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November 7, 2006

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RE: Guidance Recommendations Relating to a Modification of Revenue Procedure 97-14

Dear John and Rebecca:

Enclosed is a discussion of guidance recommendations by the National Association of Bond Lawyers (NABL) for a modification of Revenue Procedure 97-14 to clarify that research agreements containing "Bayh-Dole Rights" do not result in private business use, as defined in Section 141 of the Internal Revenue Code and Treasury Regulation § 1.141-3, of tax-exempt bond financed facilities and to expand the second safe harbor to include single-sponsor research arrangements. In addition, NABL has enclosed Exhibit A, a copy of Revenue Procedure 97-14 which has been marked to show recommended modifications. A list of the NABL Sponsored Research Working Group who participated in the preparation of the recommendations is also enclosed as Exhibit B.

NABL continues to seek clarification in this matter in order to facilitate compliance. If the Treasury or IRS would like to discuss the recommendations, NABL would welcome the opportunity.

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If you have questions, please contact me at 949/725-4237 or through email at clew@sycr.com or Elizabeth Wagner, Director of Governmental Affairs, at 202/682-1498 or through email at ewagner@nabl.org.

Thank you for the opportunity to submit NABL's recommendations. We look forward to working with you.

Sincerely,

Carol L. Lew

Carol L. Lew

Enclosures

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National Association *of* Bond Lawyers

RECOMMENDATIONS
BY THE
NATIONAL ASSOCIATION OF BOND LAWYERS
TO THE
DEPARTMENT OF THE TREASURY
OFFICE OF TAX POLICY
AND THE
INTERNAL REVENUE SERVICE

REQUESTING A MODIFICATION OF REVENUE PROCEDURE 97-14 TO CLARIFY THAT RESEARCH AGREEMENTS CONTAINING "BAYH-DOLE RIGHTS" DO NOT RESULT IN PRIVATE BUSINESS USE OF TAX-EXEMPT BOND FINANCED FACILITIES AND TO EXPAND THE SECOND SAFE HARBOR TO INCLUDE SINGLE-SPONSOR RESEARCH ARRANGEMENTS

The following comments are submitted on behalf of the National Association of Bond Lawyers ("NABL") Sponsored Research Working Group ("Working Group"). These comments relate to the need for modifying guidance regarding research activities conducted by governmental entities or 501(c)(3) organizations (the "Research Institutions") pursuant to research agreements governed by the Bayh-Dole Act (defined below) or containing provisions similar to those required by the Bayh-Dole Act. For the reasons set forth below, NABL respectfully requests that Revenue Procedure 97-14, 1997-1 C.B. 634 ("Rev. Proc. 97-14"), be clarified to expressly provide that such research agreements do not result in private business use, as defined in Section 141(b)(6)(A) of the Internal Revenue Code of 1986, as amended (the "Code"), and Treasury Regulation § 1.141-3, of facilities financed with tax-exempt bonds. Additionally, NABL respectfully requests that the second safe harbor set forth in Section 5.03 of Rev. Proc. 97-14 be expanded to include research arrangements with single sponsors, including the federal government and its agencies.

The Bayh-Dole Act

The Patent and Trademark Law Amendments Act (P.L. 96-517, codified at 35 USC § 200 *et seq.*) (the "Bayh-Dole Act") became law on December 12, 1980. Prior to that time, neither the federal government nor its agencies (the "Federal Agencies") had consistent policies regarding what provisions should be included in contracts for research funded by the Federal Agencies ("federally-sponsored research") who would retain ownership of the resulting patents, or how to ensure utilization of those patents for the benefit of the general public. The Federal Agencies almost always retained ownership of the patents resulting from federally-sponsored research and granted non-exclusive licenses in those patents. As a result, private companies did not have any

incentive to invest the capital necessary to develop and market new products based on the patents. Consequently, the new technologies and inventions resulting from federally-sponsored research were rarely made available to the general public whose tax dollars supported that research.

