



U.S. Patent Reform in 2011 -- Implications for the Insurance & Financial Industries

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OVERVIEW

The US patent system is defined in Title 35 of the US Code. Over the past five years, seven separate bills have been introduced in Congress to reform and update the US patent system. The most recent attempt was introduced by Senator Patrick Leahy (D-VT) on January 25, 2011 as S. 23 “The Patent Reform Act of 2011.” An almost identical House of Representatives bill, the “America Invents Act”, was introduced by Representative Lamar Smith (R-TX) on March 30, 2011.

Senator Leahy, in introducing the bill, stated that a recent Thomson Reuters study predicts that China will file more patents this year than the US, and that China plans to quadruple its patent filings over the next five years. It has been almost 60 years since Congress updated the Nation’s patent system. The Senator focused on three main goals of the legislation: improve the application process by transitioning to a first-inventor-to-file system; improve the quality of patents issued by the USPTO by introducing several quality-enhancement measures; and provide more certainty in litigation.

Senator Orrin Hatch (R-UT), in supporting introductory comments, emphasized the need to update the patent system to support technological innovation, entrepreneurship, and job creation. He pointed to the greater than 700,000 patent application backlog that “represents dynamic economic growth waiting to be unleashed.”

According to Senator Hatch, passage of the Act “would move the United States to a first-inventor-to-file system, which will bring greater harmony and improve our competitiveness. Also, among other things, the bill would improve the system for administratively challenging the validity of a patent at the USPTO; improve patent quality; create a supplemental examination process for patent owners; prevent patents from being issued on claims for tax strategies; and provide fee-setting authority for the USPTO Director to ensure the Office is properly funded.”

Following its late January introduction to the Senate Judiciary Committee, a series of hearings were held. On Tuesday, March 8, 2011, the full Senate passed the bill on a 95-5 vote.

The Patent Reform Bills & the Insurance & Financial Industries

In this white paper, we will examine two key aspects of these bills (referring to the relevant sections in the Senate version) that have significant implications for the insurance and financial industries:

- First inventor to file
- Tax strategies deemed within the prior art.

FIRST INVENTOR TO FILE

Section 2 of the Patent Reform Act shifts the US patent system to a “first to file” basis, in contrast to the “first to invent” approach it has used thus far. Section 2 amends Section 100 of Title 35 of the US Code by inserting the following language:

“(i)(1) The term ‘effective filing date’ of a claimed invention in a patent or application for patent means--

“(A) if subparagraph (B) does not apply, the actual filing date of the patent or the application for the patent containing a claim to the invention; or

“(B) the filing date of the earliest application for which the patent or application is entitled, as to such invention, to a right of priority under section 119, 365(a), or 365(b) or to the benefit of an earlier filing date under section 120, 121, or 365(c).”

A first to file system would move the US patent system to greater harmony with other international systems, which many parties who submitted testimony to the Judiciary Committee stated would increase US inventors’ and manufacturers’ ability to effectively compete internationally. A first to file system would eliminate the subjectivity that can be involved in determining the first inventor in the current system, and subsequently reduce what can be very significant litigation costs and time delays. As noted by Karen Kerrigan, President & CEO of the Small business & Entrepreneurship Council,

“In a 2004 report from the National Research Council of the National Academies (titled “A Patent System for the 21st Century”), it was pointed out: “For those subject to challenge under first-to-invent, the proceeding is costly and often very protracted; frequently it moves from a USPTO administrative proceeding to full court litigation. In both venues it is not only evidence of who first reduced the invention to practice that is at issue but also questions of proof of conception, diligence, abandonment, suppression, and concealment, some of them requiring inquiry into what an inventor thought and

when the inventor thought it.” The costs of this entire process fall more heavily on small businesses and individual inventors.

As for the international marketplace, patent harmonization among nations will make it easier, including less costly, for small firms and inventors to gain patent protection in other nations, which is critical to being able to compete internationally. By moving to a first-inventor-to-file system, small firms will in no way be disadvantaged, while opportunities in international markets will expand.”

Senator Christopher Coons (D-DE) stated that, “Transition to first-to-file is an improvement over the current system because it provides increased predictability, certainty, and transparency. Patent priority will depend on the date of public disclosure and the effective filing date rather than on secret inventor notebooks, secret personal files which may or may not be admissible and often lead to long and contentious litigation . . .”

