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EXAMINER

ART UNIT PAPER NUMBER

DATE MAILED: 03/21/2012

Please find below and/or attached an Office communication concerning this application or proceeding.

<b>Office Action in Ex Parte Reexamination</b>	<b>Control No.</b> 90/009,868	<b>Patent Under Reexamination</b> 6567790
	<b>Examiner</b> SAMUEL RIMELL	<b>Art Unit</b> 3992

-- The MAILING DATE of this communication appears on the cover sheet with the correspondence address --

- a ☒ Responsive to the communication(s) filed on 12 October 2011.      b ☒ This action is made FINAL.  
c ☐ A statement under 37 CFR 1.530 has not been received from the patent owner.

A shortened statutory period for response to this action is set to expire 2 month(s) from the mailing date of this letter. Failure to respond within the period for response will result in termination of the proceeding and issuance of an *ex parte* reexamination certificate in accordance with this action. 37 CFR 1.550(d). **EXTENSIONS OF TIME ARE GOVERNED BY 37 CFR 1.550(c).** If the period for response specified above is less than thirty (30) days, a response within the statutory minimum of thirty (30) days will be considered timely.

**Part I THE FOLLOWING ATTACHMENT(S) ARE PART OF THIS ACTION:**

1. ☒ Notice of References Cited by Examiner, PTO-892.      3. ☐ Interview Summary, PTO-474.  
2. ☐ Information Disclosure Statement, PTO/SB/08.      4. ☐ \_\_\_\_\_.

**Part II SUMMARY OF ACTION**

- 1a. ☒ Claims 1-37 are subject to reexamination.  
1b. ☐ Claims \_\_\_\_\_ are not subject to reexamination.  
2. ☐ Claims \_\_\_\_\_ have been canceled in the present reexamination proceeding.  
3. ☐ Claims \_\_\_\_\_ are patentable and/or confirmed.  
4. ☒ Claims 1-37 are rejected.  
5. ☐ Claims \_\_\_\_\_ are objected to.  
6. ☐ The drawings, filed on \_\_\_\_\_ are acceptable.  
7. ☐ The proposed drawing correction, filed on \_\_\_\_\_ has been (7a) ☐ approved (7b) ☐ disapproved.  
8. ☐ Acknowledgment is made of the priority claim under 35 U.S.C. § 119(a)-(d) or (f).  
a) ☐ All b) ☐ Some\* c) ☐ None of the certified copies have  
1 ☐ been received.  
2 ☐ not been received.  
3 ☐ been filed in Application No. \_\_\_\_\_.  
4 ☐ been filed in reexamination Control No. \_\_\_\_\_.  
5 ☐ been received by the International Bureau in PCT application No. \_\_\_\_\_.  
\* See the attached detailed Office action for a list of the certified copies not received.  
9. ☐ Since the proceeding appears to be in condition for issuance of an *ex parte* reexamination certificate except for formal matters, prosecution as to the merits is closed in accordance with the practice under *Ex parte* Quayle, 1935 C.D. 11, 453 O.G. 213.  
10. ☐ Other: \_\_\_\_\_

cc: Requester (if third party requester)

**EX PARTE REEXAMINATION FINAL OFFICE ACTION**

This is a final office action in the *Ex Parte* reexamination proceeding 90/009,868 for U.S. Patent 6,567,790. Claims 1-25 were the original claims of U.S. Patent 6,567,790. Claims 26-37 were added by Patent Owner in the amendment of October 12, 2011. Claims 1-37 are rejected in the present action. This action has been made final. See MPEP 2271 and 706.07(a).

**Responses by Patent Owner**

- Claim amendment adding new claims 26-37 submitted October 12, 2011.
- Declaration of Jerome M. Hesch under 37 CFR 1.132 submitted October 12, 2011.
- Remarks of Patent Owner submitted October 12, 2011.
- Declaration of Robert C. Slane under 37 CFR 1.132 submitted October 12, 2011.

**Consideration of Responses by Patent Owner**

Each of the four documents recited above have been reviewed and are approved for entry in this proceeding. Each are addressed individually in this action.

**Additional Prior Art**

The addition of new claims by patent owner necessitates consideration of additional prior art. Examiner herewith submits in this action the document "*Introduction to the Black-Scholes Model*". The Black-Scholes pricing formula, as well as the Merton Adjustment to the Black-Scholes formula to include dividend payments, were both published in 1973, more than one year prior to the patent filing date of December 1, 1999. The document content is therefore available as prior art under 35 USC 102(b) and 35 USC 103(a).

### **Statutory Rejections**

The following is a quotation of 35 U.S.C. 103(a) which forms the basis for all obviousness rejections set forth in this Office action:

(a) A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negated by the manner in which the invention was made.

Claims 1, 2 and 12 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and Rothschild article.

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at pages 3-8, and are hereby incorporated by reference in their entirety.

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Claims 3-6 and 9 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and Rothschild article as applied to claims 1, 2 and 12 above, and further in view of PRL 9451056 and Coplan article.

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at pages 8-15, and are hereby incorporated by reference in their entirety.

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Claims 7-8 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art, Rothschild Article, PRL 9451056 and Coplan article as applied to claims 3-6 and 9 above, and further in view of Coplan article and Barron's Dictionary.

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The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at pages 15-19, and are hereby incorporated by reference in their entirety.

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Claims 10-11 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and the Rothschild article as applied to claims 1, 2 and 12, and further in view of Marcus article.

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at pages 19-21, and are hereby incorporated by reference in their entirety.

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Claims 13, 14 and 24 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and the Rothschild article as applied to claims 1, 2 and 12, and further in view of Maurer article and Benesh article

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at pages 21-26, and are hereby incorporated by reference in their entirety.

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Claims 15-18, 21 and 25 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art, the Rothschild article, the Maurer article and the Benesh article as applied to claims 13, 14 and 24 above, and further in view of PRL 9451056 and Coplan article.

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at pages 26-27, and are hereby incorporated by reference in their entirety.

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Claims 19-20 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art, the Rothschild article, the Maurer article, the Benesh article, PRL 9451056 and the Coplan article as applied to claims 15-18 and 21 above, and further in view of Coplan article and Barron's Dictionary.

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at page 27, and are hereby incorporated by reference in their entirety.

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Claims 22 and 23 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and the Rothschild article, the Maurer article and the Benesh article as applied to claims 13, 14 and 24 above, and further in view of Marcus article.

The reasons for this rejection were set forth in the non-final office action of July 12, 2011 at page 27, and are hereby incorporated by reference in their entirety.

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**New Grounds of Rejection Necessitated by Addition of Claims**

Claims 26-37 were added by Patent Owner in the amendment of October 12, 2011. The following pages address new grounds of rejection for these newly added claims:

The following is a quotation of 35 U.S.C. 103(a) which forms the basis for all obviousness rejections set forth in this Office action:

(a) A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negated by the manner in which the invention was made.

Claim 26 is rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and Rothschild article.

**Claim 26: The method of claim 1** (see application of Zaluda article , Patent Owner's Admitted Prior Art and Rothschild article as applied to claim 1), **wherein the value of the stock options has been determined when the stock options are transferred to the GRAT** (see Rothschild article at paragraph 6, "payments equal to 27.888% of trust on creation". The value of the trust must be determined in order to calculate what constitutes 27.888% of that value. The creation of the trust is the transfer of the initial gift to the trust; i.e., the transfer of the stock options to the trust as taught by the Zaluda article).

Claim 30 is rejected under 35 U.S.C. 103(a) as being unpatentable Zaluda article in view of Patent Owner's Admitted Prior Art and the Rothschild article as applied to claims 1, 2 and 12, and further in view of Maurer article and Benesh article.

**Claim 30: The method of claim 13** (see application of Zaluda article , Patent Owner's Admitted Prior Art, Rothschild article , Maurer article and Benesh article as applied to claim 13), **wherein the value of the stock options has been determined when the stock options are transferred to the GRAT** (see Rothschild article at paragraph 6, "payments equal to 27.888% of trust on creation". The value of the trust must be determined in order to calculate what constitutes 27.888% of that value. The creation of the trust is the transfer of the initial gift to the trust; i.e., the transfer of the stock options to the trust as taught by the Zaluda article).

Claim 34 is rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art, the Rothschild article, the Maurer article and the

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Benesh article as applied to claims 13, 14 and 24 above, and further in view of PRL 9451056 and Coplan article.

**Claim 34: The method of claim 25** (see application of Zaluda article in view of Patent Owner's Admitted Prior Art, the Rothschild article, the Maurer article, the Benesh article, PRL 9451056 and the Coplan article as applied to claim 25), **wherein the value of the stock options has been determined when the stock options are transferred to the GRAT** (see Rothschild article at paragraph 6, "payments equal to 27.888% of trust on creation". The value of the trust must be determined in order to calculate what constitutes 27.888% of that value. The creation of the trust is the transfer of the initial gift to the trust; i.e., the transfer of the stock options to the trust as taught by the Zaluda article).

Claims 27-29 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner's Admitted Prior Art and Rothschild article as applied to claim 1, and further in view of Introduction to the Black Scholes Model.

**Claim 27: The method of claim 1** (see application of Zaluda article , Patent Owner's Admitted Prior Art and Rothschild article as applied to claim 1), **wherein each valuation of each of the stock options** (Introduction to the Black Scholes Model, page 1, first paragraph, "pricing of employee stock options") **is determined based on:**

**an exercise price of the stock option** (Introduction to the Black Scholes Model, bottom of page 1, "X=strike price" is the price of the option when it is exercised);

**a current price of a stock underlying the stock option** (Introduction to the Black Scholes Model, bottom of page 1, "S=Underlying Stock Price");



**a volatility of the stock underlying the stock option** (Introduction to the Black Scholes Model, top of page 2, “V=Volatility”);

**an expected dividend yield of the stock underlying the stock option** (Introduction to the Black Scholes Model, last paragraph of page 2 through page 3, the Merton Extension to the Black Scholes model (1973) provides a variable “d” for dividends per year);

**a risk-free interest rate over a remaining term of the stock option** (Introduction to the Black Scholes Model, page 2, first paragraph, “R=risk free rate of interest”); and

**an expected life of the stock option** (Introduction to the Black Scholes Model, page 2, first paragraph, “T= time to maturity”).

It would have been obvious to one of ordinary skill in the art to modify Zaluda article in view of Patent Owner’s Admitted Prior Art and Rothschild article by applying the teachings of Introduction to the Black Scholes Model in order to provide a well known and highly regarded pricing model for stock options (Introduction to the Black Scholes Model, page 1, first and second paragraphs).

**Claim 28: The method of claim 27** (see application of over Zaluda article in view of Patent Owner’s Admitted Prior Art, Rothschild article and Introduction to the Black Scholes Model to claim 27), **wherein each valuation is performed by the signal processing device** (Patent Owner’s Admitted Prior Art at col. 4, lines 53-57, “computer software applications are available that perform this calculation, such as NumberCruncher by Leimberg & LeClair Inc, Bryn Mawr Pa., and Zcalc by Lexcite Development, LLC of Arlington Heights, Ill.”).

**Claim 29: The method of claim 27** (see application of Zaluda article in view of Patent Owner’s Admitted Prior Art, Rothschild article and Introduction to the Black Scholes Model to

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claim 27), **further comprising an initial valuation of the stock options** (see Rothschild article at paragraph 6, “payments equal to 27.888% of trust on creation”. The value of the trust must be determined in order to calculate what constitutes 27.888% of that value) **to determine the transfer tax liability** (see Rothschild article at paragraph 4, “The value of the income and remainder interests of a GRAT for gift tax purposes are determined under Table B of the Treasury Tables, using the section 7520 rate”. Also note that determining the value of annual income necessarily requires a valuation of the deposited capital that is producing that income).

Claims 31-33 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner’s Admitted Prior Art and the Rothschild article, Maurer article and Benesh article as applied to claim 13, and further in view of Introduction to the Black Scholes Model.

**Claim 31: The method of claim 13** (see application of Zaluda article , Patent Owner’s Admitted Prior Art , Rothschild article, Maurer article and Benesh article as applied to claim 13), **wherein each valuation of each of the stock options** (Introduction to the Black Scholes Model, page 1, first paragraph, “pricing of employee stock options”) **is determined based on:**

**an exercise price of the stock option** (Introduction to the Black Scholes Model, bottom of page 1, “X=strike price” is the price of the option when it is exercised);

**a current price of a stock underlying the stock option** (Introduction to the Black Scholes Model, bottom of page 1, “S=Underlying Stock Price”);

**a volatility of the stock underlying the stock option** (Introduction to the Black Scholes Model, top of page 2, “V=Volatility”);

**an expected dividend yield of the stock underlying the stock option** (Introduction to the Black Scholes Model, last paragraph of page 2 through page 3, the Merton Extension to the Black Scholes model (1973) provides a variable “d” for dividends per year);

**a risk-free interest rate over a remaining term of the stock option** (Introduction to the Black Scholes Model, page 2, first paragraph, “R=risk free rate of interest”); **and**

**an expected life of the stock option** (Introduction to the Black Scholes Model, page 2, first paragraph, “T= time to maturity”).

