited *Comiskey* in its *Bilski* opinion and compared the two patents, but because it announced a new test in *Bilski* it did not rely on its reasoning in *Comiskey*.

[56](#)

"A search of the PTO database reveals dozens of issued patents with the term 'hedging' in the title or abstract ..., related to hedging risk in sports wagers, insurance contracts, employee stock options, and the like." Brief for Petitioner, pages 57-58.

[57](#)

Data gathering is often given as an example of insignificant extra-solution activity.

[58](#)

Brief for Respondent, page 53, fn. 30.

[59](#)

Transcript of Oral Argument, page 35.

[60](#)

See note 53, *supra*.

[61](#)

The following discussion of the Interim *Bilski* Guidance excludes any factor that refers to "a law of nature."

[62](#)

Instructing "how business should be conducted" is an example of a general concept; how that concept is used determines whether the invention is patent-eligible. The category itself is not deemed patent-ineligible as an abstract idea. Although the phrase is taken from Justice's Kennedy's opinion, it sounds very much like what Justice Stevens would have held not to be patentable subject matter in *Bilski*—"a claim that merely describes a method of doing business."

[63](#)

See *In re Ferguson*, 558 F3d 1359 (CA-F.C., 2009), *cert. den.*

[64](#)

See the briefs in *Ferguson v. PTO*, Petition for Writ of Certiorari.

[65](#)

Justice Stevens, who would have held patents on methods of doing business unpatentable, did not explain what he meant by such patents. He made clear, however, that he would have upheld the patent in *State Street Bank*, *supra* note 48, by writing that Judge Rich's opinion in that case "dealt with whether a piece of software could be patented and addressed only claims directed at machines, not processes. His opinion may therefore be better understood as holding that an otherwise patentable process is not unpatentable simply because it is directed toward the conduct of doing business—an issue the Court has no occasion to address today." Thus even Justice Stevens and the Justices who joined his opinion might view a tax strategy that made significant use of computer software as patentable, as either a machine or as a process, depending on how the claims were drafted.

[66](#)

Brief for Respondent, page 39, quoting the PTO 2009 Interim Instructions. Programmed computers also may be patentable as machines, as in *State Street Bank*. The Federal Circuit has held that a computer operating pursuant to software may represent patentable subject matter "because a general purpose computer in effect becomes a special purpose computer once it is programmed to perform particular functions pursuant to instructions from program software." See *In re Alappat*, 33 F3d 1526 (CA-F.C., 1994). That is, once programmed, a general-purpose computer becomes a new machine.

[67](#)

See the text accompanying notes 26 and 27, *supra*.

[68](#)

U.S. Patent No. 6,292,788.

[69](#)

See JCS-31-06, *supra* note 20, page 19 (contrasting patented tax strategies that focus on use of a computer from those that rely primarily on the tax structure itself).

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U.S. Patent 7,765,132 (tax refund system), U.S. Patent No. 7,752,105 (computer-aided process of funding, including a private constant dollar instrument), U.S. Patent No. 7,752,090 (system and method for reversing accounting distortions and calculating a true value of a business), U.S. Patent No. 7,747,489 (computer-aided process for real purchasing power financial product), U.S. Patent No. 7,747,486 (financial analysis system interface), U.S. Patent 7,739,170 (System and Methods for Analysis of Portfolio Returns and Trade Cost Measurement Based on Fiduciary Roles), U.S. Patent No. 7,729,972 (methodologies and systems for trade execution and recordkeeping in a fund of hedge funds environment), U.S. Patent No. 7,729,968 (method for obtaining and/or providing a liquidity commitment). Of course, all of these patent applications were reviewed at least initially during the pendency of *Bilski* when only applications that met the machine-or-transformation test could be approved.

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See Chumney, Baumer, and Sawyers, "Patents Gone Wild: An Ethical Examination and Legal Analysis of Tax-Related and Tax Strategy Patents," 40 Am. Bus. L.J. 343 (2009), page 358.

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Cf. Dreyfuss, "Are Business Method Patents Bad for Business?," 16 Santa Clara Comp. & High Tech L.J. 263 (2000), pages 278-79 (urging that only new applications, that is, new and nonobvious computer implementations, but not the business model that the software implements, be candidates for patent protection).

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For tax lawyers used to Regulations and rules from Treasury and the IRS, it is important to note that the PTO has no authority to issue substantive rules. See 35 U.S.C. section 2(b)(2); *Merck & Co., Inc. v. Kessler*, 80 F3d 1543 (CA-F.C., 1996). The PTO specifically states that the Interim *Bilski* Guidance "does not constitute substantive rule making and hence does not have the force and effect of law."

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Current exceptions to patentability exist for national security and public safety. See 35 U.S.C. section 181 (denying patents for inventions that would be detrimental to the national security), 45 U.S.C. section 2013(c) (prohibiting patents for nuclear material and atomic energy). Another approach that has been suggested is to permit patenting of tax strategies, but to deny liability for infringement or inducing infringement, as is currently the case for patents on medical procedures. Such an approach, however, faces congressional opposition because of a perceived conflict with TRIPs, the Agreement on Trade Related Aspects of Intellectual Property Rights. See Aprill, "Responding to Tax Strategy Patents," Proceedings of the USC Gould School of Law's 59th Inst. on Fed. Tax., pages 2-23 to 2-33 (2007).

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See "AICPA Says Congress Should Ban Tax Strategy Patents," 2010 TNT 124-26.

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