

Patented Tax Strategies, Ethics and Circular 230: Protecting Yourself and Your Client

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Introduction

In the past decade the United States Patent and Trademark Office (“PTO”) has granted dozens of patents on tax planning strategies.¹ The PTO granted these patents on the authority of *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, a Federal Circuit decision holding “business methods” patentable.² However, the patentability standard employed in *State Street* (invention must produce a “useful, concrete and tangible result”) was overruled in October 2008 by *In re Bilski*,³ which instead held that an applicant for a patent must show that a process claim is either tied to a particular machine or that the claim “transforms an article.”

The impact the *Bilski* “machine or transformation” test, if upheld,⁴ will have on business methods patents, including tax patents, is unclear. It would probably result in some tax strategy patents being more susceptible to challenge on the ground of not

¹ See generally William S. Drennan, *The Patented Loophole: How Should Congress Respond to this Judicial Invention*, 59 FLA. L. REV. 229 (2007).

² 149 F.3d 1368 (1998) (“data processing system for managing a financial services configuration of a portfolio constituting a partnership” in a manner consistent with the partnership regulations, where computer was a “virtual necessity” to performing the task; held , patentable), cert. denied, 525 US 1093 (1999) .

³ 545 F.3d 943 (Fed. Cir. 2008).

⁴ A petition for certiorari was filed on January 28, 2009 (No. 08-964)

covering patentable subject matter⁵ and might cause the PTO to view applications for tax strategy patents less favorably. On the other hand, patent lawyers might figure out how to draft around such a change in the patentability standard. In any event, *Bilski*, even if upheld, will not automatically void any existing patents. Instead, any patents that may be voidable will remain presumptively valid until successfully challenged, a costly process in itself. There is also the possibility that Congress will step in to prohibit the granting of patents on tax strategies,⁶ but such legislation, if enacted, would probably protect the rights of existing patents holders. Where then does this situation leave the tax lawyer or estate planner who is working on providing a tax strategy for a client that may infringe on an existing patent or who has developed a tax strategy that she has patented and seeks to profit from the use of the patent. This article addresses these issues.

The tax lawyer or estate planner may confront patents on tax planning strategies in two principal situations. In the first, the lawyer may be providing tax planning advice to a client which, if implemented, may infringe on an existing patent held by another person. For example, an estate planner who is about to recommend the use of a stock option grantor retained annuity trust (“SOGRAT”) to her client may need to consider the relevance of U.S. Patent No. 6,567,790, the so-called SOGRAT patent.⁷ In the second

⁵ See *Fort Properties, Inc. v. American Master Lease, LLC*, 2009 U.S. Dist. LEXIS 7217 (C.D. Ca. 2009) (method for creating an investment instrument called a “deedshare” out of real property that could be exchanged in a section 1031 transaction as a tenancy-in-common interest for another such interest held not patentable under *Bilski* test because creation of a “deedshare” does not constitute “transformation of an article”).

⁶ In the last Congress, the House of Representatives passed a bill, H.R. 1908 (entitled the Patent Reform Act of 2007), which would have ended the granting of most, if not all, tax strategy patents). At least two Senate bills (S. 681 and S. 2369) would also have addressed the issue, but neither was passed.

⁷ A patent for “Establishing and Maintaining Grantor Retained Annuity Trusts Funded by Nonqualified Stock Options (issued May 30, 2003). An action alleging infringement of this patent was filed in 2006. See William C. Weinsheimer and Barry L. Grossman, *Patenting Estate Planning Techniques: A Patently*

situation, the lawyer may hold a patent on a particular tax strategy which the lawyer hopes either to implement as part of tax planning for the lawyer's own client or to license for use by clients of other lawyers. Although the specific ethical issues raised by these two situations involve overlapping concerns (both, for example, present significant conflicts between the interests of the lawyer and the interests of her client), the two situations are sufficiently distinct to merit separate treatment and will be addressed seriatim, with greater emphasis on the first situation inasmuch as it seems to present issues of more widespread concern.

In a third situation, the lawyer may have implemented a novel tax planning strategy for a client and be interested in the possibility of patenting the strategy. This raises questions as to who, the lawyer or the client, is entitled, as the "inventor," to patent the strategy in addition to some of the issues presented in the second situation. While the subject of obtaining a patent is beyond the scope of this article, suffice it to say that the careful lawyer should be sure that where novel tax planning is involved, the engagement letter clearly provides who owns the right to patent the resulting strategy.⁸

Difficult Issue, 22 No. 3 PRAC. TAX LAW. 37 (2008). Thomas J. Monks, *Everything You Always Wanted to Know about Patents But Were Afraid to Ask: A Tax Practitioner's Primer on Patenting Tax Strategies*, 61 TAX LAW. 907 (2008). The case was settled by stipulation of the parties with a consent final judgment declaring the SOGRAT patent valid and enforceable and a confidential patent license agreement. See Gary C. Bubb, *Commentary: Patented tax strategies – Are you serious?*, R.I. LAW. WEEKLY (Aug. 20, 2007).

⁸ If the engagement fails to address this issue and the lawyer later seeks to patent the tax planning strategy involved, the lawyer may be faced with a number of ethical quandaries, among them whether the lawyer's attempt to patent the strategy may result in the disclosure of otherwise confidential information relating to the representation of the client. Model Rule 1.6(a) prohibits such disclosure (subject to certain exceptions not here relevant), unless the client gives informed consent to disclose the information. This rule would apply to disclosure of any protected client information to the United State Patent and Trademark Office, absent informed consent. Since the client would usually gain nothing from such disclosure (the client may feel nondisclosure will reduce her prospects of being audited or protect her privacy concerns) and therefore prefer that there be no disclosure made, obtaining the client's informed consent to make disclosure would be tricky at best.

Lawyer Advising Client Where Possibility of Relevant Patent

Any lawyer planning to provide tax planning advice to a client that calls for implementing a plan that is not part of the conventional tax planning wisdom of the profession, that is, is a plan that is “novel” and not “obvious,” may find that the planning strategy has already been “invented” by someone else and patented. In fact, because the PTO’s research efforts in the tax field prior to granting patents have been sorely lacking, patents have been granted that to the tax bar appear to be neither novel nor non-obvious. In reasonably close cases, then, the careful practitioner might be forgiven for thinking that a strategy that has not been fairly extensively vetted in the literature might have been patented. This raises the basic questions: When does a tax lawyer have to do a patent search? What is the lawyer’s risk if she does not do a patent search?

The answer to the second question (what is the lawyer’s risk?) informs analysis of the first question. At this stage, if the lawyer fails to locate a possibly controlling patent that at least arguably covers the tax plan that is implemented, the lawyer may be charged by the patent holder with either infringement or inducing infringement. In addition, the client may be charged with infringement, in which case the client may turn around and sue the lawyer for malpractice. If the lawyer’s handling of the engagement has been particularly inept, the lawyer might also be sanctioned by the State bar. State bar rules differ from the legal standards that determine the presence or absence of malpractice liability because a malpractice liability only arises if the breach of a legal duty to the client is the proximate cause of some loss or damage to the client, while the ethical rules

are violated if an ethical duty to the client is breached, regardless of whether the breach causes any loss or damage to the client. In addition, the Scope of the Model Rules of Professional Conduct expressly states that violating a Rule “should not itself give rise to a cause of action against a lawyer” or create a presumption “that a legal duty has been breached.”⁹ But, State bar disciplinary action, while theoretically requiring a lesser showing than is required for a successful malpractice action, is unlikely unless the client complains in the first instance.

The lawyer might also be subject to discipline by the IRS Office of Professional Responsibility (“OPR”) for violation of Circular 230. Although Circular 230 regulates those admitted to practice before the Internal Revenue Service (“the Service”), it defines “practice before” the Service broadly to include “rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion.”¹⁰ Since a lawyer (or CPA or enrolled agent) is a practitioner subject to Circular 230,¹¹ when they provide written advice with respect to tax planning having a “potential for tax avoidance or evasion,” a phrase that is likely to cover the written advice about almost any patented tax strategy, they are “practicing” before the Service and subject to the provisions of Circular 230. Furthermore, discipline by the OPR is likely to lead to discipline by State authorities. Nonetheless, as a practical matter, like a State disciplinary body, OPR is unlikely to act absent an initial client

⁹ Model Rules of Prof. Conduct (“MRPC”), Scope [20], adding in the last sentence, however, that “a lawyer’s violation of a Rule may be evidence of breach of the applicable standard of conduct.”