It would have been obvious to one of ordinary skill in the art to modify Zaluda article , Patent Owner’s Admitted Prior Art , Rothschild article, Maurer article and Benesh article by applying the teachings of Introduction to the Black Scholes Model in order to provide a well known and highly regarded pricing model for stock options (Introduction to the Black Scholes Model, page 1, first and second paragraphs).

**Claim 32: The method of claim 31** (see application of over Zaluda article in view of Patent Owner’s Admitted Prior Art, Rothschild article, Maurer article, Benesh article and Introduction to the Black Scholes Model to claim 31), **wherein each valuation is performed by the signal processing device** (Patent Owner’s Admitted Prior Art at col. 4, lines 53-57, “computer software applications are available that perform this calculation, such as NumberCruncher by Leimberg & LeClair Inc, Bryn Mawr Pa., and Zcalc by Lexcite Development, LLC of Arlington Heights, Ill.”).

**Claim 33: The method of claim 31** (see application of Zaluda article, Patent Owner’s Admitted Prior Art , Rothschild article, Maurer article, Benesh article and Introduction to the Black Scholes Model as applied to claim 31) **further comprising an initial valuation of the**

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**stock options** (see Rothschild article at paragraph 6, “payments equal to 27.888% of trust on creation”. The value of the trust must be determined in order to calculate what constitutes 27.888% of that value) **to determine the transfer tax liability** (see Rothschild article at paragraph 4, “The value of the income and remainder interests of a GRAT for gift tax purposes are determined under Table B of the Treasury Tables, using the section 7520 rate”. Also note that determining the value of annual income necessarily requires a valuation of the deposited capital that is producing that income).

Claims 35-37 are rejected under 35 U.S.C. 103(a) as being unpatentable over Zaluda article in view of Patent Owner’s Admitted Prior Art, the Rothschild article, the Maurer article the Benesh article, PRL 9451056 and Coplan article as applied to claim 25, and further in view of Introduction to the Black Scholes Model.

**Claim 35: The method of claim 25** (see application of Zaluda article in view of Patent Owner’s Admitted Prior Art, the Rothschild article, the Maurer article the Benesh article, PRL 9451056 and Coplan article as applied to claim 25), **wherein each valuation of each of the stock options** (Introduction to the Black Scholes Model, page 1, first paragraph, “pricing of employee stock options”) **is determined based on:**

**an exercise price of the stock option** (Introduction to the Black Scholes Model, bottom of page 1, “X=strike price” is the price of the option when it is exercised);

**a current price of a stock underlying the stock option** (Introduction to the Black Scholes Model, bottom of page 1, “S=Underlying Stock Price”);

**a volatility of the stock underlying the stock option** (Introduction to the Black Scholes Model, top of page 2, “V=Volatility”);

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**an expected dividend yield of the stock underlying the stock option** (Introduction to the Black Scholes Model, last paragraph of page 2 through page 3, the Merton Extension to the Black Scholes model (1973) provides a variable “d” for dividends per year);

**a risk-free interest rate over a remaining term of the stock option** (Introduction to the Black Scholes Model, page 2, first paragraph, “R=risk free rate of interest”); **and**

**an expected life of the stock option** (Introduction to the Black Scholes Model, page 2, first paragraph, “T= time to maturity”).

It would have been obvious to one of ordinary skill in the art to modify Zaluda, Patent Owner’s Admitted Prior Art, the Rothschild article, the Maurer article, the Benesh article, PRL 9451056 and Coplan article by applying the teachings of Introduction to the Black Scholes Model in order to provide a well known and highly regarded pricing model for stock options (Introduction to the Black Scholes Model, page 1, first and second paragraphs).

**Claim 36: The method of claim 35** (see application of Zaluda article in view of Patent Owner’s Admitted Prior Art, the Rothschild article, the Maurer article the Benesh article, PRL 9451056, Coplan article and Introduction to the Black Scholes Model as applied to claim 35) **wherein each valuation is performed by the signal processing device** (Patent Owner’s Admitted Prior Art at col. 4, lines 53-57, “computer software applications are available that perform this calculation, such as NumberCruncher by Leimberg & LeClair Inc, Bryn Mawr Pa., and Zcalc by Lexcite Development, LLC of Arlington Heights, Ill.”).

**Claim 37: The method of claim 35** (see application of Zaluda article in view of Patent Owner’s Admitted Prior Art, the Rothschild article, the Maurer article the Benesh article, PRL 9451056, Coplan Article and Introduction to the Black Scholes Model as applied to claim 35)

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**further comprising an initial valuation of the stock options** (see Rothschild article at paragraph 6, “payments equal to 27.888% of trust on creation”. The value of the trust must be determined in order to calculate what constitutes 27.888% of that value) **to determine the transfer tax liability** (see Rothschild article at paragraph 4, “The value of the income and remainder interests of a GRAT for gift tax purposes are determined under Table B of the Treasury Tables, using the section 7520 rate”. Also note that determining the value of annual income necessarily requires a valuation of the deposited capital that is producing that income).

**Consideration of Declaration of Jerome M. Hesch under 37 CFR 1.132**  
**submitted October 12, 2011.**

(1) Declarant states the following at page 5, second paragraph of the Declaration:

*“There are several significant differences that would have made a person having ordinary skill in the art pause before putting stock options into a GRAT before the teachings of the Slane patent were known. Potential concerns specific to a GRAT could have included:*

- Whether the exercise of stock options by the GRAT could give rise to Securities and Exchange Commission (SEC) insider trading issues;*
- What assignment of income and Section 83 income tax issues would arise in connection with the exercise of stock options by the GRAT;*
- How the stock options might be best valued, and what valuation issues there might be; and*
- How restrictions on transferability of stock options would impact the use of*

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*the GRAT for stock options”.*

These assertions regarding “potential concerns” are not persuasive for the following reasons:

(A) *“Whether the exercise of stock options by the GRAT could give rise to Securities and Exchange Commission (SEC) insider trading issues”*: This issue is addressed in patent owner’s specification at col. 1, lines 22-24, where patent owner states: “a change in securities law (Rule 16b-3 of the Securities and Exchange Commission regulations) eliminated a non-transferability requirement for options in order to qualify for the exemption from insider trading...” Since this is a public ruling produced by a public agency, a person of ordinary skill in the estate planning art would be well apprised of this exemption from insider trading issues, and accordingly would not be prevented or otherwise deterred from gifting stock options to family members. Indications of “concerns about insider trading” contradict patent owner’s specification, since the specification acknowledges a clear and lawful exemption from this issue in the specific case of stock options being appropriately gifted to family members or to a trust (patent owner’s specification at col. 1, lines 25-28).

(B) *“What assignment of income and Section 83 income tax issues would arise in connection with the exercise of stock options by the GRAT”*.

As correctly indicated by Declarant Hesch, the Section 83 income tax issues pertain to the exercise of stock options (i.e. purchase of actual stock), not the transfer of the options (transferring the options into or out of a trust). Within the context of granting stock options to a trust, and returning stock options out of a trust back to the grantor, the stock options are not exercised during these transfers. They are simply transferred into or out of the trust. In the

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present invention, the exercise of the stock options does not occur until after the stock options have been transferred out of the trust, which means that if any Section 83 issues were to arise, they would arise separately from the usage of the trust. This is demonstrated in patent owner's specification at column 5, Table 2, where options are paid (transferred out) of the trust. Col. 5, lines 51-53 of the specification further states that exercise of the stock options does not occur until the grantor substitutes an equivalent amount of cash into the trust. In fact, there is no "exercise of stock options by the GRAT". There is only the transfer of stock options out of the GRAT and exchange of stock options for cash at the end of the GRAT life.

Secondly, Patent owner's disclosure makes no recognition anywhere of issues arising under Section 83. If such issues are supposed to arise by the operation of GRAT, then patent owner has no explanation of how the disclosed invention avoids these very same issues. This is further evidence that the so called "Section 83 issues" are not in fact issues which arise as a result of operating a GRAT.

*(C) How the stock options might be best valued, and what valuation issues there might be:*

None of the original patent claims 1-25 provide any indication of what type of valuation method is used, so there is no requirement that the prior art provide analysis or consideration of the "best valuation method" within the art. Newly added claims 27, 31 and 35 do address a specific valuation technique using the Black Scholes formula variables, but this technique is fully taught by the reference Introduction to the Black Scholes Model cited in this action.

*(D) "How restrictions on transferability of stock options would impact the use of the GRAT for stock options":*



Patent owner's specification at col. 1, lines 21-28 states: "a change in securities law (Rule 16b-3 of the Securities and Exchange Commission regulations) eliminated a non-transferability requirement for options in order to qualify for the exemption from insider trading under that rule. Therefore, many corporations have recently allowed non-qualified stock options to be gifted by recipients to family members..." Patent owner's own discussion of the relevant art recognizes that restrictions on transferability of stock options were eliminated, resulting in many corporations permitting the transfer of stock options to designated family members. This directly contradicts assertions that a person of ordinary skill in the estate planning art would be exceedingly concerned about, or prevented from, lawfully transferring stock option assets from the option recipient to family members.

(2) Declarant states at page 6, second paragraph of the declaration:

*"However, a person having ordinary skill in the art of tax and estate planning would not recognize the Zaluda article as legitimately teaching the placement of stock options in a GRAT".*

This assertion is not correct. The USPTO is asserting that placement of stock options in a GRAT is fully taught by Zaluda. There are no issues of obviousness or level of skill in the art questions on this specific finding. Note the non-final office action at page 5, second paragraph, which states: "The Zaluda article at least teaches the features indicated above with respect to funding a GRAT with non-qualified stock options."

(3) Declarant at page 7, second paragraph states:

*"A GRAT requires a grantor to retain an annuity interest in the trust. If the grantor dies during the term of the GRAT, some or all of the GRAT assets would be included in the Grantor's estate. Zaluda makes no attempt to specifically identify or resolve the inconsistency between the*

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*previously stated objective when stock options are placed in a trust and what would happen if stock options were actually placed in a GRAT”.*

These assertions are not correct. There is no inconsistency in the article.

The Zaluda article at page S-244, right column, second paragraph states: “The executive should avoid retaining any interest in the trust which would include the trust assets in his estate for estate tax purposes”. A GRAT is defined as a “Grantor Retained *Annuity Trust*. The Grantor who establishes the trust, gifts the trust with certain assets, such as stock options. The Grantor then receives an annual annuity in return for a fixed period of years. Once a grantor makes the initial gift, the grantor's interest in the trust is future annuity payments, not pre-existing assets already present in the grantor's estate. Stating that a grantor may not have an interest in the trust that includes assets already available in the grantor’s estate is entirely consistent with the rules for operating a GRAT, as the grantor’s interest is a future paying annuity.

(4) Declarant at page 7, second paragraph states:

*“Moreover, Zaluda does not even mention any of the potential concerns outlined above that would have occurred to a skilled practitioner, and particularly nowhere addresses the valuation issues unique only to stock options that must be dealt with if stock options are to be placed in a GRAT”.*

The quoted assertion does not make reference to specific patent claims, but it is presumed that declarant is referring to claims 1, 13 and 25, where valuations are being defined. The article to Zaluda teaches various different vehicles in which stock options can be placed, and one of the several vehicles mentioned is the GRAT type trust (Zaluda at page S-244, right column, last paragraph). Rothschild at paragraphs 3, 7 and 9 then teach that the given trust must have its

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assets valued using appropriate valuation techniques (Rothschild at paragraph 9). The reference to Zaluda is not the reference being relied upon to teach the valuation techniques. One cannot show nonobviousness by attacking references individually where the rejections are based on combinations of references. *In re Keller*, 642 F.2d 413, 208 USPQ 871 (CCPA 1981); *In re Merck & Co., Inc.*, 800 F.2d 1091, 231 USPQ 375 (Fed. Cir. 1986).