DEEMING TAX STRATEGIES AS NON-PATENTABLE INVENTIONS

Section 14 of S. 23 is of major importance to the insurance and financial industries. This section states:

“(a) In General- For purposes of evaluating an invention under section 102 or 103 of title 35, United States Code, any strategy for reducing, avoiding, or deferring tax liability, whether known or unknown at the time of the invention or application for patent, shall be deemed insufficient to differentiate a claimed invention from the prior art.”

This new restriction applies to any tax strategy inventions dealing with federal, state, or local law, or foreign nations. This limitation of tax strategy inventions would take effect on the Act’s date of enactment, and would apply to any pending patent applications and any patents issued on or after that date.

In an attempt to limit the scope of this potentially far-reaching section, Congress states that:

“(e) Exclusion- This section does not apply to that part of an invention that is a method, apparatus, computer program product, or system, that is used solely for preparing a tax or information return or other tax filing, including one that records, transmits, transfers, or organizes data related to such filing.”

In other words, TurboTax, TaxCut, and similar programs would be exempt.

But first, what are tax strategy inventions? These inventions are included in Class 705 of the US Patent Classification System. This is the highly complex and esoteric scheme which the US Patent and Trademark Office uses to determine the central subject matter of an invention, and route that invention to the appropriate examination unit and Patent Examiner. Class 705 broadly covers business methods inventions. This class (as are all others) is broken down into numerous subclasses that are hierarchically arranged by subject matter, with more complex topics generally appearing higher in the classification scheme.

Tax strategies are dealt with in the 705/36T subclass. This subclass is a subset of 705/36R, dealing with portfolio selection, planning, or analysis, which is itself a subset of 705/35 Finance (e.g., banking, investment, or credit). From the USPTO's Manual of Classification, which provides the layout and definitions for all subject matter covered by the US Classification System, this subject matter is defined as

“Portfolio selection, planning or analysis: This subclass is indented under [subclass 35](#). Subject matter drawn to a computerized arrangement for planning the selection or evaluation of securities or other investments for a single entity.

(1) Note. The term "entity" refers to an individual or other legally recognized body.”

Additional white papers on business methods patents may be found at [The Coronado Group, Ltd. web page](#), and two of our blogs -- [Search The Way You Think](#) and [Business Methods Modus Operandi](#).

Before we look at the reasoning the Senate used to set future tax strategy inventions off limits, let's review the nature of some patents currently classified in the tax strategy area.

TAX STRATEGY PATENTS -- THE CURRENT PICTURE

As of March 11, 2011, the USPTO has issued 136 tax strategy patents, and has published 161 patent applications. Considering the issued patents, a review of those 136 shows that only 32 have been issued with a primary classification of 705/36T. In other words, according to the USPTO, only 32 of the issued tax strategy patents (23.5% of the total number issued) have that concept as their most comprehensive claim, and can be considered tax strategy inventions per se. The tax strategy aspect of the remaining 76.5% is peripheral for the purpose of awarding patents on those inventions. Another interesting aspect of the 32 issued tax strategy patents is that they are equally split (16 and 16) between those dealing chiefly with software

(e.g., tax preparation software, display of data on portfolio allocation and analysis of tax implications) and tax strategies themselves. Finally, 16 of the 136 issued patents are considered by the USPTO to be chiefly insurance patents that also contain a tax strategy aspect.

WHY THE FOCUS ON TAX STRATEGIES?

Why has Congress determined to eliminate tax strategies, other than tax preparation software, as a patentable invention under the US system? Some extracts from the Congressional Record are instructive.

From Senator Chuck Grassley (R-IA), “These [tax strategy] patents encumber the ability of taxpayers and their advisers to use the tax law freely, interfering with the voluntary tax compliance system. Tax strategy patents undermine the fairness of the Federal tax system by removing from the public domain ways to satisfy a taxpayer's legal obligations. If firms or individuals hold patents for these strategies, some taxpayers could face fees simply for complying with the Tax Code. Moreover, tax patents provide windfalls to lawyers and patent holders by granting them exclusive rights to use tax loopholes, which could provide some businesses with an unfair advantage in our competitive market system.