¹⁰ Circular 230, § 10.2(a)(4).

¹¹ Circular 230, § 10.3(a).

complaint or, in the case of OPR, a high profile tax case involving the lawyer's unethical behavior.¹²

As to the possibility of being sued directly by the patent holder for either infringement or inducing infringement, no amount of care on the part of the lawyer can preclude such liability if the implementation of the plan infringes the patent. Infringement is a strict liability action, regardless of intent or motive.¹³ In fact, if the lawyer is aware that the kind of plan might be subject to a patent, the lawyer might choose either not to go forward with such a plan or to seek a license from the patent holder on behalf of the client rather than risk being charged with infringement, even if the lawyer believes, after diligent research and/or consultation with a patent law, expert that a successful defense to any infringement action could be maintained.

General principles of legal ethics require the lawyer to provide competent representation to a client.¹⁴ In doing so, the lawyer must act with reasonable diligence.¹⁵ This requires the legal knowledge, skill, thoroughness and preparation reasonably necessary to represent the client.¹⁶ While expertise may be necessary, the expertise would be that of a lawyer of general proficiency in the field in question.¹⁷ Or, as the Restatement says in the context of malpractice liability, a lawyer owing a duty of care to

¹² These bodies are far too busy with lawyers who steal from clients, miss court filing deadlines and fail to file their own returns, all matters where the impropriety of the lawyers' conduct is crystal clear, to be bothered with patented tax strategies.

¹³ Of course, if the lawyer knew of the patent and that the plan would infringe it, the lawyer might be liable for willful infringement. See 335 U.S.C. § 284.

¹⁴ See MRPC 1.1; see also Circular 230, § 10.51 (incompetence ground for sanctioning practitioner admitted to practice before IRS).

¹⁵ MRPC 1.2; see also Circular 230, § 10.22.

¹⁶ MRPC 1.1.

¹⁷ Id., Comment [1], listing relevant factors.

a client “must exercise the competence and diligence normally exercised by lawyers in similar circumstances.”¹⁸ The standard is one of “reasonableness” under the circumstances, referring to “normal professional practice” in “the professional community ... of lawyers undertaking similar matters in the relevant jurisdiction.”¹⁹ Although the professional community reference would normally refer to the members of the State bar, in much of tax practice the professional community would presumably be nationwide.

So, to determine whether a lawyer has a duty to do a patent search as a general matter before implementing a tax planning strategy, the question becomes whether it is normal professional practice to do a patent search before implementing such a strategy. In general, the answer is surely no. However, the question really must be asked about particular cases. Hence, if a lawyer wants to implement a planning strategy as to which the lawyer has some reason to believe there may be a patent, then the lawyer must consider more carefully whether to do a patent search.

Once a lawyer is considering whether a patent search is advisable, communication with the client is probably essential.²⁰ The patent search may be expensive. The client

¹⁸ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (ALI 2000)(“Restatement”) § 52(1). In general, legal ethical standards are thought to be somewhat higher than the standards a lawyer must satisfy to avoid malpractice liability. However, in the case of “competence,” the description of the standard is similar. Furthermore, the principal risk to a lawyer in terms of his duties to the client in the context of a patented tax strategy is the possibility that the patent holder will threaten to sue or actually sue the lawyer’s client for infringement, causing the client to in turn sue the lawyer for malpractice, claiming as damages not only whatever is paid to the patent holder as damages for infringement or as a license fee, but also the cost of defending against any infringement charges.

¹⁹ *Id.*, Comment b. See *Bucquet v. Livingston*, 57 Cal. App. 3d 914 (Cal. App. 1st Dist. 1976) (similar standard applied in estate planning malpractice case).

²⁰ See MRPC 1.4, spelling out duties to communicate with the client.

may be either unwilling or unable to bear the cost. The lawyer may not even know what the search will cost or have the expertise to conduct the search, in which case the lawyer probably has a duty to discuss with the client the possibility of referring the client to a patent lawyer who has the expertise needed to do the search.²¹ Note that the lawyer probably should not consult a lawyer on her own without the client's approval, except perhaps for a general inquiry about the cost and time required for searches. Anything said about the specific subject of the search without the client's advance approval would probably violate ethical prohibitions on disclosing confidential client information.²²

Of course, if the patent search can be done at a modest cost and the lawyer has the necessary expertise, the lawyer might be safe in undertaking the search without a specific discussion of the issue with the client, but communicating with the client first is clearly the best course, since the search presumably is only being done because there is a possibility of finding a problematic patent. The client may prefer not to have the search done at all and to have the lawyer instead develop and pursue an alternative plan.

If a relevant patent is located, the lawyer's duty to communicate with the client increases exponentially. Furthermore, if the proposed tax plan for the client would either clearly, or even just possibly, infringe the patent, it may be in the client's best interest to go directly to the patent holder for representation if the patent holder is a member in good

²¹ If the lawyer lacks the expertise to conduct the search, the lawyer may want to learn to conduct the search herself at the client's expense. This, of course, creates a significant conflict of interest subject to the analysis discussed *infra* text accompanying notes 23 ff.

²² See, for example, MRPC 1.6(a). The lawyer could argue that such disclosure "is impliedly authorized in order to carry out the representation," but given the potential harm to the client from such disclosure, it would be wiser to discuss the issue with the client and obtain the client's informed consent before disclosing any confidential information to another lawyer.

standing of the State bar. The lawyer, however, is likely to feel strongly about retaining the client even if that involves more expense to the client as the lawyer tries to “draft around” the patent. Advising the client on what to do in this situation therefore presents the lawyer with a significant conflict of interest.²³ In fact, this conflict may infect the lawyer’s evaluation of the patent – the lawyer may be tempted to downplay the relevance or significance of the patent in order to retain the client. So this is the time to discuss the conflict with the client, present the client with alternatives, and obtain the client’s informed consent to having the lawyer proceed to continue in the engagement, subject to whatever limitations the client feels are appropriate, such as having the viability of the patent reviewed by a knowledgeable patent lawyer.

Model Rule 1.7 and section 10.29 of Circular 230 contain parallel, although not identical, requirements for obtaining informed consent to represent a client when there is a “significant risk” that the representation will be “materially limited” by the lawyer’s personal interest.²⁴ The lawyer must (1) “reasonably” believe that she will be able to provide “competent and diligent representation” to the client²⁵ and (2) obtain informed consent from the client. The Model Rule requires that the consent be “confirmed in

²³ See MRPC 1.7; Circular 230, § 10.29.

²⁴ The State Bar rules on this subject vary. Generally speaking, a lawyer providing written advice about a tax planning strategy that has “a potential for tax avoidance or evasion” is defined as engaged in practice before the IRS and thus subject to the provisions of Circular 230. Circular 230, § 10.2(a)(4). Since Circular 230’s informed consent requirement is more rigorous than that in Model Rule 1.7, lawyers concerned with patented tax strategy related issues should probably comply with the requirements of Circular 230. However, in a situation where the lawyer does not come within the parameters of Circular 230’s definition of practice before the IRS, perhaps because the advice is oral, the lawyer may be able to obtain informed consent by merely complying with less demanding State Bar rules, such as those resembling Model Rule 1.7. See text *infra*.