(5) Declarant at page 7, last paragraph states:

*"Further evincing this point, I personally recall reading the Zaluda article back when it was published, and my impression at the time was that it disclosed nothing new".*

This assertion is moot. There is no requirement in the law that prior art be original or "new" at the time of its publication. It is the subject matter being claimed for patent that must be demonstrated as new or unobvious, not the prior art being compared to it. The requirements for qualifying documents as prior art are defined at 35 USC 102; 35 USC 103; MPEP 706.02; MPEP 2121 and MPEP 2128).

(6) Declarant at pages 7-8 states:

*"The underlying assumption appears to be that, simply because the IRS endorsed such valuation models for stock options, it would then be obvious to a person having ordinary skill in the art to use them regardless of the particular application. That is simply not how it works in the tax and estate planning field.....*

*In other words, even though foundational material to allow one to conclude that an installment sale to a grantor trust would be a viable estate planning technique was available in 1985, estate planning professions(sic)(professionals) did not begin to consider the use of installment sales to a grantor trust in estate planning until the private letter ruling in 1995".*

These assertions are not correct. Obviousness is not determined by one single factor (*KSR International Co. v. Teleflex Inc.*, 127 S. Ct. 1727, 82 USPQ2d 1385 (2007)), and the factor of delay, in particular, is not considered to be one such factor. See *In re Wright*, 569 F.2d 1124, 1127, 193 USPQ 332, 335 (CCPA 1977) (100 year old patent was properly relied upon in a rejection based on a combination of references). See also *Ex parte Meyer*, 6 USPQ2d 1966 (Bd. Pat. App. & Inter. 1988) (length of time between the issuance of prior art patents relied upon (1920 and 1976) was not persuasive of unobviousness).

Secondly, none of the claims currently of record recite a requirement to use IRS procedure 98-34 as a technique for stock option valuation, so this is not actually an issue subject to consideration in this proceeding. Claims 27, 31 and 35 do recite a requirement to use the variables known from the Black Scholes Test, but there is no mention of any specific IRS sanctioned test. As a result, there are no issues of obviousness related to the application of the IRS procedure 98-34.

(7) Declarant at page 9, second paragraph states:

*“Just because the IRS announced that Black-Scholes and related models would be accepted for valuation purposes, that does not necessarily mean that tax and estate professionals would readily appreciate their applicability in the context of a stock option GRAT.”*

These assertions are not correct. None of original claims 1-25 make any reference to the usage of the Black Scholes model in stock option valuation, so this assertion is not an issue for these claims. Newly added claims 27, 31 and 35 do make mention of the variables that appear in the Black Scholes model, but these are taught by the prior art document Introduction to the Black

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Scholes Model. This paper describes the Black Scholes model as “..one of the most important papers within finance theory” (page 1, first paragraph) and “..is used everyday” (page 1, first paragraph). This evidence, combined with admission both patent owner (patent specification at col. 4, lines 15-17) and declarant (declaration at page 9, second paragraph, lines 1-3) that this technique is endorsed by the IRS provides clear motivation for the person of ordinary skill in the estate planning art to rely upon this model, as discussed with respect to claims 27, 31 and 35.

(8) Declarant at page 10, first paragraph states:

*“As discussed above, in connection with the initial valuation of GRAT assets, the desire of the skilled practitioner was to try to minimize the initial valuation as much as possible. In fact, Rev. Proc. 98:34 specifically forbids discounting the value of the stock options (see Rev. Proc., para. 4.02(6)). Since the focus in 1999 was on transferring assets that could be discounted to a GRAT, the actual practical application of Rev. Proc. 98-34 in the field of estate planning at the time the Slane patent was filed, tended to teach away from applying Rev. Proc. 98-34 to at least the initial valuation of GRAT assets”.*

These assertions are moot. Patent Owner's patent specification makes no mention of discounting assets after they have been valued, nor is any mention of it made in the claims of record. The patent owner does not recognize this concept in the original disclosure, so there is no requirement that this issue be recognized in the prior art.

Even assuming for the sake of discussion that a person of ordinary skill in the art would have been aware of the possibility of discounting assets after valuation, this does not mean that this same skilled artisan would have been deterred from using a lawfully sanctioned valuation technique. It is reasonable to conclude that a person of ordinary skill in the art of estate planning

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would be mindful of possible criminal and civil liability problems which would arise if a valuation technique were used that was not appropriately approved for use, even if that technique produced more a desirable valuation result for the client. The fact that a person of ordinary skill might be aware of more desirable valuation techniques does not mean that the artisan would be either prevented from using or deterred from using a legally approved standard.

(9) Declarant at page 10, second paragraph states:

*“The failure of the Zaluda article to mention, much less address, any of these obstacles necessitates the conclusion that the juxtaposition of stock options and GRATs occurring therein is merely accidental, and would not be taken as seriously teaching the placement of stock options into a GRAT”.*

These assertions are not correct. The prior art must be taken on its face for what it teaches (*In re Heck*, 699 F.2d 1331, 1332-33, 216 USPQ 1038, 1039 (Fed. Cir. 1983)). The article to Zaluda teaches various different vehicles in which stock options can be placed, and one of the several vehicles mentioned is the GRAT type trust (Zaluda at page S-244, right column, last paragraph). Any speculative questions about whether Zaluda “accidentally” or “seriously” teaches the application of stock option to a GRAT are not relevant, as this reference clearly teaches the applications of stock options in a GRAT type vehicle.

(10) Declarant at page 10, second paragraph states:

*“Even if the Zaluda article had suggested this to a knowledgeable practitioner, the particular failure of the Zaluda article to address valuation conundrum would have rendered it non-enabling to anyone actually trying to successfully establish a GRAT.”*

These assertions are not correct. The Zaluda article was published in September 1997. Declarant states at page 9, first paragraph that installment sales to a grantor trust (i.e. a trust where the grantor receives installment payments, or GRAT) were being used by estate planning professionals beginning in 1995. If this is indeed the case, then any "valuation conundrums" would be resolved by 1995, two years before Zaluda published his article.

Secondly, Declarant is failing to consider the teachings of Rothschild, which was relied upon in the rejection of independent claims 1, 13 and 25 to teach the claimed valuation steps. The assertions of Declarant appear to be based exclusively on a consideration of the Zaluda reference by itself, without taking into account the teachings provided by Rothschild that directly address the valuation issue. One cannot show nonobviousness by attacking references individually where the rejections are based on combinations of references. *In re Keller*, 642 F.2d 413, 208 USPQ 871 (CCPA 1981); *In re Merck & Co., Inc.*, 800 F.2d 1091, 231 USPQ 375 (Fed. Cir. 1986).

**Consideration of Declaration of Robert C. Slane under 37 CFR 1.132**

**Submitted October 12, 2011**

This declaration is a disclosure of a depositions proceeding in related litigation. This information disclosure has been reviewed and considered, and its presence in the record is noted.

**Response to Remarks of Patent Owner submitted October 12, 2011**

(1) Patent owner at page 10, second to last paragraph through page 11, first paragraph states:

*“The Patent Owner recognizes that a statement in the Specification identifying the work of another as prior art constitutes an admission. However, there is no such statement in the '790 patent identifying either the Treasury Regulations or software packages as prior art.*

*The Patent Owner is not necessarily denying that the Treasury Regulations and software packages are, in their own right, prior art. However, absent some express admission, they are not prior art based on the mere fact that they are discussed in the '790 patent, nor does the discussion of a prior art reference (whether admitted prior art or not) in a patent specification render the entire discussion as an admission”.*

These assertions are not correct. 37 CFR 1.104 states:

“In rejecting claims, the examiner may rely upon admissions by applicant, or the patent owner is a reexamination proceeding as to any matter affecting patentability”.

MPEP 2129, Section I states:

“A statement by an applicant in the specification made during prosecution identifying the work of another as prior art is an admission which can be relied upon for both anticipation and obviousness determinations, regardless of whether the admitted prior art would otherwise qualify as prior art under the statutory categories of 35 USC 102. *Riverwood Int'l Corp. v. R.A. Jones & Co.*, 324 F.3d 1346, 1354, 66 USPQ2d 1331, 1337 (Fed. Cir. 2003); *Constant v. Advanced Micro-Devices Inc.*, 848 F.2d 1560, 1570, 7 USPQ2d 1057, 1063 (Fed. Cir. 1988)”.

In this instance patent owner is challenging the examiner's position that a quotation from col. 2, lines 43-62 of the patent under reexamination is admitted prior, even if it otherwise actually is prior art.



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The quotation from the specification is a description of the Internal Revenue Code section that defines the details of a GRAT type trust, along with the restrictions related to this particular type of instrument. It is clear that the inventor in this quoted section is not describing his own invention, but describing published IRS rules and procedures. Since the inventor of record is not the Internal Revenue Service, it is clear that the work being identified is that of another entity. Additionally, since this work was evidently known to the patent owner at the time of invention, it also constitutes prior art. (Note the statement by patent owner above, "*not necessarily denying...*", where patent owner does not refute the subject matter in question as being prior art). In accordance with MPEP 2129, the quoted statement in the patent specification constitutes an admission of work by another that is also prior art, hence the finding that it is admitted prior art. Pursuant to 37 CFR 1.104, it may also be applied in anticipation and obviousness type rejections.

(2) Patent owner at page 11, second paragraph states:

*"What does the Examiner think is prior art here? Is it the content of the discussed Treasury Regulations and the capabilities of the Software Packages? If so, why doesn't the Examiner simply cite to the Treasury Regulations themselves, and to the published information about the software packages?"*

The prior art is exactly what was identified as prior art in both the previous and current office action. There is no ambiguity as to what is being relied upon as prior art.

(3) Patent owner at page 12, last paragraph states:

*"First, Zaluda does not, in any real sense, disclose placing stock options in a GRAT".*

This assertion is not correct. The prior art must be taken on its face for what it teaches (*In re Heck*, 699 F.2d 1331, 1332-33, 216 USPQ 1038, 1039 (Fed. Cir. 1983)). The article to Zaluda teaches various different vehicles in which stock options can be placed, and one of the several vehicles mentioned is the GRAT type trust (Zaluda at page S-244, right column, last paragraph). Any speculative questions about whether Zaluda “really” or “seriously” teaches the application of stock option to a GRAT are not relevant, as this reference clearly teaches the usage of a GRAT as one type of vehicle for holding stock options.

(4) Patent owner at page 13, first paragraph states:

*“Second, neither Zaluda alone, nor Zaluda combined with other cited prior art references, presents an enabling disclosure that would permit a person having ordinary skill in the art to practice the claimed invention because they fail to satisfactorily address the valuation problems associated with stock options”.*

These are assertions are not correct. First, patent owner’s specification makes no mention of any critical valuation problems associated with valuing stock options in GRATs. To the contrary, patent owner's specification at col. 4, lines 15-17 acknowledges the existence of IRS approved procedures for valuing stock options at the time of invention. None of the original claims 1-25 make any mention of the criticality of valuation techniques, demonstrating that this is not a critical point in the construction of a GRAT, or a feature that would result in non-enablement.

Secondly, the Zaluda article was published in September 1997. Declarant states at page 9, first paragraph that installment sales to a grantor trust (i.e. a trust where the grantor receives installment payments, or GRAT) were being used by estate planning professionals beginning in

1995. If this is indeed the case, then any “valuation conundrums” would be resolved by 1995, two years before Zaluda published his article.

Third, Declarant is failing to consider the teachings of Rothschild, which was relied upon in the rejection of independent claims 1, 13 and 25 to teach the claimed valuation steps. The assertions of Declarant appear to be based exclusively on a consideration of the Zaluda reference by itself, without taking into account the teachings provided by Rothschild that directly address the valuation issue. One cannot show nonobviousness by attacking references individually where the rejections are based on combinations of references. *In re Keller*, 642 F.2d 413, 208 USPQ 871 (CCPA 1981); *In re Merck & Co., Inc.*, 800 F.2d 1091, 231 USPQ 375 (Fed. Cir. 1986).

(5) Patent owner at page 13, first paragraph states:

*“Third, although the Internal Revenue Service (“the IRS”) endorsed certain valuation models for stock options (like the Black-Scholes Model), the state of the art prior to the '790 patent strongly taught away from using them in the context of a GRAT.”.*

The IRS endorsement of any tax practice technique would not logically deter a practitioner from using that technique. Quite to the contrary, it appears to be evidence of a strong motivation to use that technique. The fact that a practitioner might be aware of other non-authorized techniques, even ones that produce far more favorable results, does not mean that a practitioner would risk possible legal sanctions by avoiding the authorized techniques and using only the unauthorized techniques.

