AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION
241 18th Street, South, Suite 700, Arlington, VA 22202 Phone: 703.415.0780 – Fax: 703.415.0786 – www.aipla.org

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Internal Revenue Service
Room 5203, Internal Revenue Service,
PO Box 7604, Ben Franklin Station,
Washington, DC 20044

Reference: CC:PA:LPD:PR (REG–129916–07)

Comments on Proposed Rule: "Patented Transactions"
REG–129916–07
Bulletin No. 2007-43
October 22, 2007

Dear Sirs:

The American Intellectual Property Law Association (AIPLA) appreciates the opportunity to offer comments regarding the rule proposed by the U.S. Internal Revenue Service (IRS) on "Patented Transactions".

AIPLA is a national bar association whose more than 17,000 members are primarily lawyers in private and corporate practice, in government service, and in the academic community. AIPLA represents a wide and diverse spectrum of individuals, companies, and institutions involved directly or indirectly in the practice of patent, trademark, copyright, and unfair competition law, as well as other fields of law affecting intellectual property. Our members represent both owners and users of intellectual property.

Introduction

The proposed regulations would establish additional rules relating to the disclosure of reportable transactions under sections 6011 and 6111 of the Internal Revenue Code (Code). The regulations would add a patented transactions category of reportable transaction to the regulations under §1.6011–4 of the Income Tax Regulations. Our comments are directed toward the clarity of the rules, namely the scope of a reportable transaction for taxpayers and material advisors, as it relates to patent applications, and the payment of a royalty under a patent as absolute proof of use of a patented tax planning method.

Comments

1. The scope of a reportable transaction as it relates to patent applications.

From example 5 in the proposed regulations, it appears that §1.6011-4(b)(7)(F) would require reporting, as a patented transaction, the fees paid to the United States Patent and Trademark Office (USPTO) and to an attorney for preparing and prosecuting a patent application on a tax planning method. Such a reporting requirement may be difficult to perform for several reasons. First, it is important to note that it would take many years from the time that an invention is conceived by an inventor (A in the example) until a patent application is filed and a patent ultimately issues. Second, during this period, a patent *application*, unlike an issued patent, cannot be enforced. Third, a patent

application may include a description of multiple inventions, some of which may not be claimed at the time the application is filed. In addition, some of the inventions in a patent related to tax advice or strategies may be directed to generic methods of calculation, which are not subject to reporting. Fourth, claims to tax advice or strategies may be cancelled from the application prior to issuance as a patent. Thus, it is not possible to know during the time when an application is pending before the USPTO whether claims may issue that are related to a tax planning method and subject to the reporting requirements. Due to these difficulties, AIPLA believes that patent applications should be excluded from the reporting requirements.

Should there be a need for considering pending patent applications in the regulations, at a minimum, the regulations should indicate that at least one pending claim in an application must be directed toward a tax planning method in order for the reporting requirement to apply. Note that this would then encompass patent applications that are amended years after filing to include claims directed to a tax planning method. In addition to the issues surrounding applications, some transactions, such as licenses and sales of a business, may embrace an entire portfolio of patents and applications that may include a patent to a tax planning method. The purpose of a transaction may be far removed from such an incidental patent. Therefore, the regulations should clarify that reporting is required only when one or more tax planning patents are a significant part of the transaction.

2. The definition of a tax planning method.

AIPLA would also like to point out that it can be very difficult to identify patents that are directed to a tax planning method. The scope of a patent is defined by its claims. Claim interpretation can be a very complex endeavor as illustrated by efforts devoted to that issue in patent litigation. The regulations should make it clear that at least one claim of a patent must be solely directed toward a tax planning method for the patent to be subject to the reporting requirements. The current definition of tax planning method includes patents to inventory control, methods of valuation of assets (see *State Street Bank & Trust Company v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998)), methods of generating invoices, and methods, systems and devices directed toward any aspect of business management that may affect tax. Given that some patent owners may have thousands of patents, along with the complexity of claim interpretation, proper identification of patents directed toward tax planning methods may entail significant efforts. Further, given these difficulties, any penalties associated with failure to report patented transactions should only be assessed based on an intent-to-deceive standard.

Without a clear definition of a tax planning method, some patent owners may be over inclusive in their reporting, providing too much information to be of benefit to the IRS. The current definition refers to ". . . any plan, strategy, technique, or structure designed to affect federal income, estate, gift, generation skipping transfer, employment, or excise taxes". The term "designed" seems to imply intent, but it is not clear if the definition is meant to include patents intended to claim tax planning methods, or only those that actually claim tax planning methods. We believe that the latter was intended. As a result, AIPLA suggests the definition of a tax planning method be clarified to cover: ". . . any plan, strategy, technique, or structure primarily affecting federal income, estate, gift, generation skipping transfer, employment, or excise taxes".

3. Payment of a royalty under a patent is not proof of use of a patented tax planning method.

Just as the IRS recognizes that issuance of a patent does not constitute approval of any tax avoidance method, it should also be recognized that payment of a royalty under a patent related to tax planning method is not conclusive proof of use of the tax avoidance method. To infringe an issued patent, one must perform each and every step recited in one of the claims of the patent. One can also perform additional steps, but still infringe the patent. These additional steps may in fact result in a tax avoidance method being practiced that is materially different than the patented tax planning method. Still further, one may pay the royalty to be safe from any possibility of a lawsuit, even if one believes

he or she is not practicing the claimed method. Any taxpayer investigation should rely on the actual facts of transactions, and not whether a royalty was paid for the right to use a patented tax planning method.

We appreciate the opportunity to provide comments on the proposed regulations and are available to assist the IRS further in the interpretation of patent practice and procedures.

Sincerely,

Michael K. Kirk
Executive Director