²⁵ The Restatement § 122(2)(c) approaches this somewhat differently, precluding consent if “it is not reasonably likely that the lawyer will be able to provide adequate representation” to the client. This approach seems to replace the subjective test of what the lawyer “reasonably” believes with a more objective, but nonetheless equally vague, standard.

writing,” although not necessarily in a **writing signed by the client**; the writing may be a confirmation of an oral consent that is “promptly” recorded and transmitted to the client following the consent.²⁶ Circular 230, however, requires that the informed consent waiving the conflict of interest be made “at the time the existence of the conflict of interest is known” by the lawyer and be confirmed in writing by the client within a reasonable period after the consent is given, but “in no event later than 30 days.”²⁷ Although this suggests that the consent and the confirmation may be separate events, this view is somewhat dispelled by the following paragraph of Circular 230, requiring that the “written consent,” apparently referring to the confirmation, be retained for at least 36 months after the conclusion of the representation of the client.²⁸ The bottom line is that the lawyer should obtain written informed consent from the client regardless of whether the applicable rule seems to require somewhat less than this.

The tricky parts are whether the lawyer can be viewed as “reasonably” believing she can provide the client “competent and diligent representation” and whether the consent is sufficiently “informed.” Both of these analyses depend on the lawyer’s ability to clearly define the conflict and explain it adequately to the client because if the lawyer cannot do this, the lawyer probably doesn’t have sufficient understanding of the situation to reasonably believe she can provide competent and diligent representation either.²⁹ The lawyer needs to provide the client with information “reasonably adequate to make an informed decision,” including a clear explanation of the conflicts of interest, reasonably

²⁶ See MRPC 1.7, Comment [20].

²⁷ Circular 230, § 10.29(b)(3).

²⁸ *Id.*, § 10.29(c), also requiring that the consent be provided to the Service on request.

²⁹ This would be much clearer under the Restatement approach, *supra* note 25, applying a more objective test as to whether it is reasonably likely that the lawyer can provide adequate representation.

available alternatives to having the lawyer continue to represent the client, and the advantages and disadvantages of continued representation by the lawyer and of such alternatives; then, the lawyer must provide the client a reasonable opportunity to consider this information and raise questions and concerns.³⁰

The process of educating the client depends on whether the representation at issue involves (1) evaluating a tax patent or, following such an evaluation, (2) advising the client about and implementing a tax planning strategy that might be affected by the patent. In some situations, it may be practical to discuss both steps with the client at the same time, but for analytical purposes it is useful to look at them separately.

In discussing with the client the need to evaluate a tax patent before actually proposing a tax strategy to the client, the lawyer should delineate her own interests, such as retention of the client, receipt of fees for the work involved in the evaluation of the patent by either herself or a knowledgeable person in her firm, and an opportunity to acquire tax patent expertise. The lawyer should probably note that in the long run she is interested in avoiding any liability for either infringement of a patent or inducing infringement as well as the cost of defending against such claims, however lacking in merit, considerations that might cause the lawyer to err in favor of construing the potential scope of the patent as overly broad. The lawyer should also discuss her level of, or lack of, patent law expertise, the possibility that a patent law expert might be better equipped to evaluate the patent, and suggested patent lawyers whom the client might contact. Often, the lawyer should attempt to provide the client with an assessment of the

³⁰ Restatement §122, Comment (c)(i); MRPC 1.7, Comment [20].

risk of proceeding without evaluating the patent, indicating whether the lawyer would be willing to undertake the tax planning in the absence of having the patent evaluated. Of course, she can and should note her knowledge of the client's business, estate planning or personal situation to the extent relevant, the difficulty and delay required to consult a patent lawyer before proceeding, the possible expense of consulting a patent lawyer, any possibility difficulty in locating and engaging a suitable patent lawyer, and the fact that a lawyer with the appropriate expertise might be interested in using the consultation as an opportunity to "steal" the client. The client should be advised what the lawyer expects the evaluation of the patent to cost if the lawyer undertakes to do the evaluation herself or through someone in her firm. After the client has had time to consider all of these factors, the client should be in a position (1) to reject having a patent evaluation done at all, (2) to decide to refer the matter to a patent lawyer or at least to explore this option by setting up a meeting with a patent lawyer, or (3) to provide informed consent to the tax lawyer, thus authorizing the tax lawyer to evaluate the patent's possible significance to the tax planning situation involved.

Assuming the client has authorized the lawyer to evaluate the patent, the lawyer may find that the patent presents no problem. On the other hand, if there is any reasonable possibility that a tax strategy the lawyer may recommend to the client might lead to a threat of an infringement action, the lawyer is faced with a further conflict of interest. Again, the client must be fully informed. The nature of the information to be provided will depend on the likelihood that implementing the proposed tax strategy will trigger a threat by the patent holder of an action for infringement.

If the lawyer reasonably believes that the likelihood³¹ of such a threat is high, and indeed the lawyer reasonably expects the filing of an infringement suit if the threat does not lead to the response the patent holder wants, and that the suit might very well succeed, the client has three obvious choices: (1) Ask the lawyer for an alternative plan that will not infringe the patent, (2) Seek a license from the patent holder, probably through the lawyer, or (3) If the patent holder is a lawyer authorized to practice in the jurisdiction, seek out the patent holder. The lawyer must again fully inform the client to receive the client's informed consent to proceeding. The lawyer must clearly explain her personal interests that may be at odds with the client's interest. The most important of these interests are that the lawyer does not want to lose the client, to risk liability for infringement or inducing infringement, or to risk liability for malpractice. Alternatives (2) and (3) may protect the lawyer against these latter risks, but may result in losing the client to at least some extent.³²

Although seeking a license from the patent holder will require payment of a license fee, this may be the least of the problems with seeking the license. First of all, the patent holder may refuse to grant the license. If the patent holder is a lawyer, he may prefer instead to limit the use of the patented strategy to his own clients, clients who he

³¹ This raises a serious quandary, discussed below: If the implementation of a tax planning strategy is essentially handled in such a way that its existence is confidential, is the likelihood of discovery by the patent holder something that can be taken into account in providing advice to the client?

³² Of course, if the lawyer has reason to know that the patented strategy will not achieve the desired tax results, the lawyer should say so rather than referring the client to the patent holder or arranging to obtain a license from the patent holder. Not saying so might in itself be sufficiently negligent to result in malpractice liability if the client in fact follows the lawyer's advice to obtain a license to implement the strategy or engages the patent holder to implement the tax planning strategy, and the patented strategy ultimately fails to deliver the expected tax benefits.

can therefore charge however much he wants for the use of the patent, since license fees do not appear to be subject to the usual standards regarding legal fees.³³ Although the licensing transaction would then probably be treated as a business transaction entered into with a client, the rules of a provision like Model Rule 1.8, requiring, *inter alia*, that the terms of the transaction be fair and reasonable to the client and that after full disclosure the client provide informed consent in writing to the terms and the lawyer's role in the transaction (Model Rule 8.1 is discussed more fully below)³⁴ may have limited applicability because the patent law clearly envisions giving the patent holder a monopoly over the use of the patent, including the right to exclude others from using the patent at all. Even assuming that the patent holder is willing to consider granting a license to use the patent, making the request for a license basically puts the patent holder on notice that the lawyer has a client whose tax planning might entail use of the patented strategy, thus increasing the risk of a threat of an infringement action if the lawyer and client ultimately decide to proceed without a license on the ground that the tax planning will not infringe the patent. Despite the lawyer's best judgment on this point, the cost of resisting even a dubious claim of infringement cannot be ignored.

Finally, obtaining a license from the patent holder may require disclosure of confidential information to the patent holder,³⁵ a fact that the client may find disturbing, particularly if there is any doubt about whether the hoped for tax benefits of the planned

³³ See, e.g., MRPC 1.5 (prohibiting unreasonable fees and indicating factors to consider in determining reasonableness of fee); Circular 230, § 10.27 (prohibiting unconscionable fees in connection with matters before the Service). Both of these provisions also limit the circumstances in which contingent fees may be charged.

³⁴ *Infra* text accompanying notes 78-81.