(6) Patent owner at page 14, second paragraph states:

*“In the brief discussion of making a gift to a trust, the Zaluda article happens to mention that the trust could be a grantor trust, a GRAT or a GRUT. (Id., p. S-244.). The question arises,*

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*then, of whether the Zaluda article is simply making a show of completeness by providing a laundry list of different types of trusts - one of which happens to be a GRAT, or actually making a serious suggestion that stock options should be placed into a GRAT? The answer is clearly the former”.*

These assertions are not correct. The prior art must be taken on its face for what it teaches (*In re Heck*, 699 F.2d 1331, 1332-33, 216 USPQ 1038, 1039 (Fed. Cir. 1983)). The article to Zaluda teaches various different vehicles in which stock options can be placed, and one of the several vehicles mentioned is the GRAT type trust (Zaluda at page S-244, right column, last paragraph). Any speculative questions about whether Zaluda “accidentally” or “seriously” teaches the application of stock option to a GRAT are not relevant, as this reference clearly teaches the applications of stock options in a GRAT type vehicle.

(7) Patent owner at page 15, second paragraph states:

*“Given this general attitude of the tax and estate planning field regarding stock options, would a mere mention that a trust could be structured as a GRAT – without addressing any of the prospective concerns - constitute a legitimate teaching to put stock options into a GRAT? Clearly not. (See, e.g., Hesch declaration, pp. 6-7.)”.*

These assertions are not correct. The prior art must be taken on its face for what it teaches (*In re Heck*, 699 F.2d 1331, 1332-33, 216 USPQ 1038, 1039 (Fed. Cir. 1983)). The article to Zaluda teaches various different vehicles in which stock options can be placed, and one of the several vehicles mentioned is the GRAT type trust (Zaluda at page S-244, right column, last paragraph). Any speculative questions about whether Zaluda “accidentally”, “seriously”, or “legitimately” teaches the application of stock option to a GRAT are not relevant.

(8) Patent owner at page 15, third paragraph states:

*"The Zaluda article is not even internally consistent on the considerations involved with placing stock options into a trust. For instance, when discussing transferring stock options to a trust created for the benefit of family members, the Zaluda article states that: The executive should avoid retaining any interest in the trust which would include the trust assets in his estate for estate tax purposes. (Zaluda article, p. S-244.)"*

These assertions are not correct. The Zaluda article at page S-244, right column, second paragraph states: "The executive should avoid retaining any interest in the trust which would include the trust assets in his estate for estate tax purposes". A GRAT is defined as a "Grantor Retained **Annuity Trust**". The Grantor who establishes the trust, gifts the trust with certain assets, such as stock options. The Grantor then receives a future paying annual annuity in return for a fixed period of years. Once a grantor makes the initial gift, the grantor's interest in the trust is future annuity payments, not pre-existing assets already present in the grantor's estate. Stating that a grantor may not have an interest in the trust that includes assets already available in the grantor's estate is entirely consistent with the rules for operating a GRAT. No inconsistency is found from these statements.

(9) Patent owner at page 17, second paragraph states:

*"The Patent Owner appreciates that it is not relevant whether the Zaluda article was widely disseminated with respect to whether it qualifies as prior art. That is not the point of the foregoing observations - rather they show the true nature of what the Zaluda article actually discloses, or more accurately, doesn't disclose. The Zaluda article was in the BNA Tax Management Memorandum - it would have been read widely by those in the estate planning*

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*field. Despite that, the leaders in that field had never heard of placing stock options in a GRAT several years after the Zaluda article appeared. The only explanation for this attitude is that everybody dismissed the Zaluda article reference to GRATs as a mere passing reference, which was not taken seriously in the absence of any consideration of the concerns unique to stock options.”*

These assertions are not correct. The Zaluda article at page S-244 states: “This article discusses commonly used incentive plan alternatives and examines their use in in estate and gift tax planning”. In other words, Zaluda is providing a summary of otherwise well known techniques for placing stock options in tax vehicles for purposes of estate planning. As indicated at page S-244 of Zaluda in the last paragraph, one of those well known vehicles was a GRAT type trust. There is no evidence that “..everybody dismissed the Zaluda article..”

A second consideration is the fact that prior art is not defined by degree of acceptance. It is a fundamental principle of law that prior art is established by accessibility of information to the public, not degree of acceptance by the public (*In re Wyer*, 655 F.2d 221, 210 USPQ 790 (CCPA 1981); *Carella v. Starlight Archery*, 804 F.2d 135, 231 USPQ 644 (Fed. Cir. 1986); *In re Hall*, 781 F.2d 897, 228 USPQ 453 (Fed. Cir. 1986)). In the case of *Hall*, the prior art was actually a doctoral thesis shelved in a library, not even an article published in a widely read trade bulletin. This thesis was determined by the Federal Circuit to constitute prior art. With the present case of Zaluda being asserted by the USPTO as prior art, there is no requirement to demonstrate that Zaluda was widely adopted or accepted without reservations. It is only necessary to establish that it was published prior to the claimed invention and accessible to the

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public to determine that its content defines prior art. The publication of Zaluda by BNA demonstrates both the publication requirement and the accessibility requirement.

(10) Patent owner at page 18, second third paragraph states:

*"The Examiner looks to the Rothschild article's teaching of paying annuities from the trust property as teaching payment in kind, and simply asserts that "[a]s the value of the shares of stock is volatile, this necessarily requires performing a valuation at each annuity payment in order to determine the number of shares needed to make the fixed annuity payment." (Office Action, pp. 5-6.) Applicant respectfully submits that this position is an oversimplification, which overlooks GRAT requirements and the unique nature of stock options.*

*As described above, if an appraisal is performed to provide this valuation, it would have to be paid for. If the appraisal is performed solely for the benefit of the GRAT and paid for by the grantor, it will disqualify the GRAT. There is no recognition of this problem in the Zaluda article, much less any hint of a solution."*

These assertions are moot. None of the claims of record are concerned about who pays for the appraisal to determine the valuation of the stock options. Accordingly, it is not an issue that must be recognized or disclosed in the prior art. Since this is also a question that is outside the scope of any claims in this proceeding, it is not an issue that is subject to review in this proceeding (37 CFR 1.552(c)).

(11) Patent owner at page 18, last paragraph states:

*"The Rothschild article does not address valuation beyond a parenthetical "applying appropriate valuation methods".*

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Although it is unknown here to which claim or claim that patent owner is referring, presumably, reference is being made to the independent claims 1, 13 and 25. In each of these independent claims, there is no limitation on the actual valuation method being used. The only requirement is that some valuation of some type be made to stock option assets in the trust. Rothschild provides these teachings.

The article to Zaluda teaches various different vehicles in which stock options can be placed, and one of the several vehicles mentioned is the GRAT type trust (Zaluda at page S-244, right column, last paragraph). Rothschild at paragraphs 3, 7 and 9 then teach that the given trust must have its assets valued using appropriate valuation techniques (Rothschild at paragraph 9). None of the independent claims refer to the specific valuation method which is being used, so Rothschild is equally not required to contain such specifics.

(12) Patent owner at page 19, last paragraph through page 20 states:

*"When specifically questioned on how a GRAT trustee would know how many options to use if making a payment in kind to satisfy an annuity, in view of the GRAT document's silence on valuation, the following exchange occurred (with Mr. Lang's statements being preceded by "A. "):*

Q. And it's [the trust document] silent about whether the trustee would perform a valuation as each annuity comes due, right?

A. It is silent in terms of an express provision to that effect. But in my judgment, the trustee would be under a duty based on fiduciary duties that apply to trustees to have that valuation performed.

Q.

By what means?

A.

By getting an expert appraisal.



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Q.

Each year for the annuity?

A. Each year in which stock options would be used to pay the annuity, the trustee would be duty bound to obtain an appraisal.

Q. And do you think that would require an appraisal as opposed to simply relying on some approved model for valuation?

A. Yes, I think it would - it would require an appraisal. (Id., Appendix B., pp. 164-165; [bracketed text] added.)

*Thus, even a practitioner claiming to have attempted actually placing stock options into a GRAT was not cognizant of the significant valuation issues arising in connection therewith, and believed it was necessary to use an expert appraisal that would, in fact, disqualify the GRAT."*

For purposes of a statutory reexamination proceeding (35 USC 303; 35 USC 304), the testimony of Mr. Lang is not relevant. None of the claims of record, nor patent owner's specification makes any reference to the need for expert appraisal or the concept that such appraisal might disqualify the GRAT. Since the reexamination involves an examination of the claims issued in a patent (35 USC 304; 37 CFR 1.510), subject matter which delves outside the scope of those claims is not subject to review in a reexamination proceeding (37 CFR 1.552 (c)).

It is also noted that scope of a reexamination proceeding is limited to the consideration of patents and printed publications in view of the claims subject to reexamination (37 CFR 1.552(a)). There is no evidence that the subject matter being discussed by Mr. Lang pertains to either patents or printed publications, and thus this discussion is outside the statutorily defined scope of a reexamination proceeding.

(13) Patent owner at page 21, first paragraph states:

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*“The '790 patent makes reference to Revenue Procedure 98-34 ("Rev. Proc. 98-34") with respect to how to value stock options. Using such models allows valuation to be performed with readily available software, instead of requiring a professional appraisal. Thus, the appraisal problem is avoided. However, the Examiner should not suppose that the mere fact the IRS endorsed such models for option valuation would have led the skilled practitioner, back in 1999, to use them.”*

None of the claims of record make any reference to a requirement for a professional appraisal, so any assertions pertaining to such requirements are moot. None of the original patent claims 1-25 as well provide any indication of what type of valuation method is used, so there is no requirement that the prior art provide analysis or consideration of the "best valuation method", or the usage of IRS Revenue Procedure 98-34. Newly added claims 27, 31 and 35 do address a specific valuation technique using the Black Scholes formula variables, but this technique is fully taught by the reference Introduction to the Black Scholes Model cited in this action.

(14) Patent owner at page 21, second paragraph states:

*“The first factor to consider is, that when it came to valuing GRAT assets for tax purposes, discounting was the name of the game. The assets had to appreciate or otherwise generate returns in excess of the § 7520 rate used to determine the present value of annuity payments or the GRAT would be a failure. By using assets that an appraiser could discount, artificial appreciation could be introduced later in the asset's life to facilitate meeting the tax objectives of the GRAT. (See, e.g., Hesch declaration, pp. 2-4; see particularly, paragraph 6.) Rev. Proc. 98-34, on the other hand, expressly forbade discounting the value of stock options. (See, e.g., Hesch declaration, p. 10)”.*

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These assertions are moot. Patent Owner's patent specification makes no mention of discounting assets after they have been valued, nor is any mention of it made in the claims of record. The patent owner does not recognize this concept in the original disclosure, so there is no requirement that this issue be recognized in the prior art.

Even assuming for the sake of discussion that a person of ordinary skill in the art would have been aware of the possibility of discounting assets after valuation, this does not mean that this same skilled artisan would have been deterred from using a lawfully sanctioned valuation technique, even one that prohibits discounting. It is reasonable to conclude that a person of ordinary skill in the art of estate planning would be mindful of possible criminal and civil liability problems which would arise if a valuation technique were used that was not appropriately approved for use, even if that technique produced more desirable valuation results.

(15) Patent owner at page 22, last paragraph states:

*"There is simply no principled basis for assuming that just because the regulations necessary to allow a given tax minimization tool to work are all out there, that the invention is necessarily obvious".*

The USPTO is not asserting that the mere existence of tools necessary to operate are GRAT are sufficient to teach the claimed invention would have been obvious. In each of the statutory rejections, reasons for obviousness are provided, in addition to the statutory rejections. These reasons are fully consistent with current law for determining obviousness (*KSR International Co. v. Teleflex Inc. (KSR)*, 550 U.S. 398, 82 USPQ2d 1385 (2007); *Graham v. John Deere*, 383 U.S. 1, 148 USPQ 459 (1966)) and establish a *prima facie* case of obviousness in each instance.

**Conclusion**

Patent owner's amendment filed October 12, 2011 necessitated the new grounds of rejection presented in this Office action. Accordingly, **THIS ACTION IS MADE FINAL**. See MPEP § 706.07(a).

A shortened statutory period for response to this action is set to expire TWO MONTHS from the mailing date of this action.

**Extensions of time under 37 CFR 1.136(a) do not apply in reexamination proceedings.** The provisions of 37 CFR 1.136 apply only to "an applicant" and not to parties in a reexamination proceeding. Further, in 35 U.S.C. 305 and in 37 CFR 1.550(a), it is required that reexamination proceedings "will be conducted with special dispatch within the Office."

