

## Research and Private Business Use

July 24, 2014

### **Purpose and Introduction**

The University of Minnesota (U of MN) can be subject to unfavorable tax consequences if a particular research agreement results in private business use (PBU) under Internal Revenue Code Section 141. A nongovernmental sponsor of research may be treated as a private business user of the facility in which the research is conducted, potentially jeopardizing the tax-exempt status of the interest on relevant tax-exempt bonds when certain limits are exceeded. A nongovernmental sponsor is any sponsor other than the State or local government, including a corporation or the Federal Government.

### **Research Safe Harbors**

There are two safe harbors for “basic research” arrangements under Rev. Proc. 2007-47, which if complied with, will not result in PBU. Basic research is defined as any original investigation for the advancement of scientific knowledge not having a specific commercial objective. The research must preserve meaningful publication rights. The IRS has concluded that product testing supporting the trade or business of a specific nongovernmental person is not basic research. Likewise, clinical testing of privately owned drugs will not constitute basic research.

The first safe harbor in Rev. Proc. 2007-47 concerns corporate-sponsored research agreements. If corporate-sponsored, an agreement does not result in PBU if the license or other use of technology by the sponsor is permitted only on the same terms as the recipient would allow use by any unrelated, non-sponsoring party, and the price paid must be determined at the time the license is available for use. Therefore, if the sponsor pays fair market value for the license at the time the license is available for use, there is no PBU. The royalty may not be pre-set in advance of the discovery.

The second safe harbor in Rev. Proc. 2007-47 concerns industry or federally-sponsored research agreements in which one or more sponsors agree to fund basic research. If sponsored by federal government or trade/industry, an agreement will not result in PBU if

- the university determines the research to be performed and the manner in which it is to be performed;
- title to any patent or other product incidentally resulting from the basic research lies exclusively with the university; and
- the sponsor(s) is entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.

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### **Federal Government Use/ Bayh-Dole**

Though a private business user, rights of the Federal Government and its agencies mandated by Bayh-Dole Act will not cause the agreement to fail the PBU test as long as all other requirements are satisfied. Therefore, PBU may be avoided even though the Federal Government or its agencies receive certain rights to inventions that result from federally funded research activities as long as the general purpose of such rights is to ensure public benefits from the dissemination and use of the results of federally sponsored research. Any other rights provided to the Federal Government may result in PBU.

### **Measuring PBU - Mixed Use Component**

Research that creates PBU may occur in a facility in which non-PBU research is being conducted at the same time. This condition of simultaneous use is referred to as mixed use. In mixed use situations, there needs to be a way to measure the portion of a facility that is devoted to PBU verses non-PBU activities. Generally, this can be accomplished by looking at the variable factors associated with the PBU such as the amount of time or the amount of revenues devoted to the activity compared to time and revenues devoted to all activities in the facility.

### **Questions to Help Determine if PBU Exists in Research Arrangements**

Affirmative answers to the following questions warrants exploring whether private business use is occurring:

- Is there a specific commercial objective to the research being conducted?
- Are meaningful publication rights released at the commencement of the research?
- Does the research involve product testing supporting a non-governmental business?
- Does the research involve clinical testing of privately owned drugs?
- Does a corporate sponsor have preferred terms or rights for the use of any research product?
- Is the charge for the rights to use the research product determined before the product developed in research is available for use?
- Are the research topic and the manner in which the research will be performed determined by someone other than the University?
- Are intellectual rights to any research product developed incidentally to basic research owned other than exclusively by the University?
- Is the sponsor entitled to more than a nonexclusive, royalty-free license to use any research product?