³⁵ The client's informed consent should be obtained before making any such disclosure. See MRPC 1.6(a), discussed *supra* note 22.

strategy would be upheld if challenged by the Service. The patent holder might be asked to sign a nondisclosure agreement, but this would probably not protect the client from a Service effort to, for example, subpoena a list of persons licensed to use the patented strategy.³⁶ The lawyer should explain this as clearly as possible, further explaining the possible advantages to the client of retaining the patent holder directly, particularly if the patent holder is a lawyer. Then, much of the client's confidential information would be protected from disclosure by the patent holder/ lawyer in many contexts under legal ethical standards,³⁷ as well as protected from disclosure in litigation by the attorney-client privilege.³⁸ Another possibility might be to discuss with the client retaining the patent holder lawyer as co-counsel in conjunction with obtaining a license to use the patent.³⁹ However, if either of these alternatives is pursued, the fact that the client participated in a

³⁶See IRC §§ 6111 and 6112 (requiring "material advisors" with respect to reportable transactions to maintain lists of investors in such transactions and provide information on the transactions to the Service), discussed in *United States v. BDO Seidman*, 337 F.3d 802, 812-813 (7th Cir. 2003) ("BDO's affirmative duty to disclose its clients' participation in potentially abusive tax shelters renders the Does' situation easily distinguishable from the limited circumstances in which we have determined that a client's identity was information subject to attorney client privilege"). Proposed Treas. Reg. §1.6011-4(b)(7) would classify transactions involving patented tax strategies as reportable transactions. See also *Doe v. KPMG, LLC*, 325 F. Supp. 746 (N.D. Texas 2004) (identities of tax shelter investors not privileged since investors have no reasonable expectation of confidentiality).

³⁷ See, e.g., MRPC 1.6.

³⁸ The tax practitioner privilege of IRC § 7525 might apply if the patent holder is a non-lawyer federally authorized tax practitioner, such as a CPA or an enrolled agent, but the protections of this privilege are more limited than the attorney-client privilege (it does not apply at all in criminal proceedings or in state administrative or judicial proceedings, including divorce proceedings) and is not available for communications regarding corporate tax shelters. In an appropriate circumstance, however, the lawyer may need to explain this privilege to the client in order to obtain the client's informed consent to having the lawyer continue the representation as opposed to having the client go directly to the patent holder who happens to be a federally authorized tax practitioner.

³⁹ This would require attention to applicable ethical rules addressing fee-sharing, such as MRPC 1.5(e), which requires that the total fee be reasonable, the sharing of the fee be in proportion to the services performed by each lawyer or the lawyers assume joint responsibility for the representation, and the client agree to the arrangement in writing. Since the license fee is not a legal fee, it would presumably not be subject to such a rule.

transaction involving a patented tax strategy would probably still not be protected by the attorney client privilege from disclosure to the Service.⁴⁰

Suppose the lawyer concludes that the likelihood of a threatened infringement action is substantial if the planned tax planning strategy is implemented and the patent holder learns of this, but the lawyer also believes that the patent holder is unlikely to learn that the planning strategy has been used by the client. This raises the question whether a lawyer may ethically consider the likelihood that a patent holder will not learn of the client's use of a tax planning strategy that at least arguably infringes the patent in advising a client whether to use the strategy. Model Rule 1.2(d) prohibits a lawyer from counseling a client to engage in conduct, or assisting a client in conduct, "the lawyer knows is criminal or fraudulent." This language seems to be narrower than the provision of the earlier Model Code of Professional Responsibility, which referred to "illegal or fraudulent" conduct,⁴¹ which would be more likely to be viewed as prohibiting advice to a client to go ahead and infringe a patent because the patent holder would be unlikely to learn of the infringement.⁴² Even under the current rules, this advice seems unlikely to pass muster if the lawyer believes that the patent would be upheld and that the use of the strategy at issue would infringe the patent.

⁴⁰ See note 36, *supra*.

⁴¹ DR 7-102(a)(7).

⁴² See RONALD D. ROTUNDA & JOHN S. DZIENKOWSKI, *PROFESSIONAL RESPONSIBILITY: A STUDENT'S GUIDE* (2007-2008) at 111 n.2 (Model Code language "could even include a violation of civil law, such as tortious conduct").

In the current environment, however, particularly in light of the decision in *In re Bilski*,⁴³ the lawyer may reasonably believe that the patent's viability is uncertain.⁴⁴ Or, the lawyer may think that, regardless of the viability of the patent, that the likelihood that the tax plan implemented for the client would be found to infringe the patent is uncertain. Assuming the lawyer so advises the client, suppose the client then asks whether the patent holder is likely to learn of the tax plan, perhaps an estate plan that involves no publicly disclosed trusts. Can the lawyer say no, perhaps adding how the holder of the SOGRAT patent learned of the alleged infringement of that patent that led to an infringement suit that was ultimately settled?⁴⁵ Many lawyers would probably feel that responding to this question is okay, despite the fact that this is an indirect way of advising the client to ignore the patent because the client's tax plan will never come to the attention of the holder. It is noteworthy that in an analogous situation, whether a tax lawyer can respond to a client's inquiry about the likelihood of an audit of the client's return (particularly when the lawyer has reason to believe that the client will rely on the information in deciding whether to file a complete and accurate return), has generated considerable controversy,⁴⁶ although it is clear that a return preparer may not take the likelihood of an audit into account in evaluating the likelihood of a return position being sustained on its merits.⁴⁷

⁴³ Supra note 3.

⁴⁴ See *Fort Properties, Inc. v. American Master Lease, LLC*, supra note 5.

⁴⁵ See Thomas M. Monks, supra note 7, 907 TAX LAW. at 908-909;

⁴⁶ See Michael B. Lang, *Commentary on Return Preparer Obligations*, 3 FLA. TAX REV. 128, 141 n.51 (1996).

⁴⁷ See Treas. Reg. § 1.6694-2(b)(1) (application of more likely than not standard).

By contrast, suppose the lawyer concludes that, on the merits, if an action for infringement is brought, either the patent would be voided or its reach would likely be held not to extend to the tax plan used for the client involved. If the threat of an infringement action is likely, is it enough for the lawyer simply to advise that such an action would probably be unsuccessful? In this context, it is important to note that patent litigation is expensive. The client may have to expend a considerable sum, perhaps more than \$1,000,000, in **successfully** defending against an infringement action. In fact, the client may ultimately be better off yielding to a demand for payment of a license fee, which may be far less than the cost of successful litigation. The lawyer should spell this out to the client as a possible cost of going forward with the tax planning strategy even if the lawyer believes the patent would be voided if challenged or would be unlikely to be viewed by a court as extending to the tax plan recommended to the client. Absent such advice, the lawyer may be at risk of being sued in malpractice **for the costs of a successful defense** against an infringement action or for any negotiated license fee.⁴⁸

The lawyer should, of course, explain alternatives, if any, to the proposed tax strategy that may raise the specter of a possible patent infringement claim, clearly noting the advantages and disadvantages any such alternative. Some clients may prefer to implement a plan that offers less tax savings potential, but does not risk any possible entanglement with patent issues. In any event, once the lawyer has fully informed the

⁴⁸ See, for example, *Jackson Jordan, Inc v. Leydig, Voit & Mayer*, 1992 Ill LEXIS 213 (Ill. 1992) (duty not merely to protect client against meritorious patent infringement actions, but “in a broader sense, to protect it against the uncertainty and expense of ultimately unsuccessful challenges of its products”; injury would have occurred “once the client was faced with the expense of defending a patent infringement claim, regardless of its eventual outcome”), *different result on another issue following rehearing*, 158 Ill.2d 240 (1994).

client and the client has had a chance to consider the issues fully and has decided to proceed with implementation of a tax strategy as to which the possibility of at least the threat of an infringement action remains, regardless of whether the client has decided either to authorize the lawyer to obtain a license from the patent holder or to take the risk of proceeding with the strategy without attempting to secure a license, the lawyer should obtain the client's consent in writing, as explained earlier.

In the process of fully informing the client of various tax strategies, the lawyer should have provided the client with her best assessment of the likelihood each particular strategy would achieve the hope for tax consequences. At this stage of the engagement, the lawyer's advice must reflect the levels of competence and diligence expected of lawyers generally in advising clients,⁴⁹ except to the extent the advice takes the form of a covered opinion under section 10.35 of Circular 230, discussed below.⁵⁰ That is, there is no special standard for tax practice. Once the lawyer is specifically recommending a particular tax strategy, particularly if the lawyer also provides post-implementation advice about how the tax consequences of the strategy will then be reflected on the client's tax return(s), additional issues and standards may need to be addressed. Of course, if the lawyer is recommending a patented tax strategy to a client, both the lawyer and the client may be inclined to think that they may rely on statements in the patent or patent application or the license agreement with the patent holder with respect to the tax consequences of using the strategy. By and large, this is not true. Indeed, depending on the nature of the lawyer's advice to the client and the timing of the advice, the lawyer

⁴⁹These standards are discussed supra, text accompanying note 14 ff.