**Extensions of time in reexamination proceedings are provided for in 37 CFR 1.550(c).** A request for extension of time must be filed on or before the day on which a response to this action is due, and it must be accompanied by the petition fee set forth in 37 CFR 1.17(g). The mere filing of a request will not effect any extension of time. An extension of time will be granted only for sufficient cause, and for a reasonable time specified.

The filing of a timely first response to this final rejection will be construed as including a request to extend the shortened statutory period for an additional month, which will be granted even if previous extensions have been granted. In no event, however, will the statutory period for response expire later than **SIX MONTHS** from the mailing date of the final action. See MPEP § 2265.

**All** correspondence relating to this ex parte reexamination proceeding should be directed:

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By Mail to: Mail Stop *Ex Parte* Reexam  
Central Reexamination Unit  
Commissioner for Patents  
United States Patent & Trademark Office  
P.O. Box 1450  
Alexandria, VA 22313-1450

By FAX to: (571) 273-9900  
Central Reexamination Unit

By hand: Customer Service Window  
Randolph Building  
401 Dulany Street  
Alexandria, VA 22314

Any inquiry concerning this communication should be directed to the Central  
Reexamination Unit at telephone number at (571) 272-7705.

/Sam Rimell/

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Sam Rimell

Primary Patent Examiner

Central Reexamination Unit 3992

/C. S./

Primary Examiner, Art Unit 3992

/Matthew L. Brooks/  
CRU SPE 3992



US006567790B1

(12) **United States Patent**  
Slane

(10) Patent No.: **US 6,567,790 B1**  
(45) Date of Patent: **May 20, 2003**

(54) **ESTABLISHING AND MANAGING GRANTOR RETAINED ANNUITY TRUSTS FUNDED BY NONQUALIFIED STOCK OPTIONS**

(75) Inventor: **Robert C. Slane, Maitland, FL (US)**

(73) Assignee: **Wealth Transfer Group, L.L.C., Altamont Springs, FL (US)**

(\*) Notice: Subject to any disclaimer, the term of this patent is extended or adjusted under 35 U.S.C. 154(b) by 0 days.

(21) Appl. No.: **09/453,364**

(22) Filed: **Dec. 1, 1999**

(51) Int. Cl.<sup>7</sup> ..... **G06F 17/60**

(52) U.S. Cl. .... **705/36**

(58) Field of Search ..... **705/36, 35, 37**

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Estate Planning & Taxation Coordinator, Grantor Retained Annuity Trust (GRAT), ¶ 39,141, Sep. 7, 1999.

Title 26—Internal Revenue Code, Subtitle A, Chapter 1, Subchapter P, Part V, Subpart A, Sec. 1274, Jan. 26, 1998.

(List continued on next page.)

Primary Examiner—Robert P. Olszewski

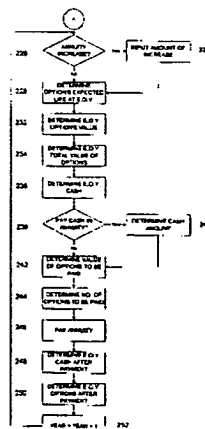
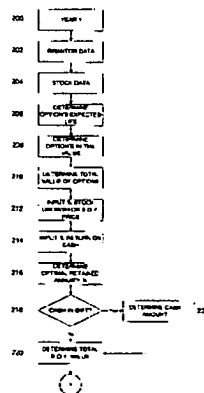
Assistant Examiner—Andrew J. Fischer

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(57) **ABSTRACT**

An estate planning method for minimizing transfer tax liability with respect to the transfer of the value of stock options from a holder of stock options to a family member of the holder. The method comprises establishing a Grantor Retained Annuity Trust (GRAT) funded with nonqualified stock options. The method maximizes the transfer of wealth from the grantor of the GRAT to a family member by minimizing the amount of estate and gift taxes paid. By placing the options outside the grantor's estate, the method takes advantage of the appreciation of the options in said GRAT. In one embodiment the method also maximizes the amount transferred to the family member by keeping as many of the options as possible in the GRAT until immediately prior to the termination of the GRAT, when the grantor substitutes an equivalent value of assets into the GRAT for the remaining options, and then exercises the options. The method is used for evaluation purposes in establishing the GRAT, and responds to a variety of grantor-selected options. An Irrevocable Life Insurance Trust (ILIT) may also be established to provide life insurance should the grantor die before the termination of the GRAT. If the GRAT continues until its natural termination date the ILIT will receive the assets of said GRAT and may purchase further life insurance on the grantor.

**25 Claims, 5 Drawing Sheets**



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FIG. 1

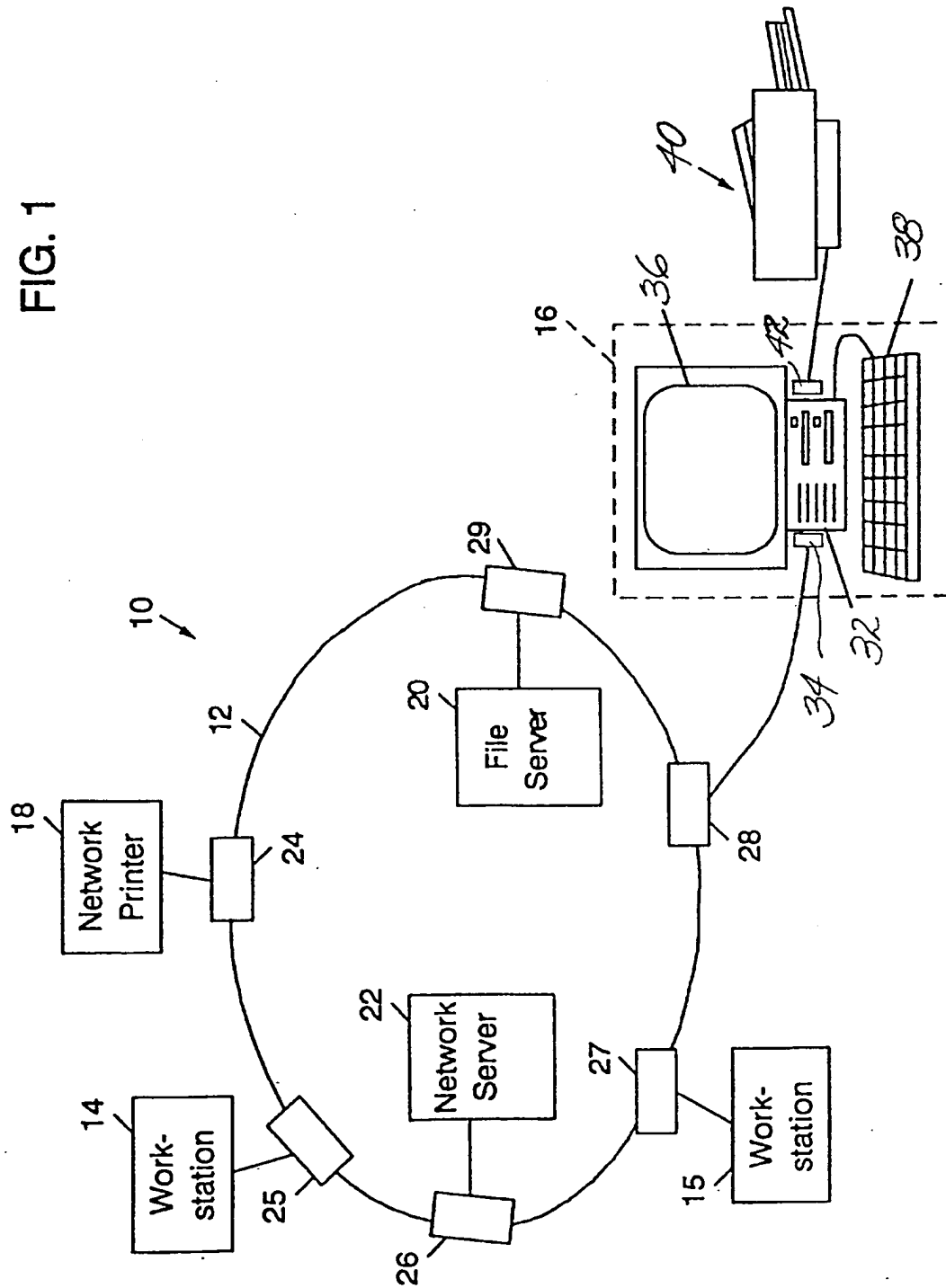
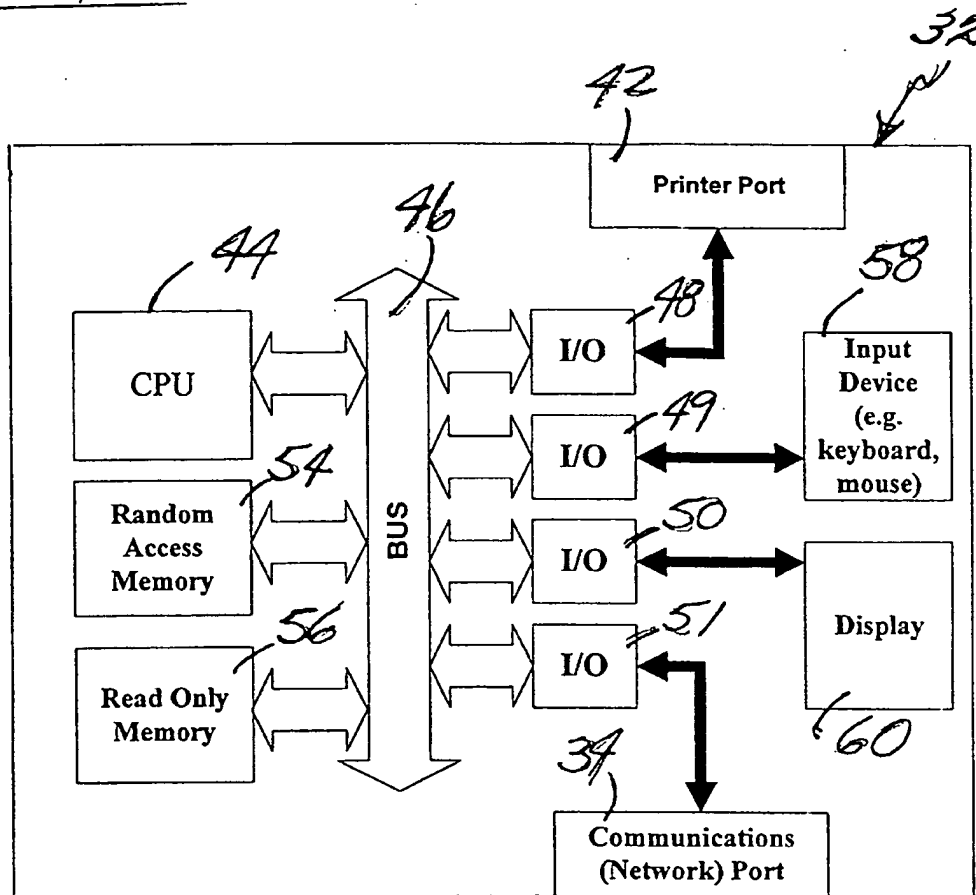




FIG 2.