Congress enacted the Bayh-Dole Act in 1980 to benefit the general public in two ways: (1) by ensuring that inventions resulting from federally-sponsored research would be made available to the general public, and (2) by stimulating the United States economy. The Bayh-Dole Act provides as follows with respect to its policy and objective:

> "It is the policy and objective of the Congress to use the patent system to promote the utilization of inventions arising from federally supported research or development; to encourage maximum participation of small business firms in federally supported research and development efforts; to promote collaboration between commercial concerns and nonprofit organizations[1], including universities; to ensure that inventions made by nonprofit organizations and small business firms are used in a manner to promote free competitions and enterprise; to promote the commercialization and public availability of inventions made in the United States by United States industry and labor; to ensure that the Government obtains sufficient rights in federally supported inventions to meet the needs of the Government and protect the public against nonuse or unreasonable use of inventions; and to minimize the costs of administering policies in this area."

35 USC § 200.

To accomplish the stated policies and objectives, the Bayh-Dole Act provides a uniform set of rules that applies when any Federal Agency enters into a contract, grant or cooperative agreement (a "funding agreement") for the performance of experimental, developmental or research work funded in whole or in part by the federal government (*i.e.*, federally-sponsored research). With certain rare exceptions, each person, nonprofit organization or small business firm that is a party to a funding agreement (a "contractor") may elect to retain title to any subject invention. 35 USC § 202(a). Each funding agreement must include the following provisions (the "Bayh-Dole Rights"):

> (1) The contractor must disclose each subject invention to the Federal Agency within a reasonable time after it is made and the federal government may receive title to the invention if not timely disclosed;
>
> (2) The contractor must make an election to retain title within a reasonable time after disclosure and the federal government may receive title to the invention if a timely election is not made;

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[1] "Nonprofit organizations" includes universities and other institutions of higher education and organizations described in Section 501(c)(3) of the Code (*i.e.*, governmental and 501(c)(3) Research Institutions). 35 USC § 201(i).

(3) If an election to retain title is made, the contractor must file patent applications within a reasonable time and the federal government may receive title if timely patent applications are not filed;

(4) If the contractor retains title, the Federal Agency will have a nonexclusive, nontransferable, irrevocable, paid-up license to practice or have practiced for or on behalf of the United States any subject invention throughout the world and, if so provided, may also have additional sublicensing rights with foreign governments or international organizations;

(5) The Federal Agency may require periodic reporting on the utilization or efforts at obtaining utilization of the subject invention;

(6) An obligation on the part of a contractor or its assignee to include in any United States patent application and any patent issuing thereon a statement specifying that the invention was developed with federal funds and that the federal government has certain rights in the invention;

(7) In the case of a nonprofit organization, (A) a general prohibition on the assignment of rights to a subject invention in the United States without approval, (B) a prohibition against the granting of exclusive licenses for certain time periods, (C) a requirement that the contractor share royalties with the inventor, and (D) a requirement that any net royalties or income be used for the support of scientific research or education;

(8) The requirements of 35 USC § 203, which are entitled "march-in rights" (*emphasis added and described below*); and

(9) The requirements of 35 USC § 204, which generally provides that a contractor or its assignee may not grant any person the exclusive right to use or sell any subject invention in the United States unless that person agrees that any products embodying the invention or produced through the use of the invention will be manufactured substantially in the United States.

35 USC § 202(c).

<u>Rights Granted to Federal Agencies by the Bayh-Dole Act</u>

The Working Group believes that the inclusion of Bayh-Dole Rights in a research agreement should not result in private business use. Under the Bayh-Dole Act, the Federal Agencies are not given authority to direct or control the applicable research or to control the use or disposition of research facilities. What a Federal Agency receives under the Bayh-Dole Act are tools to ensure that grant funds benefit the public. These tools include: (i) the right to obtain title to a subject invention, if the contractor does not disclose the invention, elect to retain title to the invention or file a patent application with respect to the invention in a timely manner; (ii) the right to require periodic reports regarding the utilization or efforts to utilize a subject invention; and (iii) the right to have a nonexclusive, nontransferable, irrevocable, paid-up license to practice

or have practiced for or on behalf of the United States the subject invention throughout the world.