⁵⁰Text accompanying notes 65 ff.

may be subject to standards applicable to return preparers under section 6694 of the Internal Revenue and Circular 230 and /or be subject to the so-called covered opinion rules of Circular 230.

If the lawyer is a “tax return preparer” with respect to the advice given with respect to the consequences of the patented tax strategy,⁵¹ the lawyer may only advise a client to take a position that satisfies one of the standards of section 6694(a) of the Internal Revenue Code. Otherwise, the lawyer may be subject to a penalty under section 6694(a) in an amount equal to the greater of \$1,000 or 50 percent of the income derived with respect to the tax return or claim for refund involved. In the case of a position with respect to a “tax shelter”⁵² or a “reportable transaction,”⁵³ the statute requires that there be a reasonable belief that the position “would more likely than not be sustained on its merits.”⁵⁴ Otherwise, the position must either be supported by “substantial authority,” or

⁵¹ For the definition of “tax return preparer,” see IRC § 7701(a)(36), elaborated on in Treas. Reg. § 301.7701-15. For present purposes, in addition to those typically understood to be return preparers, the term “tax return preparer” can be generally thought of as including any person who provides advice with respect to events that have occurred at the time the advice is provided if the advice leads to a position or entry that constitutes a “substantial portion” of the return. See Treas. Reg. § 301.7701-15(b)(2). This definition means that planning advice not followed by significant post-implementation advice about how the tax consequences of the tax strategy will be reflected on the return will not generally implicate the return preparer standards. In fact, the regulations include a special rule that permits a planner to provide a modest amount of post-implementation advice and still avoid the return preparer standards. See Treas. Reg. § 301.7701-15(b)(2)(i) (if post-transaction time spent on advice is less than 5 percent of the aggregate time spent advising with respect to the position, it is not taken into account in determining whether an individual is a tax return preparer, subject, however, to an anti-abuse exception).

⁵² “Tax shelter” is defined for this purpose by IRC § 6662(d)(2)(C)(ii). This definition is limited to a partnership, other entity, or other plan or arrangement with a significant purpose of avoiding or evading Federal **income** tax. So advice with respect to a position on an estate or gift tax return, for example, would not be advice with respect to a tax shelter position under section 6694. However, if the advice otherwise qualifies as a “covered opinion” under section 10.35 of Circular 230, it would be subject to the requirements applicable to covered opinions. This discrepancy in coverage of non-income tax advice will probably be changed eventually by amendment of section 6662 of the Code.

⁵³ For “reportable transactions,” see IRC § 6662A.

⁵⁴ IRC § 6694(a)(2)(C).

both have a “reasonable basis” and be adequately disclosed.⁵⁵ The preparer may avoid a penalty with respect to a substandard position if the preparer had reasonable cause for her failure to satisfy the standards and acted in good faith.⁵⁶ It is clear that in determining whether the standards apply, the return preparer must analyze the pertinent facts and authorities,⁵⁷ and that such authorities do not include patent applications, patents or patent license agreements.⁵⁸ As a result, in general, a lawyer giving advice to a client that would result in the lawyer being treated as a tax return preparer may not rely on statements in the patent application, the patent or the patent license agreement as authorities in determining whether the standards of section 6694 apply.⁵⁹

The section 6694 regulations do provide that the preparer may rely in good faith without verification upon information provided by the taxpayer and on information and advice provided by another advisor, tax return preparer or other party (including another advisor or return preparer at the preparer’s firm), both for showing that a position meets the substantive standards of section 6694(a) and to demonstrate reasonable cause and good faith.⁶⁰ However, it is clear that the good faith part of this reliance principle means that the preparer must have reason to believe that the advisor was competent to render the

⁵⁵ IRC § 6694(a)(2)(A) and (B).

⁵⁶ IRC § 6694(a)(3).

⁵⁷ Treas. Reg. § 1.6694-2(b) (more likely than not standard); Notice 2009-5, 2009-3 IRB 309 (referring to Treas. Reg. § 1.6662-2, -3, and -4 for substantial authority analysis). It seems likely that this aspect of the Notice will eventually be incorporated into additional regulations under section 6694.

⁵⁸ See Treas. Reg. § 1.6662-4(d).

⁵⁹ Treas. Reg. § 1.6662-4(d)(3)(ii), however, does provide that “a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision.” It is, of course, possible that something in the patent or the patent application would provide such a “well-reasoned construction” of the statute, but this construction, rather than the patent or application, would then be the authority (the reasoning having presumably been evaluated de novo by the preparer).

⁶⁰ Treas. Reg. § 1.6694-1(e)(1) and -2(e)(5) (reasonable cause, good faith; seems to allow reliance on advice provided by the taxpayer, but this may be a drafting error).

advice and that the advice not be unreasonable on its face or otherwise suspect.⁶¹ Much of the puffery found in patent applications and patents would undoubtedly fail this standard. But, even if that is not the case, the term “advice” in this context seems to imply advice with respect to the taxpayer’s tax situation rather than generic statements more characteristic of scholarly articles or general discussions about tax strategies. Since statements in a patent or patent application would not be specifically directed at the taxpayer’s situation, these aspects of the regulations should not be read as permitting the preparer involved to rely on the patent or the application as authority for any tax position resulting from the use of the patented tax strategy for section 6694 purposes.

Of course, if the lawyer actually receives specific advice from the patent holder with respect to the client’s use of the patented strategy, the lawyer may rely on this advice if she has reason to believe the patent holder is competent to provide the advice and the advice is not otherwise suspect. Such advice may apparently be oral or written, and might be found in the patent license agreement (perhaps in part by incorporation of statements in the patent), although the lawyer in this case should be sure to consider whether such “advice” can be relied upon under the standards spelled out in the regulations. The regulations do not appear to require that the patent holder in this context actually be a lawyer, CPA or enrolled agent otherwise permitted to practice before the Service, although if this is not the case, the patent holder in giving the advice may be engaged in unauthorized practice of law. Since cooperating with the patent holder in such circumstances in advising the lawyer’s client may violate ethical rules barring a

⁶¹ Thus, the advice cannot be relied upon if the preparer knew or should have known that the person giving the advice did not know all the relevant facts or that the advice or information was no longer reliable due to developments in the law since the time at which the advice was given. *Ibid*, last sentence.

lawyer from assisting a non-lawyer in engaging in the unauthorized practice of law,⁶² the lawyer should probably refrain from relying on advice from a patent holder who is not a lawyer, CPA or enrolled agent.

Circular 230, § 10.34 has historically tracked the standards of section 6694 of the Code with the consequence that tax return preparer behavior that could lead to a penalty under section 6694 of the Code could also result in disciplinary action by the Director of OPR for violation of section 10.34 of Circular 230, provided the violation of section 10.34 was the result of either recklessness or gross incompetence.⁶³ Although section 10.34 has not yet been amended to reflect the recent changes to section 6694 of the Code, it is likely that it will be amended to again provide a parallel standard to that in the Code, thus leaving the preparer who violates the Code provision (which is essentially a strict liability standard) also open to possible disciplinary action by the IRS.⁶⁴ And, in the case of a lawyer, disciplinary action by the IRS will often lead to disciplinary action by the appropriate State bar authorities.

If the lawyer is not providing advice to the client about the tax consequences of the patented strategy at a time or in a way that would make the lawyer a tax return preparer with respect to the advice, whether the lawyer may rely on statements in the patent, the patent application or a patent license agreement is not as explicitly covered by

⁶² See, e.g., MRPC 5.5(a). If the patent holder has been disbarred or suspended from practice before the Service, accepting assistance (advice) from the patent holder would violate Circular 230, § 10.24(a).