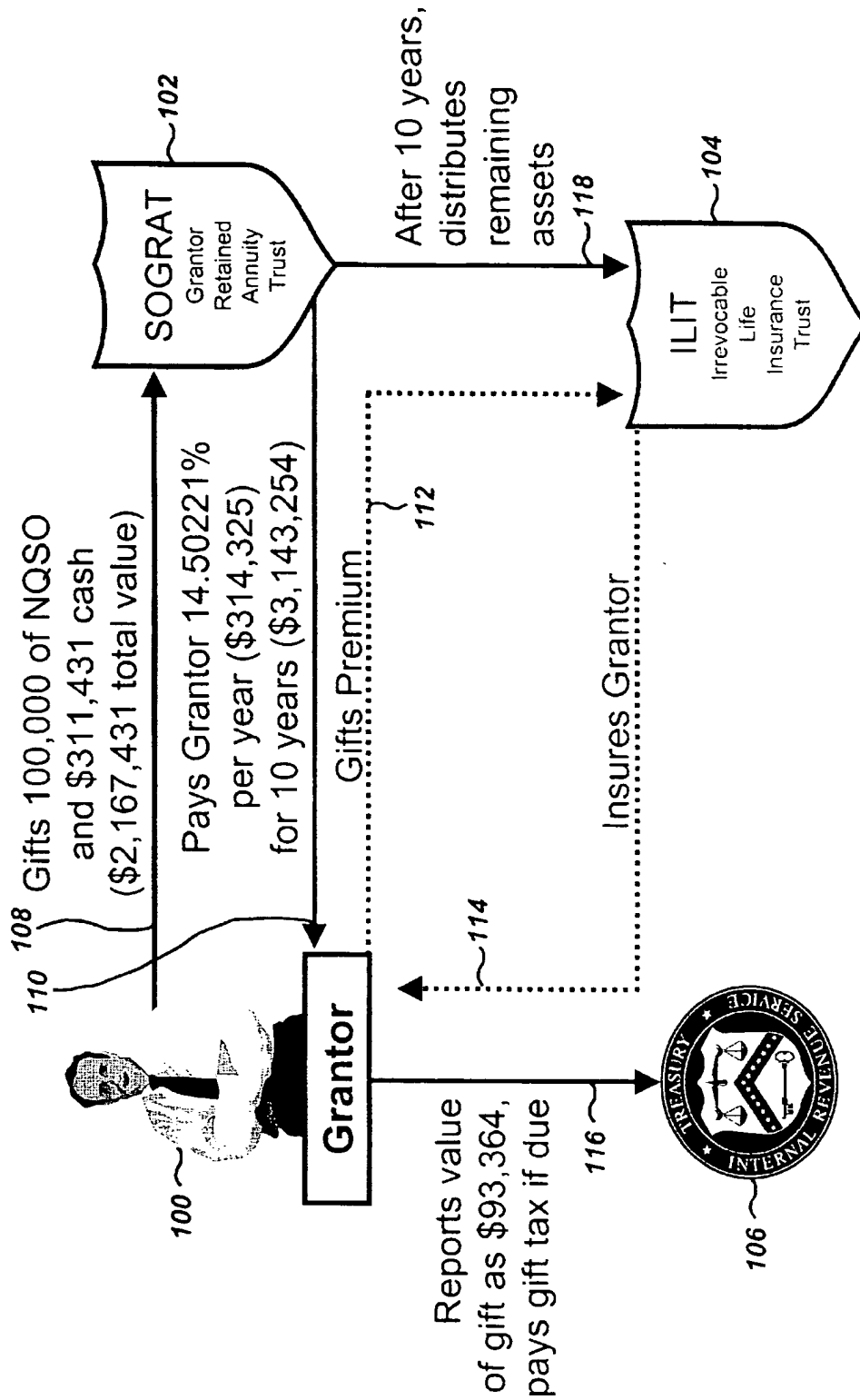
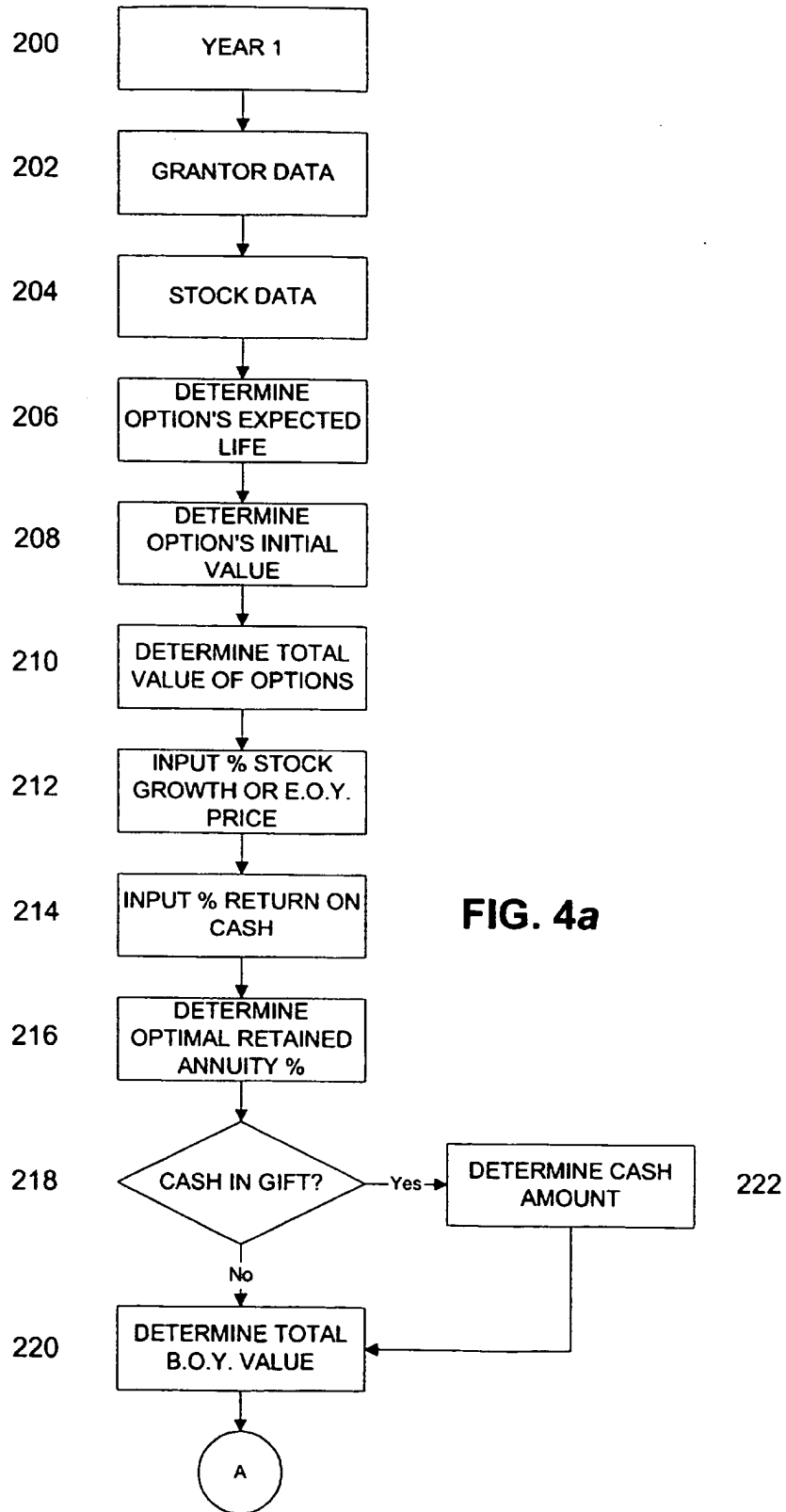


FIG. 3



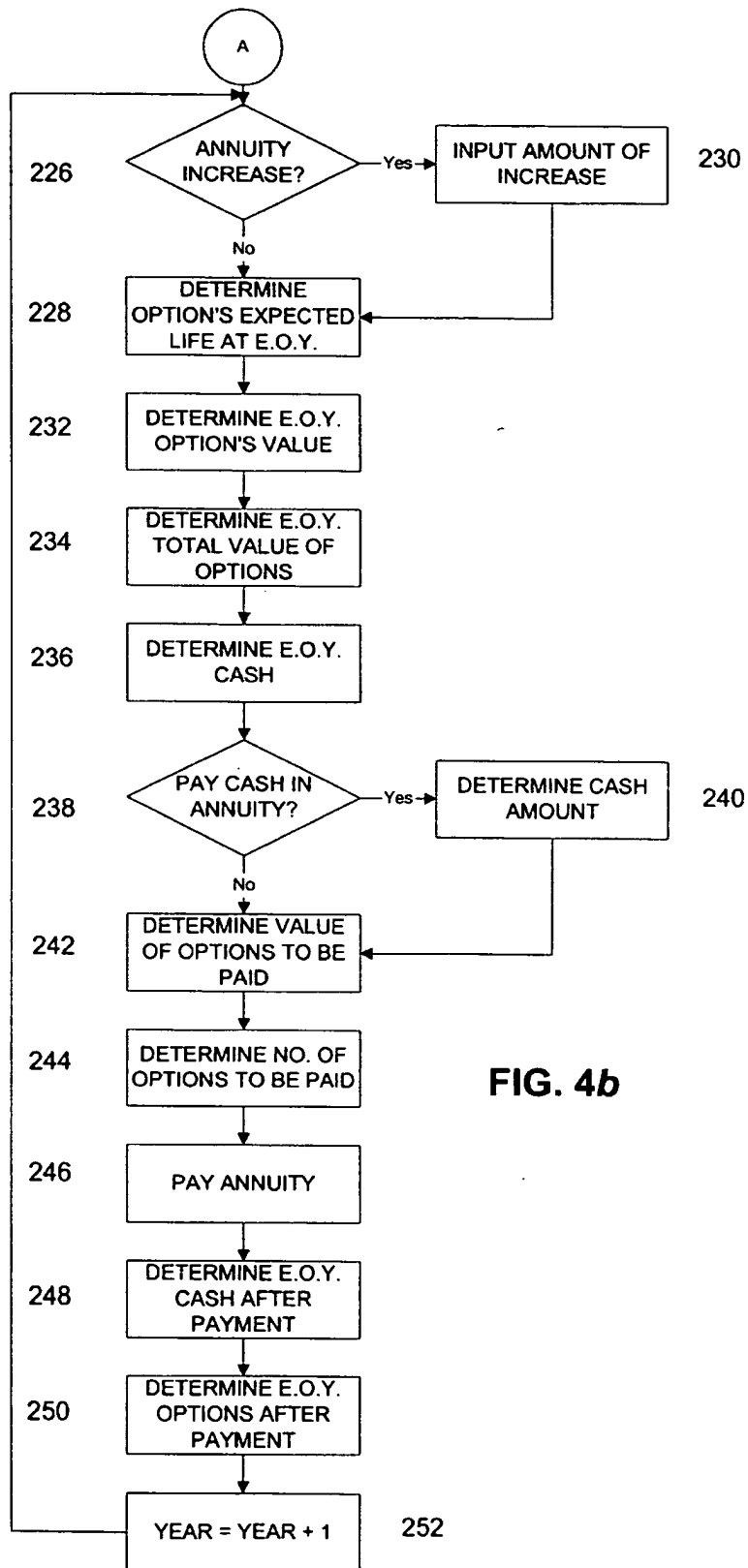


FIG. 4b

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# ESTABLISHING AND MANAGING GRANTOR RETAINED ANNUITY TRUSTS FUNDED BY NONQUALIFIED STOCK OPTIONS

## TECHNICAL FIELD

The present invention relates to estate planning, and more particularly, to a method for minimizing tax liability with respect to the transfer of stock options from a holder of stock options to a family member of the holder.

## BACKGROUND ART

Corporations are increasingly awarding their directors and key employees nonqualified stock options, which give the recipient the right to purchase stock at a predetermined exercise price. The right to purchase the stock may begin either immediately or after the end of a vesting period, and may end after periods of, for example, five or ten years. In 1996, a change in the securities law (Rule 16b-3 of the Securities and Exchange Commission regulations) eliminated a nontransferability requirement for options in order to qualify for the exemption from insider trading under that rule. Therefore, many corporations have recently allowed nonqualified stock options to be gifted by recipients to family members or to trusts for their family members' benefit.

Income tax is incurred on the difference between the fair market value of the stock at the time of exercise of the options and the exercise price. Gift tax is incurred at the time the gift of the options is completed, and estate tax is incurred when options or the value realized from the exercise of the options held by a decedent are passed on to heirs or devisees. Estate planning is used to try to minimize the transfer tax liability on the transfer of assets from the option holder to a family member.

While known approaches to estate planning have had and will continue to have their benefits, they require substantial estate and gift taxes to be paid. For many holders of nonqualified stock options, estate and gift transfers are taxed at up to a 55% rate, and in some instances 60%, contributing to significant depletion of wealth. As the use of stock options in compensation has increased, the need for a method to address the transfer tax consequences has become more important.

## DISCLOSURE OF INVENTION

The object of the present invention is to provide a means by which a holder of nonqualified stock options may transfer the value of the options to family members with minimum transfer tax liability.

According to the present invention, the holder (grantor) establishes a Grantor Retained Annuity Trust (GRAT) and transfers stock options and possibly other assets to the GRAT. The grantor retains a right to receive an annuity amount stated as a percentage of the initial transfer. The annuity payment comprises cash, stock options, or other assets. At the end of the GRAT's term, the assets of the GRAT are distributed to one or more family member beneficiaries or a trust for the family member's benefit. The taxes on the transfer of assets are minimized by (1) calculating an optimum annuity percentage to reduce the value of the taxable gift, and (2) minimizing estate taxes through use of the GRAT. The present invention also determines the length of the term of the GRAT, beginning and end of year

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asset value, and the form of payment of the annuity each year based on either estimated or actual input variables as selected by the user.

These and other objects, features, and advantages of the present invention will become more apparent in light of the following detailed description of a best mode embodiment thereof, as illustrated in the accompanying Drawings.