In addition, the Working Group understands that the Federal Agencies do not typically obtain title to the applicable inventions, and that the nonexclusive licenses received by the Federal Agencies are not typically utilized. The Council on Governmental Relations ("COGR"), in their background submission to the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS"), dated June 29, 2006 ("COGR Background"), page 6, stated that "the early development stage nature of university inventions, and the need for the private sector to invest substantial additional resources to bring most university inventions to practical application, [make] the government license right . . . not to be widely practiced.[2]"

As stated above, each funding agreement under the Bayh-Dole Act must also contain provisions that grant the Federal Agency march-in rights. Pursuant to 35 USC § 203, if a contractor acquires title to a subject invention, the contracting Federal Agency has the right to require the contractor, an assignee or an exclusive licensee of the subject invention to grant a license in any field of use to a responsible applicant or applicants. The license may be nonexclusive, partially exclusive or exclusive, and the terms of the license must be reasonable under the circumstances. If the contractor, assignee or exclusive licensee refuses to grant the license, the Federal Agency has the right to grant the license itself (*i.e.*, the right to march-in and act on behalf of the owner of the subject invention).

The ability to exercise march-in rights is not absolute, however. The Federal Agency may only exercise march-in rights if it first determines that the action is necessary for one of the following reasons:

> (a) the contractor, assignee or licensee has not taken, or is not expected to take within a reasonable time, effective steps to achieve practical application of the subject invention;
>
> (b) to alleviate health or safety needs not reasonably satisfied by the contractor, assignee or licensee;
>
> (c) to meet requirements for public use not reasonably satisfied by the contractor, assignee or licensee; or
>
> (d) the agreement with an exclusive licensee that any products embodying, or produced through the use of, the subject invention will be manufactured substantially in the United States has not been obtained or waived or because the exclusive licensee is in breach of such an agreement.

[2] Although the COGR Background indicates that the license may be utilized in very limited situations such as perhaps those relating to the Department of Defense [Page 6], it affirms that these facts do not differ significantly for "classified" research. The primary distinction between classified and unclassified research is the additional classified research requirements pertaining to protection of information, (*e.g.*, publication of dissertations, Federal Agency approval of patents, and use of separate facilities) [Pages 3 and 7].

35 USC § 203(1).

Again, the Working Group believes that a research agreement containing Bayh-Dole Rights, including march-in rights, should not result in private business use. Evidently, march-in rights have never been exercised by any Federal Agency. They cannot be exercised solely for the convenience of a Federal Agency. Rather, march-in rights are a statutory mechanism provided the federal government to ensure that grant funds are used to benefit the public.

Further, the IRS has not previously treated as significant, for purposes of Section 141 of the Code, restrictions on grants that are not expected to be utilized but are merely tools to ensure expenditure of the grant for a proper purpose. *See* Treasury Regulation § 1.148-6(d)(4)(iii) and P.L.R. 9203021 (October 21, 1991) (grants for housing in the form of loans did not result in private business use as loan features were merely to ensure proper expenditure of grants and were not expected nor needed to be utilized). March-in rights and the above-described nonexclusive license should be similarly treated; they should not result in private business use as they are not expected nor needed to be utilized and are intended to ensure proper use of the applicable grant.

The Tax Reform Act of 1986 Legislative History and the Bayh-Dole Act

The Working Group believes that the legislative history to the Tax Reform Act of 1986 (P.L. 99-514) (the "1986 Act") supports the conclusion that Bayh-Dole Rights do not result in private business use under Section 141 of the Code. The 1986 Act was enacted almost six years after enactment of the Bayh-Dole Act. At that time, Congress acknowledged that Research Institutions conducted research for nongovernmental[3] persons in bond-financed facilities and specifically stated that the conduct of research pursuant to certain cooperative research agreements would not result in private business use of those facilities. The House Ways and Means Committee stated as follows:

* * *

> "The committee is aware that the conduct of basic research is an integral function of universities, and that State universities may enter into cooperative agreements with nongovernmental persons for the conduct of such basic research. The findings in connection with research conducted at these facilities are disseminated to the general public through various scientific and technical journals. Title to any patent incidentally resulting from the research conducted pursuant to the cooperative arrangements lies exclusively with the educational institution, and not with any nongovernmental person. Similarly, no nongovernmental participant in the cooperative research arrangement is entitled to preferential use of any product of the research (including any patent). The committee intends that use of bond-financed property by nongovernmental persons pursuant to such a cooperative research arrangement is not to be

[3] The 1986 Act added Section 150 of the Code providing that "[t]he term 'governmental unit' does not include the United States or any agency or instrumentality thereof."

considered when determining the degree of nongovernmental use of the property provided that the nongovernmental use does not involve the commercial exploitation of the research activities or the conduct of a separate, trade or business (*e.g.*, an unrelated trade or business activity under sec. 511). The committee further understands that section 501(c)(3) universities may enter into similar cooperative arrangements; activities of such section 501(c)(3) organizations are treated as related to their educational function to the same extent that like activities of a State educational institution are treated as governmental activities."

* * *

H.R.Rep. No. 99-426, 524.

The Senate Finance Committee stated as follows:

* * *

"The committee also is aware that the conduct of basic research is an integral function of universities, and that section 501(c)(3) universities may enter into cooperative agreements with other nongovernmental persons for the conduct of such basic research.[4] The committee intends that the use of bond-financed property by a university to perform general (as opposed to product development) research supported or sponsored by such other persons pursuant to a cooperative research arrangement is not to be treated as trade or business use by such person, nor is the research support to be considered direct or indirect repayment of the bonds, provided that any agreed use of any resulting technology by the nonuniversity sponsoring person is permitted only on the same terms by which the university permits such use by any other nonsponsoring unrelated party. Thus, a cooperative research agreement which provides for a license of any resulting technology at a royalty rate fixed in advance of the performance of the research could constitute such a trade or business use; however, an agreement with only a first right of refusal (at a competitive price) for the sponsoring person would not constitute such a use."

* * *

S.Rep.No. 99-313, 842.

Finally, the Conference Report provides:

* * *

[4] State and other governmental universities may enter into similar arrangements. The determination of whether such an arrangement involves a use in a trade or business of a person other than the university is the same for State or other governmental universities as for universities that are section 501(c)(3) organizations. [Footnote Number 406 in original.]

> "The House bill provides that use of bond-financed research facilities at governmental and section 501(c)(3) universities by private businesses is not treated as a trade or business use if the use is pursuant to certain cooperative research agreements pursuant to which title to and control of any resulting patents rest exclusively with the university rather than the private business. Under this special rule, control is not treated as resting exclusively with the university if the research agreement provides for use of resulting patents by participating private businesses in advance of development of the product which is the subject of the patent."
>
> * * *
>
> "The Senate amendment follows the House bill with two modifications. First, the amendment clarifies that universities may enter into agreements permitting exclusive use of resulting patents with participating private businesses provided the private business pays a fair market price for use of the patent. Second, the amendment provides that the university may permit sponsoring private businesses to use resulting patents without charge, provided the use is on a nonexclusive basis."
>
> * * *
>
> "The conference agreement follows the Senate amendment on treatment of private use under certain cooperative research agreements, with a clarification that the amount charged participating private businesses for the use of patents or other resulting technology must be determined at the time the patent or technology is available for use. As under the House bill and Senate amendment, private use pursuant to research agreements not satisfying the requirements of the conference agreement is counted for purposes of the trade or business use and security interest tests and the private loan restriction (if the use in substance involves a loan)."
>
> * * *

H.Conf.Rep. No. 99-841, II-685-II-689.

The types of cooperative research agreements identified by Congress, in the above-cited legislative history, as not resulting in private business use of bond-financed research facilities include agreements pursuant to which title to and control of any resulting patent rests exclusively with the Research Institutions and agreements pursuant to which the Research Institutions may grant the sponsor a nonexclusive license to use the resulting patents without charge. Both of these provisions were (and are) required by the Bayh-Dole Act to be included in funding agreements between Research Institutions and Federal Agencies (*i.e.*, they are Bayh-Dole Rights). If these provisions may be included in cooperative research agreements with private business sponsors without resulting in private business use, the Working Group believes that they should not result in private business use when included in funding agreements with the Federal Agencies.