⁶³ Circular 230, § 10.52(a)(2).

⁶⁴ Current practice, however, does not result in an automatic referral of section 6694 cases to the Office of Professional Responsibility for disciplinary action, presumably because of the requirement of reckless or grossly incompetent behavior.

existing ethical or legal provisions. Regardless of whether such advice can be relied upon, if the lawyer is providing written advice with respect to a patented tax planning strategy, the advice is likely to be subject to the requirements of Circular 230, § 10.35, relating to “covered opinions.” Covered opinions include written advice concerning one or more Federal tax issues arising from so-called listed transactions under Treas. Reg. § 1.6011-4(b)(2); any partnership, other entity or plan or arrangement the principal purpose of which is the avoidance or evasion of any Federal tax; or any partnership, other entity, plan or arrangement a significant purpose of which is the avoidance or evasion of any Federal tax if the advice is a “reliance opinion,” a “marketed opinion,” or subject to either conditions of confidentiality or contractual protection.⁶⁵ Of particular significance in this context is the “reliance opinion,” defined as written advice which “concludes at a confidence level of at least more likely than not ... that one or more significant Federal tax issues would be resolved in the taxpayer’s favor.”⁶⁶

A lawyer providing a client written advice about a patented tax strategy will generally be providing a reliance opinion unless the strategy does not have a significant purpose of avoiding or evading taxes, which seems by definition unlikely in the case of a tax strategy, or the lawyer prominently discloses in the advice “that it was not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the

⁶⁵ Circular 230, § 10.35(b)(2). For “conditions of confidentiality,” see section 10.35(b)(6). For “contractual protection,” see section 10.35(b)(7).

⁶⁶ Circular 230, § 10.35(b)(4)(i). A Federal tax issue is “significant” if the Service has a reasonable basis for a successful challenge of the taxpayer’s position on the issue and the resolution of the issue “could have a significant impact ... on the overall Federal tax treatment of the transaction(s) or matter(s) addressed in the opinion.” *Supra*, § 10.35(b)(3), second sentence.

purpose of avoiding penalties....”⁶⁷ Prominent disclosure means the disclaimer must be “readily apparent to a reader of the written advice,” which depends on the facts and circumstances, including the length of the written advice and the taxpayer’s sophistication. However, the disclosure must be set forth in a separate section (rather than in a footnote, which is why the author has chosen to put this sentence in the text rather than in a footnote) in a typeface no smaller than that used for any discussion of the facts and law in the advice.⁶⁸

If the client wants penalty protection, the lawyer must satisfy the requirements of section 10.35(c) of Circular 230. These requirements, a detailed analysis of which is beyond the scope of this work,⁶⁹ call for an expensive, detailed and comprehensive analysis, beginning with identifying and ascertaining all the facts the practitioner determines to be relevant, relating the law to the facts, considering all significant Federal tax issues, and providing the practitioner’s conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each such issue. Before undertaking this effort, the lawyer should provide the client as realistic an estimate as possible of the cost of undertaking this analysis and providing the reliance opinion, allowing the client to make the final decision whether to obtain the reliance opinion or to forego penalty protection.⁷⁰ However, if the opinion would be with respect to a “principal purpose” of

⁶⁷ Circular 230, § 10.35(b)(4)(ii), which nonetheless excludes from this opt out disclaimer privilege advice with respect to either a listed transaction or a principal purpose of tax avoidance or evasion situation described in section 10.35(b)(2)(i)(A) or (B) respectively. In these cases, the lawyer is subject to the covered opinion requirements regardless.

⁶⁸ Circular 230, § 10.35(b)(8).

⁶⁹ See generally Isaac Roang, *Current Development 2005-2006: To Disclaim or Not to Disclaim: IRS Circular 230 Requirements for Written Advice*, 19 GEO. J. LEGAL ETHICS 937 (2006).

⁷⁰ The taxpayer and the lawyer may agree that the opinion will be limited to less than all of the significant Federal tax issues. For this possibility, see Circular 230, § 10.35(c)(3)(v) and (e)(3).

tax avoidance or evasion transaction or a listed transaction, the lawyer cannot provide written advice except in a form that meets the covered opinion requirements.⁷¹

The lawyer practitioner's reliance opinion may not be based on any unreasonable factual assumptions or unreasonable factual representations, statements or findings of anyone.⁷² The lawyer practitioner may rely on the opinion of another practitioner with respect to one or more Federal tax issues, unless the lawyer practitioner knows or should know she should not rely on the other practitioner's opinion.⁷³ Since the term "practitioner" is defined in Circular 230,⁷⁴ the lawyer may only rely on the opinion of a defined practitioner, a CPA, attorney enrolled agent, enrolled actuary or enrolled retirement plan agent not under suspension or disbarment from practice before the Service. In any event, in the patented strategy context, reliance on the opinion of another practitioner presumably means reliance on advice with respect to the taxpayer's situation, not reliance on the patent or the patent application. Although an opinion meeting the requirements of section 10.35 satisfies the lawyer's responsibilities under that provision, the opinion's persuasiveness and the taxpayer's good faith reliance on the opinion are determined separately under the applicable law and regulations.⁷⁵ The lawyer would be wise to include a statement to this effect at the end of the opinion letter, although it would be a most unusual situation in which the taxpayer would not be able to rely on a reliance

⁷¹ Supra note 67.

⁷² Circular 230, § 10.35(c)(1)(ii) and (iii), which also require that the opinion identify in a separate section all factual assumptions relied upon and all factual representations, statements and findings of the taxpayer (but not of anyone else – why not?) relied upon.

⁷³ Circular 230, § 10.35(d)(1), also requiring the lawyer practitioner to identify the other opinion and set for its conclusions.

⁷⁴ Section 10.2(a)(5), referring to section 10.3(a) through (e).

⁷⁵ Circular 230, § 10.35(f)(1).

opinion satisfying the covered opinion requirements of section 10.35 for penalty protection.

Written advice not subject to the covered opinion requirements of section 10.35 of Circular 230 is subject to the modest requirements of section 10.37. These requirements are more procedural than substantive, mandating consideration of all relevant facts that the lawyer knows or should know, but barring the lawyer from relying on unreasonable factual or legal assumptions or unreasonably relying on representations, statements, findings or agreements of anyone. No particular level of confidence that the hoped for tax consequences will be achieved is required. If a lawyer advising a client with respect to the implementation of a patented tax strategy can avoid the covered opinion rules, written advice is only a viable option if the taxpayer is not concerned about penalty protection. But, if the taxpayer is not concerned about penalty protection, it would seem that oral advice would suffice, although the wise practitioner would want to make a contemporaneous record of the oral advice in case of a dispute with the client at some future time. In fact, in the context of advice about implementation of a patented tax strategy, making a contemporaneous record any time a client declines to request a reliance opinion would be a wise course.

Lawyer Seeking to Profit from Patent She Owns

A lawyer who obtains and holds a patent on a particular tax strategy which the lawyer hopes either to implement as part of tax planning for the lawyer's own clients or

to license for use by clients of others must grapple with both ethical rules of general application and a number of special provisions of Circular 230 and even the Internal Revenue Code. None of these provisions envisions patents on tax planning strategies or, more generally, on other legal planning strategies. The very existence of such patents represents a new paradigm, raising questions about how legal ethical rules and Circular 230 might apply, if at all, to the lawyer's activities in obtaining, holding, and licensing a patent, and/or in using a patent for the benefit of the lawyer's own clients. As a result, while the discussion below raises issues that this new paradigm suggests, many of these issues have yet to be resolved.

One might view the licensing of a patent to a client in connection with providing the client legal services, such as by implementing a tax strategy covered by the patent, to constitute providing a "law-related service" to the client within the meaning of Model Rule 5.7. This would make sense inasmuch as the patent itself is really the embodiment of a package of legal services. Characterizing the licensing of the patent to the holder's client as the provision of law-related services would then generally subject the licensing of the patent to all of the ethical rules of the legal profession, at least in jurisdictions with a rule such as Rule 5.7 in effect.⁷⁶ Nonetheless, a license is really an interest in property. Neither the Rule nor the accompanying Comments seem to envision the provision of any interest in property as the provision of "law-related services."⁷⁷ This situation might be

⁷⁶ See MRPC 5.7(a)(1) (applying Model Rules if the law-related services are provided in circumstances that are not distinct from the lawyer's provision of legal services to clients").