## BRIEF DESCRIPTION OF DRAWINGS

FIG. 1 is a figurative illustration of a network in which the present invention may be used;

FIG. 2 is a block diagram illustration of one of the functional elements of the embodiment of FIG. 1;

FIG. 3 is a figurative illustration of the elements included in an exemplary performance of the invention; and

FIGS. 4a and 4b are a flow chart diagram of a preferred embodiment of the present invention.

## BEST MODE FOR CARRYING OUT THE INVENTION

One goal of estate planning is to minimize the gift and estate taxes incurred on the transfer of wealth within a family from one generation to the next. Irrevocable trusts are frequently used for this purpose, with the creator (grantor) of the trust naming beneficiaries who will receive the assets of the trust at its termination. A GRAT is a special type of irrevocable trust under which the grantor transfers assets to the trust and is paid a term annuity from the trust. At the end of the GRAT term any remaining assets are distributed to the named beneficiaries.

The present invention is a method for estate planning that transfers wealth by funding a GRAT with nonqualified stock options, and cash if desired. This type of GRAT is also referred to as a SOGRAT<sup>TM</sup> (Stock Option Grantor Retained Annuity Trust). The method combines known approaches to the wealth transfer techniques of GRATs and stock options in a novel way.

SOGRAT is a trademark of The Wealth Transfer Group Inc., and an application for registration of the mark has been submitted to the U.S. Patent and Trademark Office.

Under the Internal Revenue Code, a GRAT is a trust in which the grantor retains a qualified annuity interest. As specified in Treasury Regulation §25.2702-2(a)(6), a qualified annuity interest is any interest that consists of the right to receive fixed amounts not less frequently than annually. Herein, an annuity is a payment made not less frequently than annually. To conform with Treasury Regulation §25.2702-3(b) and (d), a GRAT must meet several requirements including but not limited to (1) the interest retained by the grantor must be an irrevocable right to receive a fixed annuity amount, which may exceed the prior year's annuity amount by up to twenty percent, (2) the governing instrument of the trust must prohibit additional contributions to the trust, (3) the governing instrument must prohibit distributions to anyone other than the grantor for its term, and (4) the governing instrument must fix the term of the GRAT, which can be a term of years or for the life of the grantor, or for the shorter of those periods. The GRAT term should be at least two years and can be as long as the grantor chooses.

When any assets, including stock options, are transferred to a GRAT a percentage of the original value of the assets in the GRAT must be selected for the annuity to the grantor. The grantor is responsible for paying any gift tax due. The gift tax is based on the value of the gift, which is calculated

from the original value of the GRAT assets less the present value of the annuity payments, and including a mortality factor. As stated in Internal Revenue Code Sec. 7520(a)(2), the interest rate used in calculating the gift value is 120% of the federal midterm rate for the month in which the transfer falls, in effect under Code Sec. 1274(d)(1). At the end of the GRAT's term the remaining assets in the GRAT, in this case, stock options or other GRAT assets, go to the beneficiaries of the GRAT, who are the grantor's selected family members or a trust for their benefit (for discussion purposes herein the text will refer to the children). In the preferred embodiment, at the end of the last year of the GRAT's term the grantor substitutes cash into the GRAT in place of the assets remaining in the GRAT. The GRAT will have full benefit of the appreciation of the options that occurred within the GRAT.

In a best mode embodiment of the present invention, the steps of the method are encoded in a software program which may be adapted for execution on any one of a variety of known type signal processing devices in any one of a number of different operating system protocols. Depending on the size of a financial service, there may be one or more professionals providing financial services to one or more clients simultaneously. Therefore the software is equally adapted for installation and use in a standalone signal processor, or for installation in a file server environment for local network applications. In a best mode, the software program for the invention may be used in Microsoft Excel<sup>2</sup> software, is programmed in Visual Basic 6<sup>3</sup> or a similar program, and operates on a WINDOWS 95<sup>4</sup> or higher operating system. For network installations the operating system is WINDOWS NT<sup>5</sup> or higher with Microsoft Excel installed in each workstation performing the invention. The minimum workstation (PC) RAM memory is 4 MB, and 8 MB is preferred. Also the preferred PC peripherals are a hard disk and a CD ROM drive. The software program may be stored on a network server or hard drive, or on a portable storage medium such as diskettes, CD ROM, tape drive, or any other such storage medium known by those skilled in the art to be suitable for such purposes.

<sup>2</sup>Microsoft Excel is a registered trademark of the Microsoft Corporation.

<sup>3</sup>Visual Basic 6 is a registered trademark of the Microsoft Corporation.

<sup>4</sup>WINDOWS 95 is a registered trademark of the Microsoft Corporation.

<sup>5</sup>WINDOWS NT is a registered trademark of the Microsoft Corporation.

FIG. 1 is a figurative schematic illustration of such a local area network (LAN) 10 in which a landline 12, or other type communications medium, interconnects several workstations 14-16, a network printer 18, a file server 20, and a network server 22; each connected to the network medium through network interface cards (NICs) 24-29. The network may have any one of a number of known network topologies. The networked devices communicate with each other in the signal protocol established by the network operating system software, which is installed in the network server 22.

Each of the workstations, as shown by the workstation 16, include a computer based signal processor 32 connected through a communication port 34 to the network through NIC 28, thereby allowing the work station 16 to communicate with the other network connected workstations 14, 15, the network printer 18, the file server 20, and the network server 22. The workstation 16 further includes a user/operator viewable display 36 and an operator responsive input signaling device 38. The input signaling device is of a known type, such as a keyboard, mouse, or any other known type input signaling device which may be considered suitable by those skilled in the art for use in the operation of the invention. Preferably, the workstation 16 includes a local printer 40, which is connected to a printer port 42 of the

signal processor 32. For purposes of the present invention the printer may be any one of the various known types of print imaging devices.

FIG. 2 is a simplified schematic diagram of the signal processor 32, which includes a central processing unit (CPU) 44 connected through a Universal Signal Bus (USB) 46 to a plurality of input/output (I/O) devices 48-51, to a volatile random access signal memory (RAM) 54, and a non-volatile read only memory (ROM) 56. The I/O devices 48-51 connect the CPU 44 to the signal processor's printer port 42, the input signaling device port 58, the display port 60, and the communications port 34.

FIG. 3 is an exemplary illustration of the present invention. First, not shown in FIG. 3, the stock options are valued using the Black-Scholes model endorsed in IRS Revenue Procedure 98-34. Other models may be used so long as the option value is based on (1) the option's exercise price, (2) the underlying stock's current price, (3) the underlying stock's expected volatility, (4) the underlying stock's expected dividend yield, (5) the risk-free interest rate over the remaining term of the option, and (6) the option's expected life. The exercise price is in the recipient's stock option contract, and the stock's current price is readily available. Volatility is the measure of the tendency of a stock price to change, and under the Statement of Financial Accounting Standards No. 123 is required: to be disclosed in the company's financial statements, as is item (4), the stock's expected dividend yield. The dividend yield is the expected dividend payment divided by the stock's average price. Item (5), the risk-free interest rate is published in the financial section of most business publications and is the yield on a zero-coupon Treasury bond with a remaining term equal to the option's remaining life. The last item, the option's expected life, is to be calculated by one of two methods, either the "maximum remaining term" or the "computed expected life," also set forth in Revenue Procedure 98-34. Assumed data is provided in Table 1 hereinbelow.

In the example shown in FIG. 3, the grantor 100 transfers \$311,431 in cash and 100,000 nonqualified stock options 108 to a ten-year GRAT 102. The cash is included to be used to pay the annuity in case the value of the options decreases, in order to keep the options in the GRAT 102 for as long as possible. The annuity amount is fixed and will require more options to reach that fixed amount if the options have decreased in value. The optimum annuity 110 is that which results in the lowest possible gift, and is determined by calculating an annuity payment that will as closely as possible equal on a present value basis the principal contributed to the GRAT. The calculation complies with IRS Revenue Ruling 77-454 and various regulations, including Treasury Reg. §25.7520-3(b)(2)(v) Example 5. Computer software applications are available that perform this calculation, such as NumberCruncher by Leimberg & LeClair, Inc., of Bryn Mawr, Pa. and zCalc by Lexcite Development, LLC of Arlington Heights, Ill. The optimum annuity percentage in the example in FIG. 3 is 14.50221% of the assets transferred to the GRAT 102, or \$314,325. The cash will be paid out of the GRAT 102 first, allowing the options to have more time to appreciate, the goal being to maximize the number of options left in the GRAT at the end of the GRAT term. The gift is valued at \$93,364 based on the value of the assets transferred to the GRAT less the present value of the annuity and a mortality component. The grantor 100 must pay at a rate of up to 60% of the gift value as the gift tax 116 to the IRS 106 in an amount as high as \$56,018.

TABLE 1

Assumptions	
Executive or Director Recipient of Options	Age 55
Income Tax Bracket	40%
Estate Value	\$20,000,000
Estate Tax Bracket	55%
Prior Taxable Gifts	\$3,000,000
Marginal Gift Tax Bracket	55%
Stock Price at time of Grant	\$50.00
Date	
Exercise Price	\$50.00
Stock Volatility (trailing 60 months)	20%
Expected Dividend	1.5%
Risk Free Interest Rate	6%
Options' Expected Life	10 Years
Stock Appreciation	15% per Year

Over a ten-year term for the GRAT 102, assuming appreciation of the value of the stock of 15% and 4% on the cash, the grantor 100 will have received \$3,143,254 of value. The composition of the annuity each year is shown in Table 2.

TABLE 2

Year	Cash Paid	Options Paid
1	\$314,325.44	0
2	\$8,947.22	10,451
3	\$21.32	8,604
4	\$33.38	6,906
5	\$11.08	5,569
6	\$15.62	4,514
7	\$4.85	3,681
8	\$3.84	3,020
9	\$112.34	2,490
10	\$19.52	2,064

In this example, most of the cash is paid out first. Here, the cash from year two is the earned interest on the gifted cash. The "options paid" quantity is calculated each year based on the value of the options that year, and always yields the value approximately required to pay the annuity 110. Options must be paid in the annuity in whole numbers; a fraction of an option cannot be paid. Because it is unlikely that the number of options to be paid will exactly equal the required annuity amount, a small amount of cash is retained in order to supplement the options to meet the required annuity payment each year. In addition, there will be 52,701 options remaining in the GRAT 102 at the end of the term, with a total value of \$8,025,308, plus \$1,118 remaining in cash for a total GRAT value of \$8,026,426. Prior to the end of the GRAT, the grantor 100 substitutes in an equivalent value of cash. The grantor then exercises the accumulated stock options and sells all shares to cover taxes and the cash substitution. Dollar figures are rounded to the nearest thousand hereinafter. He exercises the 100,000 options and receives 100,000 shares of stock having a value of \$20,228,000. His exercise price is \$50 per share for a total cost of \$5,000,000, leaving him with taxable income of \$15,228,000. Assuming an immediate total liquidation of all stock received from the award of the options the grantor receives \$15,228,000 in cash payment. At a 40% income tax rate, the grantor 100 pays income tax on the \$15,228,000 difference for a tax of \$6,091,000 and has a total of \$9,137,000 in after-tax cash received by exercising the options. Subtracting the \$8,025,000 he substituted into the GRAT from the cash received he nets \$1,112,000.

In the basic embodiment of the present invention, the GRAT 102 will then distribute its remaining assets to the grantor's children. In the best mode, shown in FIG. 3, the GRAT 102 will instead distribute the assets to an Irrevocable Life Insurance Trust (ILIT) 104. The ILIT 104 is ideally set up when the GRAT 102 is started, funded 112 with gifts from the grantor 100. The purpose of the ILIT 104 is to provide a life insurance policy insuring 114 the grantor 100 that can cover the estate taxes if the grantor 100 dies before the natural expiration of the GRAT 102, whereupon all the assets of the GRAT 102 go to the grantor's estate, depending on the terms of the GRAT. The policy has the ILIT 104 as its named beneficiary, and the children are the ultimate beneficiaries of the ILIT. In addition, if the grantor 100 lives to the end of the term of the GRAT 102, the assets distributed to the ILIT 104 would be available to be used to purchase additional life insurance, for a split dollar rollout, or continued premium payment. Split dollar agreements most frequently occur in the employer/employee context, often with the employer corporation paying most of an insurance premium and the employee paying the remainder. If the employee wishes to acquire the policy in full, the employee must reimburse the corporation for all premiums advanced by the corporation. This is referred to as a rollout. The funds for the rollout could come from the GRAT assets that are distributed to the ILIT. Also, the proceeds of the life insurance could be used to buy assets from, the estate upon the death of the grantor 100 as a means to get cash into the estate to pay the estate taxes (it is not tax efficient for the ILIT to pay the estate taxes directly).