Further, the General Explanation of the Tax Reform Act of 1986, prepared by the Staff of the Joint Committee on Taxation (the "Blue Book"), includes a reference that supports the conclusion that none of the Bayh-Dole Rights results in private business use. On page 1162, the Blue Book refers to research arrangements currently (*i.e.*, 1986) sponsored by the National Science Foundation (the "NSF," a Federal Agency) when more fully describing one type of cooperative research arrangement permitted by the 1986 Act; NSF arrangements were (and are) governed by the Bayh-Dole Act and did (and do) include the Bayh-Dole Rights. The Blue Book states that cooperative research agreements with nongovernmental persons that contain provisions similar to those included in research sponsored by the NSF will not result in private business use of bond-financed research facilities. The authors of the Blue Book seem to imply that research agreements which are subject to the Bayh-Dole Act (*e.g.*, NSF arrangements) or which include provisions similar to agreements governed by the Bayh-Dole Act (*i.e.*, the Bayh-Dole Rights) do not result in private business use.

Promulgation of Private Activity Bond Regulations and Issuance of Rev. Proc. 97-14

In 1997, Treasury promulgated Treasury Regulations §§ 1.141-1 through 1.141-16 (the "Private Activity Bond Regulations") to provide additional guidance regarding Section 141 of the Code, including the private business use test of Section 141(b)(1). T.D. 8712, effective May 16, 1997. Treasury Regulation § 1.141-3(b)(1) provides that the private business use test is met only if a nongovernmental person has "special legal entitlements" to use the bond-financed property. With respect to research agreements, Treasury Regulation § 1.141-3(b)(6)(i) provides that whether or not an agreement results in private business use of the bond-financed property is based on all of the facts and circumstances.

Simultaneously with the promulgation of the Private Activity Bond Regulations, the IRS issued Rev. Proc. 97-14 to provide additional guidance with respect to research agreements. Rev. Proc. 97-14 sets forth two "safe harbors," and research agreements that meet the requirements of one of these safe harbors do not result in private business use for purposes of Section 141 of the Code.

Under the first safe harbor of Rev. Proc. 97-14, research agreements relating to property used for basic research supported or sponsored by a corporate sponsor will not result in private business use if any license or other use of the resulting technology by the sponsor is permitted only on the same terms as the recipient would permit the license or other use by any unrelated, non-sponsoring party (that is, the sponsor must pay a competitive price for its use).[5]

Under the second safe harbor of Rev. Proc. 97-14, cooperative research arrangements will not result in private business use under Section 141 of the Code if (1) multiple unrelated sponsors agree to fund governmentally performed basic research, (2) the research and the manner in which it is performed is determined by the Research Institution, (3) title to any patent or other

[5] Under Rev. Proc. 97-14, "basic research" means, for purposes of Section 141, any original investigation for the advancement of scientific knowledge not having a specific commercial objective. For example, product testing supporting the trade or business of a specific nongovernmental person is not treated as basic research. A "sponsor" means any person, other than a qualified user, that supports or sponsors research under a contract. In PLR 199914045 (January 8, 1999), the IRS concluded that certain federal research arrangements satisfied the requirements of the first safe harbor, but failed to address issues under the Bayh-Dole Act.

product resulting from the research lies exclusively with the Research Institution, and (4) the sponsors are entitled to no more than a nonexclusive royalty-free license to use the product of the research.

The Rev. Proc. 97-14 safe harbors are based upon examples of research arrangements in the legislative history to the 1986 Act, as clarified by the Blue Book, that do not result in private business use. The second safe harbor of Rev. Proc. 97-14, which addresses cooperative arrangements, incorporates the requirements set forth in the example in the Blue Book that referenced NSF sponsorships, but fails to incorporate the implications of that Blue Book reference -- that research agreements which are subject to the Bayh-Dole Act (*e.g.*, NSF arrangements) or which include provisions similar to those governed by the Bayh-Dole Act (*i.e.*, the Bayh-Dole Rights) do not result in private business use. Again, the Working Group believes the reference to the NSF arrangements in the Blue Book indicates that Bayh-Dole Rights were not intended to result in private business use.