⁷⁷ See MRPC 5.6 (b) and Comments [1] (lawyer "performs" law-related services) and [10] (examples of law-related services).

viewed as calling for an amendment Model Rule 5.7, but no such amendment is in the works.

Instead, a lawyer's licensing of a patented tax strategy to her own client triggers application of Model Rule 1.8, dealing with transactions between a lawyer and her client, or its equivalent. Despite extensive variations among the versions of the rule in effect in different jurisdictions, the author is not aware of any version of the Rule or Comments that refer to the licensing of patent rights to a client. While the Rule does not apply to standard commercial transactions between the lawyer and the client,⁷⁸ this form of patent licensing is clearly not a standard commercial transaction. The Rule prohibits business transactions with a client unless three tests are satisfied: (1) the transaction and terms are fair and reasonable to the client, and are fully disclosed in writing in a manner that can be reasonably understood by the client,⁷⁹ (2) the client is advised in writing of the desirability of seeking, and has a reasonable opportunity to seek, the advice of independent counsel on the transaction,⁸⁰ and (3) the client gives informed consent in writing to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.⁸¹ These standards, if they are to have any real substance, are very difficult to satisfy in this context.

⁷⁸ MRPC 1.8, Comment [1]. The Restatement § 126 makes this explicit in its version of the rule.

⁷⁹ MRPC 1.8(a)(1) refers to a situation in which the lawyer "acquires" an interest from the client, as opposed to selling, licensing or leasing an interest to the client. This is inexcusably sloppy drafting. The Rule is clearly intended to apply to transactions in which the lawyer is on either side of the property transaction. See Comment [1]. See also Restatement § 126, which is written in more general language.

⁸⁰ MRPC 1.8(a)(2).

⁸¹ MRPC 1.8(a)(3).

First of all, since the patent law gives the patent holder a monopoly over the use of the patented tax strategy, the patent holder can charge whatever license fee she wants or simply refuse to allow anyone to use the patented strategy.⁸² How can anyone say that any particular fee charge is “fair and reasonable to the client” in this context? The amount of the fee, of course, can be, and must be, fully disclosed in writing to the client, but that is not much help to the client. And the client can be advised in writing to seek the advice of independent counsel. Given the nature of the patent monopoly, what help will independent counsel be? Note that this is not an issue about the conflict of interest the lawyer may have in advising the client whether to use a tax strategy that implements his own patented strategy as opposed to another strategy – that is a separate problem. This only relates to the licensing of the patented strategy, which may in fact be the only viable option for the client. The client can give the requisite informed consent in writing based on the idea that the client is informed that the lawyer can charge whatever she wants for the patent license, although any legal fees charged for implementing the strategy will have to satisfy the fee standards of Model Rule 1.5 or the equivalent and Circular 230, and that the client has been advised and given an opportunity to in effect confirm this with independent counsel. Is this really something that should be regarded as meeting the ethical standards of the legal profession?

The real difficulty arises, however, when the lawyer is advising the client whether to use the tax strategy covered by the patent or another unpatented strategy, or perhaps a strategy patented by someone else! The lawyer clearly has a strong interest in having the

⁸² The author has proposed that the Service start a tax invention office to create tax shelters, obtain patents on the shelters, and then refuse to allow anyone to use them. This might be easier than having Congress revamp the tax laws to eliminate provisions that serve as the raw material for tax shelters.

client use the strategy on which the lawyer owns the patent. Once the client chooses the patented strategy, the lawyer's overall fees appear to be unlimited since the limitations on legal fees do not apply to licensing property. Hence, the lawyer may be reluctant to give serious consideration to other tax planning alternatives. Furthermore, the monopoly rights granted by the patent can be used to retain the client by refusing to grant a license to use the patent in conjunction with the client retaining another lawyer to implement the strategy, thus limiting the client's ability to choose counsel of her choice.⁸³ Finally the lawyer may have a strong interest in having the patented strategy used and validated. In fact, for this reason, the lawyer may be tempted to downplay any questions about the patent's validity. Of course, as the patent holder, the lawyer is not in a very good position to provide an independent evaluation of the patent's viability.

In these circumstances, can the lawyer satisfy the requirements for obtaining the client's informed consent to the representation where the lawyer's own personal interest in so great and likely at odds with client's interest? As explained previously,⁸⁴ the lawyer must reasonably believe she can provide competent and diligent representation and then obtain the client's informed consent in writing.⁸⁵ Unlike the lawyer who does

⁸³ This aspect of the patent right is at odds with the general concept of Model Rule 5.6, prohibiting lawyers from offering or making agreements that restrict a lawyer's right to practice, to which Comment [1] adds that such an agreement "also limits the freedom of clients to choose a lawyer." However, since the patent right is a creature of federal law, the patent's monopoly aspect presumably trumps this underlying principle of legal ethics.

⁸⁴ See MRPC 1.7 and Circular 230 § 10.29, discussed supra, text accompanying note 24 ff.

⁸⁵ Circular 230, § 10.29(b), which actually calls for the consent to be confirmed **by the client** within a reasonable period not exceeding 30 days after the actual consent. The informed consent may only need to be confirmed in a writing, which may be by the lawyer to the client, in some jurisdictions under Model Rule 1.7. See text accompanying note 26, supra. However, most tax planning advice will bring the practitioner under the jurisdiction of Circular 230, which also requires that the consents be retained for 36 months after the conclusion of the representation and provided to the Service on request. Section 10.29(c).

not hold a patent,⁸⁶ the patent holder may well be sufficiently knowledgeable about both the patented tax strategy and alternatives to provide competent and diligent representation to the client regardless of which course of action the client selects. However, the lawyer's ability to obtain informed consent to proceed with a plan for the client that involves the use of the patented tax strategy depends on the lawyer fully informing the client about the advantages and disadvantages of both the patented strategy and any alternatives, including the fact that the patent allows the lawyer in effect to charge whatever she wants for the license to use the patent, making that strategy potentially far more costly. Because the incentive is so great for the lawyer to favor the patented strategy over other alternatives, the lawyer should take great care to fully explain the advantages and disadvantages of all viable alternatives.⁸⁷ It would be best to provide this explanation in writing, both to allow time for the client to fully weigh the alternatives and to provide evidence that any consent was given only after the client was fully informed by the lawyer.

Although the license charged to a client for the right to use the holder's patented tax strategy is probably not subject to the fee limitations of Model Rule 1.5 or section 10.27 of Circular 230, the presence of the patent license raises several other fee issues. First, if a lawyer is implementing a tax strategy on which she holds a patent, can she charge the client a higher fee than she would otherwise charge because of her expertise on the subject? Model Rule 1.5(a) mentions the lawyer's "experience, reputation and

⁸⁶ Supra text accompanying note 29.

⁸⁷ In addition, the lawyer should probably note that patented tax strategies may be added to the categories of reportable transactions defined in the regulations under IRC § 6011, for which disclosures to the Service are required under IRC § 6011. See Proposed Treas. Reg. § 1.6011-4(b)(7).

ability” as a factor in determining whether a fee is reasonable.⁸⁸ This suggests that the lawyer’s experience and expertise with respect to the patented tax strategy can be taken into account in determining the reasonableness of the fee and that, in effect, that might justify a higher hour rate than might otherwise be charged.⁸⁹ If a fixed fee is charged, the lawyer’s experience and expertise would also justify a higher fee than might otherwise be charged. In either case, the basis or rate of the fee (and expenses) must be communicated to the client, preferably in writing, no later than a reasonable time after the beginning of the representation.⁹⁰ The lawyer should explicitly indicate that the fee for legal services is separate from any license fee for the right to use of the patented tax strategy.