FIGS. 4a and 4b are a flow chart depicting the decision-making process for establishing the GRAT funded by non-qualified stock options. A portion of the chart is also used to manage the assets of the GRAT during its term. When the GRAT is established at the beginning of year one 200, grantor data 202 is input. Grantor data 202 on the grantor includes age, highest income tax bracket, estate value, and estate and gift tax bracket. Stock data 204 includes the number of options granted, the stock price at the grant date, the exercise price of the options, the stock volatility and expected dividend yield as listed in the company's financial statements, and the risk free interest rate. From the grantor data 202 and stock data 204 the option's expected life 206, initial value 208, and total value 210 may be calculated. As previously discussed, the option's expected life 206 is calculated using one of two methods included in IRS Revenue Procedure 98-34, either the "maximum remaining term" or the "computed expected life." The option's value 208 is determined using a model such as the Black-Scholes model, also endorsed in IRS Revenue Procedure 98-34. The total value of the options 210 is the number of options multiplied by the initial value of the options 208.

Additional data provided by the grantor includes the estimated stock growth or estimated end of year stock price 212 over the life of the GRAT and the estimated return on cash investment 214. A retained annuity percentage is calculated to minimize the valuation of the gift to the GRAT. In accordance with IRS Code Section 7520, the gift is valued as the total value of the assets originally placed in the GRAT less the present value of the annuity payments, factoring in a mortality component.

The grantor must decide if cash is to be included 218 in the initial transfer. The benefit of cash in the transfer is that if the options do not appreciate in the first year or more of the GRAT, the cash will be used to pay the annuity instead of depleting the options from the GRAT. The options will stay in the GRAT longer than they would otherwise, giving

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them the opportunity to appreciate. The amount of cash in the transfer is determined 222 as an amount equal to one annuity payment on a present value basis with the interest rate being the assumed rate of return on cash. The beginning of year value 220 is the total of the options' value 210 plus the cash in the transfer 222.

The annuity is allowed to increase each year 226. The amount of the increase is limited to 20% of the prior year's annuity, and must be set prior to the start of the GRAT. The amount of increase 230 is determined by the grantor's preference. In year one, and possibly all years, there will be no increase. Next, the option's expected life at the end of year one is one year less than the initial option's life 208. The end of year option value 228 is calculated using estimated stock data 204. The end of year total option value 234 is determined by multiplying the number of options times the option value 228. The end of year cash 236 is determined based on the estimated interest rate.

A decision 238 is required whether or not to pay cash or other GRAT assets other than options in the annuity. As previously discussed, it is preferable to pay cash or other assets first in order to give the options additional time to appreciate, with the goal being to leave to greatest number of options in the GRAT as possible at the end of the GRAT's term. In the preferred embodiment, the amount of cash to be included in the annuity is therefore determined 240 by paying as much of the first annuity with cash as possible. Deducting that amount from the annuity results in the value of the options to be paid 242, from which the number of options to be paid 244 can be readily determined by dividing by the end of year option's value 232. The annuity is then "paid" 246, or in other words subtracted from the value of the assets in the GRAT in order to calculate the estimated end of year value of the GRAT. The end of year cash after payment 248 and end of year options after payment 250 of the annuity are then found by subtraction. The end of year cash after payment 248 and end of year options after payment 250 become the beginning of year values for year two, and the process repeats, starting with deciding if the annuity increases 226, and continuing through the end of the GRAT. This will result in an estimate that shows most of the cash and some of the options returned through the annuity to the grantor, and some of the options still in the GRAT. The goal is to maximize the options left in the GRAT at its end. The terms of the GRAT allow the grantor to substitute assets of equivalent value, most likely cash, into the GRAT immediately prior to the GRAT's termination. The method of the present invention has allowed the grantor to have an estimate of the transactions that will occur over the life of the GRAT.

The present invention is also useful to manage the GRAT throughout its term. Starting with choosing if the annuity will increase 226, each of the values is recalculated each year using actual rather than estimated data.

Although the invention has been shown and described with respect to a best mode embodiment thereof, it should be understood by those skilled in the art that various changes, omissions, and additions may be made to the form and detail of the disclosed embodiment without departing from the spirit and scope of the invention, as recited in the following claims.

What is claimed is:

1. A method for minimizing transfer tax liability of a grantor for the transfer of the value of nonqualified stock options to a family member grantee, the stock options having a stated exercise price and a stated period of exercise, the method performed at least in part within a signal processing device and comprising:

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establishing a Grantor Retained Annuity Trust (GRAT); funding said GRAT with assets comprising stock options, the stock options having a determined value at the time the transfer is made;

setting a term for said GRAT and a schedule and amount of annuity payments to be made from said GRAT; and performing a valuation of the stock options as each annuity payment is made and determining the number of stock options to include in the annuity payment.

2. The method of claim 1 wherein the amount of the annuity is set by determining an optimum percentage of said GRAT assets that will be said annuity with the purpose of reducing the taxable gift value.

3. The method of claim 1 wherein the step of funding includes contributing supplemental assets in addition to the stock options.

4. The method of claim 3 wherein said supplemental assets comprise an amount of cash.

5. The method of claim 4 wherein the amount of cash to be included in said transfer to said GRAT is equal to at least the first year's annuity, whereby the cash may be used to defer the payment of said options in said annuity by including some or all of said cash in at least one annuity payment, thereby reducing the number of said options required to be paid as part of said annuity, and increasing the number of said options remaining in said GRAT.

6. The method of claim 5 wherein the amount of cash comprises an additional amount of cash at least equal to the total of the end of year evaluated option values for one option for each year in the life of the GRAT, whereby said additional amount of cash may be used to pay the difference each year between the required annuity payment and the value of the options included in the annuity payment.

7. The method of claim 4 wherein the amount of cash to be included in said transfer to said GRAT is equal to at least the first year's annuity on an estimated present value basis assuming a rate of return on the cash in said GRAT, whereby the cash may be used to defer the payment of said options in said annuity by including some or all of said cash in at least one annuity payment, thereby reducing the number of said options required to be paid as part of said annuity, and increasing the number of said options remaining in said GRAT.

8. The method of claim 7 wherein the amount of cash comprises an additional amount of cash at least equal to the total of the end of year evaluated option values for one option for each year in the life of the GRAT, whereby said additional amount of cash may be used to pay the difference each year between the required annuity payment and the value of the options included in the annuity payment.

9. The method of claim 3 wherein said supplemental assets comprise an amount of stock.

10. The method of claim 1 further comprising the step of removing some or all of the stock options from said GRAT and substituting into said GRAT assets of equivalent value.

11. The method of claim 10 wherein the step of removing some or all of the stock options and substituting into said GRAT assets of equivalent value is performed following the final annuity payment but prior to the termination of said GRAT.

12. The method of claim 1 further comprising the step of determining the term of said GRAT depending on the grantor's life expectancy and the nonqualified stock option life expectancy.

13. A method for minimizing transfer tax liability of a grantor for the transfer of the value of nonqualified stock options to a family member grantee, the stock options



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having a stated exercise price and a stated period of exercise, the method performed at least in part within a signal processing device and comprising:

- establishing a Grantor Retained Annuity Trust (GRAT);
  - funding said GRAT with assets comprising stock options, the stock options having a determined value at the time the transfer is made;
  - setting a term for said GRAT and a schedule and amount of annuity payments to be made from said GRAT;
  - performing a valuation of the stock options as each annuity payment is made and determining the number of stock options to include in the annuity payment; and
  - establishing an Irrevocable Life Insurance Trust (ILIT) that provides a life insurance policy on the grantor with the family member grantees as named beneficiaries, said ILIT to receive said assets of said GRAT on said GRAT's natural termination.
14. The method of claim 13 wherein the amount of the annuity is set by determining an optimum percentage of said GRAT assets that will be said annuity with the purpose of reducing the taxable gift value.
15. The method of claim 13 wherein the step of funding includes contributing supplemental assets in addition to the stock options.
16. The method of claim 15 wherein said supplemental assets comprise an amount of cash.
17. The method of claim 16 wherein the amount of cash to be included in said transfer to said GRAT is equal to at least the first year's annuity, whereby the cash may be used to defer the payment of said options in said annuity by including some or all of said cash in at least one annuity payment, thereby reducing the number of said options required to be paid as part of said annuity, and increasing the number of said options remaining in said GRAT.
18. The method of claim 17 wherein the amount of cash comprises an additional amount of cash at least equal to the total of the end of year evaluated option values for one option for each year in the life of the GRAT, whereby said additional amount of cash may be used to pay the difference each year between the required annuity payment and the value of the options included in the annuity payment.
19. The method of claim 16 wherein the amount of cash to be included in said transfer to said GRAT is equal to at least the first year's annuity on an estimated present value basis assuming a rate of return on the cash in said GRAT, whereby the cash may be used to defer the payment of said options in said annuity by including some or all of said cash in at least one annuity payment, thereby reducing the number of said options required to be paid as part of said annuity, and increasing the number of said options remaining in said GRAT.
20. The method of claim 19 wherein the amount of cash comprises an additional amount of cash at least equal to the

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total of the end of year evaluated option values for one option for each year in the life of the GRAT, whereby said additional amount of cash may be used to pay the difference each year between the required annuity payment and the value of the options included in the annuity payment.

21. The method of claim 15 wherein said supplemental assets comprise an amount of stock.

22. The method of claim 13 further comprising the step of removing some or all of the stock options from said GRAT and substituting into said GRAT assets of equivalent value.

23. The method of claim 22 wherein the step of removing some or all of the stock options and substituting into said GRAT assets of equivalent value is performed following the final annuity payment but prior to the termination of said GRAT.

24. The method of claim 13 wherein said ILIT is established at the time said GRAT is established.

25. A method for minimizing transfer tax liability of a grantor for the transfer of the value of nonqualified stock options to a family member grantee, the stock options having a stated exercise price and a stated period of exercise, the method performed at least in part within a signal processing device and comprising:

- establishing a Grantor Retained Annuity Trust (GRAT);
- funding said GRAT with assets comprising stock options, the stock options having a determined value at the time the transfer is made;
- setting a term for said GRAT and a schedule and amount of annuity payments to be made from said GRAT;
- performing a valuation of the stock options as each annuity payment is made and determining the number of stock options to include in the annuity payment;
- determining an optimum percentage of said GRAT assets that will be said annuity with the purpose of reducing the taxable gift value;
- including an amount of cash in said transfer to said GRAT at least equal to the first year's annuity on an estimated present value basis assuming a rate of return on said amount of cash in said GRAT;
- deferring the payment of said options in said annuity by including some or all of said cash in at least one annuity payment, thereby reducing the number of said options required to be paid as part of said annuity, and increasing the number of said options remaining in said GRAT; and
- establishing at the time said GRAT is established an Irrevocable Life Insurance Trust (ILIT) that provides a life insurance policy on said grantor with said family member grantees as named beneficiaries, said ILIT to receive said assets of said GRAT on said GRAT's natural termination.

\* \* \* \* \*

UNITED STATES PATENT AND TRADEMARK OFFICE  
**CERTIFICATE OF CORRECTION**

PATENT NO. : 6,567,790 B1  
DATED : May 20, 2003  
INVENTOR(S) : Slane, Robert C.

Page 1 of 1

It is certified that error appears in the above-identified patent and that said Letters Patent is hereby corrected as shown below:

Column 9.

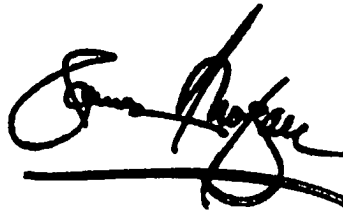
Lines 15-16, delete the phrase "with the family member grantees as named beneficiaries" and insert in place thereof -- said life insurance policy having the ILIT as named beneficiary, said ILIT having the family member grantee as named beneficiary, and --.

Column 10.

Lines 38-40, delete the phrase "at least equal to the first year's annuity on an estimated present value basis assuming a rate of return on said amount of cash in said GRAT";  
Lines 49-50, delete the phrase "said grantor with said family member grantees as named beneficiaries," and insert in place thereof -- the grantor said life insurance policy having the ILIT as named beneficiary, said ILIT having the family member grantee as named beneficiary, and --.

Signed and Sealed this

Twenty-third Day of September, 2003

A handwritten signature in black ink, appearing to read "James E. Rogan", with a horizontal line drawn underneath it.

JAMES E. ROGAN  
*Director of the United States Patent and Trademark Office*