“Our provision would ensure that all taxpayers will have equal access to strategies to comply with the Tax Code. This provision was carefully drafted with the help of the Patent and Trademark Office not to cover software preparation and other software, tools or systems used to prepare tax or information returns or manage a taxpayer's finances.”

From Senator Max Baucus (D-MT), “I am concerned by the growth in the number of patents that have been sought and issued for tax strategies for reducing, avoiding, or deferring a taxpayer's tax liability. Section 14 of S. 23 would prevent the granting of patents on these tax strategies so that the Internal Revenue Code can be applied uniformly while balancing the critical need to protect intellectual property . . . Our Federal tax system relies on the voluntary compliance of millions of taxpayers. In order for the system to work, the rules must be applied in a fair and uniform manner. To that end, everyone has the right to arrange financial affairs so as to pay the minimum amount legally required under the Internal Revenue Code.

“Patents granted on tax strategies take away this right and undermine the integrity and fairness of the tax system. These patents have been on ideas as simple as funding a certain type of tax-favored trust with a specific type of financial product or calculating the ways

to minimize the tax burden of converting to an alternative retirement plan. Rather than allowing these tax planning approaches to be available to everyone, these patents give the holder the exclusive right to exclude others from the transaction or financial arrangement. As a result, they place taxpayers in the undesirable position of having to choose between paying more than legally required in taxes or paying a royalty to a third party for use of a tax planning invention that reduces those taxes.

“The patentability of tax strategies also adds another layer of complexity to the tax laws by requiring taxpayers or their advisors to conduct patent searches and exposing them to potential patent infringement suits. And, in situations where a patent is obtained on a tax shelter designed to illegally evade taxes, the fact that a patent was granted may mislead unknowing taxpayers into believing that the strategy is valid under the tax law.”

Several points. How is it that the federal tax system is one of “voluntary compliance”? We have seen above that a small fraction of tax strategy patents are fundamentally directed toward tax strategies and minimizing tax liability. If there are conflicts between tax laws and regulations and issued patents, shouldn’t that be dealt with by either adjusting the laws and regulations, or adjusting the US Patent Classification System definition of tax strategies to be consistent with tax law? The quotes above demonstrate that the Senators understand that US patents confer a property right that can be exercised by the patent inventor or assignee, and that they can charge licensing fees for the use of their invention during the life of the patent. The Senators, however, also demonstrate that they disdain this protection and right for inventors of tax strategy inventions. Finally, by legislatively mandating that future tax strategy inventions are neither novel nor non-obvious, Congress significantly undercuts a key aspect of the US Patent system.

The Bottom Line

Should patent reform ultimately be enacted with the provisions contained in the Senate and House versions, there will be significant negative implications for the insurance and financial industries with regard to their tax strategy IP holdings. Issued patents remaining in force on the date of enactment will likely decline in value. Planned patents and applications will be deemed prior art and will not be issued as patents. It will be vital to very closely assess planned patents that might receive a 705/35 (Finance (e.g., banking, investment or credit)) classification, or one of its subclasses, to ensure that they won’t run afoul of the tax strategy limitation.

Insurance and financial companies with IP holdings should consider conducting analyses of those holdings to evaluate risk to their valuation.

How Can We Help?

There are three ways Coronado Group can help you understand where business methods patents fit into your IP and commercialization strategy:

- Coronado's business methods patent experts can help you evaluate your patents, patent applications, and invention disclosures and help you evaluate your portfolio in light of business methods patents and build a business methods patent strategy.
- Coronado Group offers **Coronado IP**, a suite of on-demand, self-directed conceptual search tools and IP analytics designed to help you search the way you think.
- Coronado Group provides a range of consulting and advisory services to insurance, financial, high tech, technology transfer, and intellectual property organizations.

Our analysts are experts on convergence - when science, technology, and innovations blend to create new inventions and new science and technology and where business methods patents fit into the commercialization continuum.

About Coronado Group

The Coronado Group, Ltd. is a specialized systems integration and professional services firm that provides advanced intellectual property research and analysis services and products. Coronado Group provides intellectual property research and analysis services to inventors, researchers, product managers, and intellectual property legal professionals focusing on the advanced intellectual property analytics and patent portfolio development.