If the lawyer has spent 100 hours developing the patented strategy and obtaining the patent, however, when the lawyer subsequently implements the strategy for a particular client, the lawyer should not “pad” the bill by billing the client for more hours than were actually spent implementing the plan for the client, no matter how tempting it is to do this instead of charging a higher stated hourly rate for the hours actually worked on the ground that the higher rate is justified by the lawyer’s expertise. Similarly, if the lawyer develops the strategy while representing a particular client, although the lawyer may properly bill the client for all hours actually spent in developing the new strategy for the client, the lawyer may not ethically charge the client for extra time spent on the

⁸⁸ Accord, ABA Model Code of Professional Responsibility Disc. Rule 2-106(B).

⁸⁹ If the lawyer is also charging a substantial fee for licensing the patent to the client, however, should this fact be considered in determining whether a higher fee based on the lawyer’s expertise is reasonable for providing the legal services to implement the tax plan?

⁹⁰ MRPC 1.5(b), also requiring that any changes in the basis or rate also be communicated. As a practical matter, information about the fees and expenses as well as the scope of the representation is best provided before the representation begins to reduce the possibility of a later misunderstanding. See Comment [2].

strategy in order to prepare and file a patent application in the lawyer's name.⁹¹ The lawyer should maintain careful records segregating the time spent on the client's plan from time spent to prepare to file the patent application.

Patents, patent applications and patent licensing agreements with respect to tax strategy patents typically include statements regarding the expected tax benefits of using the patented strategy. Some of these documents raise significant issues for the patent holder lawyer under Circular 230, and in some instances under State Bar ethical rules. While the patent application in itself probably presents no problem, the patent may be regarded as in part an effort to advertise the patented tax strategy and to solicit clients, particularly when combined with proposed language for a patent licensing agreement. Model Rule 7.1 prohibits "false or misleading" communications about the lawyer's services, defined as communications that contains a material misrepresentation of fact or law. The statements contained in patents, not being subject to any serious review for accuracy by the PTO or otherwise, are likely to violate this Rule. Circular 230 contains a similar provision,⁹² so any false or misleading statement in a patent or patent licensing agreement or incorporated into a licensing agreement by reference to a patent is likely to violate both Circular 230 and Model Rule 7.1. This is not only true for statements addressed to particular taxpayers as part of a solicitation of business or a targeted advertisement, but also of statements more in the nature of general advertisements.⁹³

⁹¹ Of course, if the engagement agreement or state law provides that any right to patent the strategy belongs to the client, the lawyer may properly charge the client a reasonable fee for preparing and filing a patent application on behalf of the client.

⁹² Circular 230, §10.30, applying expressly to any "public communication or private solicitation."

⁹³ Statements in the patent itself might be viewed, when not accompanied by any other marketing efforts or use of the patent for the holder's clients, as not constituting to a "communication" for purposes of the ethical rules. However, such statements in the patent itself are essential to any marketing (however

As previously discussed above,⁹⁴ Section 6694 of the Internal Revenue Code sets forth standards applicable to advice that a lawyer provides to a client under circumstances that cause the lawyer to be a tax return preparer with respect to the client. In addition, Circular 230 sets forth detailed rules with respect to written advice provided by practitioners subject to Circular 230, particularly with respect to covered opinions that taxpayers may rely upon for penalty protection.⁹⁵ Patent holders who advise their clients with respect to the implementation of tax strategy patents are subject to the provisions of both section 6694 and the Circular 230 covered opinion and written advice rules in the same way as non-patent holders advising clients on the implementation of a tax planning strategy. This includes the possibility of avoiding the rigorous standards of the covered opinion rules through a disclaimer if the advice at issue is neither a “principal purpose of tax avoidance or evasion” opinion nor an opinion about issues arising out of a listed transaction.⁹⁶

In addition, since licensing agreements are likely to include statements about the tax benefits that result from the use of the licensed strategy or to incorporate by reference such statements from the patent itself, these statements may be treated as written advice subject to either the covered opinion rules of section 20.35 of Circular 230 or the written advice rules of section 10.37. This situation is somewhat different from the usual

passive) of the patent and may have the result of marketing the patent in themselves. As a result, if the holder is a lawyer, such statements should be subject to both Circular 230 and any applicable State bar prohibitions on misleading or false communications.

⁹⁴ Supra text accompanying notes 51 ff.

⁹⁵ Supra text accompanying notes 69 ff.

⁹⁶ Circular 230, § 10.35(b)(4)(ii), discussed supra notes 65 and 66 and accompanying text.

application of section 10.35 or section 10.37. If the patent holder is implementing the patented strategy for his own client, the licensing agreement can simply be viewed as part of the advice to that client, analogous to legal advice generally, although the licensing transaction itself seems outside the concept of providing “law-related services” under the Model Rules.⁹⁷

If the ultimate client, however, is represented by another lawyer, then it does not appear, at least initially, that the patent holder is providing advice to the other lawyer’s client, the ultimate user of the patent, but is instead simply licensing the patent for use by the other lawyer’s client. However, if the lawyer’s client and the lawyer can rely on the advice of the patent holder for penalty protection, then it would seem appropriate to apply the Circular 230 standards in this context.⁹⁸ In these circumstances, it also seems appropriate to conclude that the patent holder owes a duty to the other lawyer who represents the client, although how this duty would be defined for tort law or general legal ethical standards is unclear. Perhaps in this situation the other lawyer should be viewed as a client of the patent holder, with all the ethical consequences that such a conclusion would entail.

In some cases, if the patent and standard licensing agreement include statements about the patented strategy’s tax benefits and these documents are used to promote or market the patented tax strategy, these documents may be considered marketed

⁹⁷ See discussion of MRPC 5.7, *supra* text accompanying notes 76 and 77.

⁹⁸ In particular, Treas. Reg. §§ 1.6694-1(e)(1) and 1.6694-2(e)(5) clearly permit the client’s lawyer to rely on the patent holder’s advice in some cases.

opinions⁹⁹ subject to the covered opinion rules, but again eligible for an opt out disclaimer to avoid the application of section 10.35's burdensome requirements if the opinion is not with respect to a listed transaction or a principal purpose of tax avoidance or evasion transaction.¹⁰⁰

Circular 230 requires practitioners to respond to proper and lawful requests for information from an officer or employee of the Service in any matter before the Service.¹⁰¹ It is unclear whether the Service can and will use this provision to request information about patented tax strategies from patent holders who are practitioners within the meaning of Circular 230.¹⁰² In particular, it is unclear whether the reference to a "matter" before the Service would limit the authority to request information to situations where a particular taxpayer is already being at least audited by the Service. In a case where the taxpayer is already being audited, if information is requested, the practitioner must promptly provide the information or records requested unless the practitioner "believes in good faith and on reasonable grounds that the records or information are privileged."¹⁰³ If the patent holder does not have an attorney client relationship with the ultimate client, represented by another lawyer, there is no attorney client relationship and therefore no privilege. As a result, the patent holder may be required to provide any

⁹⁹ Circular 230, § 10.35(b)(5).

¹⁰⁰ Circular 230, § 10.35(b)(5)(ii). This disclaimer is somewhat different from the one necessary to opt out of reliance opinion characterization under section 1035(b)(4)(ii), although it must also be prominently disclosed.

¹⁰¹ Circular 230, § 10.20(a).

¹⁰² For the term "practitioner," see Circular 230, §§ 10.2(a)(5) and 10.3(a) to (e).

¹⁰³ Circular 230, § 10.20(a). In this connection, it is notable that the identity of a participant in a tax shelter transaction is generally not privileged. See note 36 supra. When records or information requested by an officer or employee of the Service are not in the control or possession of the practitioner or his client, the practitioner must provide any information she has about who may have control or possession of the records and/or information. *Id.*, § 10.20(a)(2).

information he has about the ultimate client, whose identity alone disclosed in connection with licensing the use of the patented tax strategy may lead to a Service audit and be harmful to the ultimate client. As noted earlier,¹⁰⁴ the client's lawyer should discuss this potential problem with the client when discussing the advantages and disadvantages of using the patented tax strategy.

¹⁰⁴ Supra text accompanying notes 36-40.