Furthermore, the Working Group believes that application of the facts and circumstances test set forth in Treasury Regulation § 1.141-3(b)(6)(i), especially when viewed together with the special legal entitlements factors set forth in Treasury Regulation § 1.141-3(b)(7), leads to the conclusion that the inclusion of Bayh-Dole Rights in a research agreement, whether or not the agreement is with a Federal Agency, does not result in private business use.

In addition, the Working Group believes that single-sponsor arrangements should be covered by the second safe harbor of Rev. Proc. 97-14. Neither Rev. Proc. 97-14 nor the Blue Book express a policy reason to consider a single-sponsor arrangement for basic research as private business use, if (1) the research and the manner in which it is performed is determined by the Research Institution, (2) title to any patent or other product resulting from the research lies exclusively with the Research Institution, and (3) the sponsor is entitled to no more than a nonexclusive royalty-free license to use the product of the research. Moreover, the Working Group understands that NSF sponsorships in 1986 were generally in the form of single-sponsor agreements and that many, if not most, current Federal Agency sponsorships involve only a single Federal Agency sponsor rather than multiple unrelated sponsors. Further, if the first safe harbor of Rev. Proc. 97-14 accepts a single-sponsor arrangement with an exclusive license, why doesn't the second safe harbor accept a single-sponsor arrangement with a non-exclusive license?

Modification Requested

Given the volume of research arrangements subject to the Bayh-Dole Act or containing Bayh-Dole Rights that are entered into annually and the uncertainty in the tax treatment of these arrangements, the Working Group strongly recommends that Rev. Proc. 97-14 be modified to (1) clarify that Bayh-Dole Rights do not result in private business use for purposes of Section 141 of the Code and (2) expand the second safe harbor to cover single-sponsor arrangements, including federally-sponsored research.

Attached hereto as Exhibit A is a copy of Rev. Proc. 97-14 which has been marked to show the changes the Working Group recommends for the requested modification. Also

attached hereto as Exhibit B is a list of the members of the NABL Working Group who participated in the preparation of the recommendations.

Conclusion

Numerous research arrangements, including those subject to the Bayh-Dole Act or containing Bayh-Dole Rights, are entered into annually. To achieve certainty in this area, the Working Group strongly recommends that Rev. Proc. 97-14 be modified to clarify that Bayh-Dole Rights do not result in private business use and to expand the second safe harbor to cover single-sponsor arrangements. The Working Group believes that this modification is justified because (1) Bayh-Dole Act arrangements are substantially similar to the second safe harbor of Rev. Proc. 97-14, (2) Bayh-Dole Rights exist merely to ensure that federal grants benefit the public, and (3) the legislative history to the 1986 Act and the Blue Book indicate that Bayh-Dole Rights were not viewed as resulting in private business use.

EXHIBIT A

REVENUE PROCEDURE 97-14
(Marked with recommended modifications)

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth conditions under which a research agreement does not result in private business use under section 141(b) of the Internal Revenue Code of 1986. This revenue procedure also applies to determinations of whether a research agreement causes the test in section 145(a)(2)(B) of the 1986 Code to be met for qualified 501(c)(3) bonds.

SECTION 2. BACKGROUND

.01 Private Business Use.

(1) Under section 103(a) of the 1986 Code, gross income does not include interest on any state or local bond. Under section 103(b)(1) of the 1986 Code, however, section 103(a) of the 1986 Code does not apply to a private activity bond, unless it is a qualified bond under section 141(e) of the 1986 Code. Section 141(a)(1) of the 1986 Code defines "private activity bond" as any bond issued as part of an issue that meets both the private business use and the private security or payment tests. Under section 141(b)(1) of the 1986 Code, an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Under section 141(b)(6)(A) of the 1986 Code, private business use means direct or indirect use in a trade or business carried on by any person other than a governmental unit. Section 145(a) of the 1986 Code also applies the private business use test of section 141(b)(1) of the 1986 Code, with certain modifications.

(2) Corresponding provisions of the Internal Revenue Code of 1954 set forth the requirements for the exclusion from gross income of the interest on state or local bonds. For purposes of this revenue procedure, any reference to a 1986 Code provision includes a reference to the corresponding provision, if any, under the 1954 Code.

.02 Section 1.141-3(b)(6)(i) of the Income Tax Regulations provides, in general, that an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all of the facts and circumstances.

.03 Section 1.141-3(b)(6)(ii) provides in general that a research agreement with respect to financed property results in private business use of that property if the sponsor is treated as the lessee or owner of financed property for federal income tax purposes.

.04 Section 1.145-2(a) provides generally that sections 1.141-0 through 1.141-15 apply to section 145(a) of the 1986 Code.

.05 Section 1.145-2(b)(1) provides that, in applying sections 1.141-0 through 1.141-15 to section 145(a) of the 1986 Code, references to governmental persons include section 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under section 513(a) of the 1986 Code.

SECTION 3. DEFINITIONS

.01 Basic research, for purposes of section 141 of the 1986 Code, means any original investigation for the advancement of scientific knowledge not having a specific commercial objective. For example, product testing supporting the trade or business of a specific nongovernmental person is not treated as basic research.

.02 Qualified user means any state or local governmental unit as defined in section 1.103-1 or any instrumentality thereof. The term also includes a section 501(c)(3) organization if the financed property is not used in an unrelated trade or business under section 513(a) of the 1986 Code. The term does not include the United States or any agency or instrumentality thereof.

.03 Sponsor means any person, other than a qualified user, that supports or sponsors research under a contract.

SECTION 4. SCOPE

This revenue procedure applies when, under a research agreement, a sponsor uses property financed with proceeds of an issue of state or local bonds subject to section 141 or section 145(a)(2)(B) of the 1986 Code.

SECTION 5. OPERATING GUIDELINES FOR RESEARCH AGREEMENTS

.01 In General. If a research agreement is described in either section 5.02 or 5.03 of this revenue procedure, the research agreement itself does not result in private business use. In determining whether, or the extent to which, a research agreement results in private business use, the rights described in section 5.04 are disregarded.

.02 Corporate- Sponsored Research. A research agreement relating to property used for basic research supported or sponsored by a sponsor is described in this section 5.02 if any license or other use of resulting technology by the sponsor is permitted only on the same terms as the recipient would permit that use by any unrelated, non- sponsoring party (that is, the sponsor must pay a competitive price for its use), with the price paid for that use determined at the time the license or other resulting technology is available for use. Although the recipient need not

permit persons other than the sponsor to use any license or other resulting technology, the price paid by the sponsor must be no less than the price that would be paid by any non-sponsoring party for those same rights.

.03 ~~Cooperative~~Industry or Federally-Sponsored Research Agreements. A research agreement relating to property used pursuant to ~~a joint~~an industry ~~governmental cooperative~~ or federally-sponsored research arrangement is described in this section 5.03 if --

(1) ~~Multiple~~A single sponsor or multiple, unrelated sponsors agree to fund governmentally performed basic research;

(2) The research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research) ~~is~~are determined by the qualified user;

(3) Title to any patent or other product incidentally resulting from the basic research lies exclusively with the qualified user; and

(4) ~~Sponsors~~The sponsor or sponsors are entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.

.04 Reservation or Exercise of Certain Rights. The reservation or exercise of any or all of the rights mandated by 35 U.S.C. section 200 et seq., and the regulations promulgated thereunder, which govern the conduct of research pursuant to contracts, grants or cooperative agreements with the federal government and its agencies, and rights similar thereto, does not result in private business use.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for any research agreement entered into on or after May 16, 1997. In addition, an issuer may apply this revenue procedure to any research agreement entered into prior to May 16, 1997.

DRAFTING INFORMATION

The principal author of this revenue procedure is Loretta J. Finger of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure contact Loretta J. Finger on (202) 622-3980 (not a toll-free call).

National Association *of* Bond Lawyers

EXHIBIT B

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