

Income derived from research by a tax-exempt college, university, or hospital, or by a tax-exempt organization operated primarily for the purpose of carrying on fundamental research, does not constitute income from an unrelated trade or business. Income derived by any organization to which supplement U is applicable from research for the United States or any of its agencies or for a State or political subdivision thereof is not income from an unrelated trade or business.

Advice is requested as to the taxability of income derived by colleges, universities, hospitals and other nonprofit organizations from research activities and of income derived from research for the United States or any of its agencies or instrumentalities, or for a State or political subdivision thereof.

Section 421 of the Internal Revenue Code provides in part as follows:

(a) IN GENERAL.-There shall be levied collected, and paid for each taxable year beginning after December 31, 1950-

(1) upon the supplement U net income * * * of every organization described in subsection (b) (1), a normal tax of * * *

*% *% *

(b) ORGANIZATIONS SUBJECT TO TAX.-

(1) ORGANIZATIONS TAXABLE AS CORPORATIONS.-

(A) Organizations Exempt Under Section 101(1), (6), (7) and (14). * * *

(B) State Colleges and Universities.-The taxes imposed by subsection (a) (1) shall apply in the case of any college or university which is an agency or instrumentality of any government * * *. Such taxes shall also apply in the case of any corporation wholly owned by one or more such colleges or universities. * * *

(c) DEFINITION OF SUPPLEMENT U NET INCOME.-The term 'supplement U net income' of an organization means the amount by which its unrelated business net income (as defined in section 422) exceeds \$1,000.

Section 422 of the Code provides in part as follows:

(a) DEFINITION.-The term 'unrelated business net income' means the gross income derived by any organization

from any unrelated trade or business * * * subject to the following exceptions, additions, and limitations:

*% *% *

(7) There shall be excluded all income derived from research for (A) the United States, or any of its agencies or instrumentalities, or (B) any State or political subdivision thereof; and there shall be excluded all deductions directly connected with such income.

(8) (A) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(B) In the case of an organization operated primarily for the purposes of carrying on fundamental research the results of which are freely available to the general public, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

Section 39.422-1(b) (6) of Regulations 118 provides that in computing unrelated business net income there shall be excluded income derived from research for the United States or any of its agencies or instrumentalities or a State or political subdivision thereof, and all deductions directly connected with such income; all income derived from research by a college, university or hospital performed for any person and all deductions connected with such income; and all income derived from research by an organization operated primarily for the purpose of carrying on fundamental research (as distinguished from applied research) the results of which are freely available to the general public performed for any person and all deductions connected with such income. The term 'research' does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment and buildings. The term 'fundamental research' does not include research carried on for the primary purpose of commercial or industrial application.

In the case of tax-exempt colleges, universities, and hospitals, as well as tax-exempt organizations operated primarily for the purpose of carrying on fundamental research (as distinguished from applied research) the results of which are freely available to the general public, income derived from any research, whether fundamental or applied, will not constitute income from an unrelated trade or business. Furthermore, in the case of any organization to which the tax imposed by section 421 of the Code is applicable, income derived from any research for the United States or any State, territory, or political subdivision thereof is excluded from unrelated business income

and is not subject to supplement U tax. On the other hand, a tax-exempt organization which is not primarily engaged in fundamental research and which is not a college, university, or hospital will be subject to tax on its supplement U net income (except from sources mentioned in the preceding sentence) with respect to any research if regularly carried on and if not substantially related to its tax-exempt purposes.

Activities of a type ordinarily carried on as an incident to commercial or industrial operations such as those mentioned in the examples given in the regulations referred to above do not constitute research and are not excluded by the foregoing provisions in computing unrelated business net income of any organization subject to the supplement U tax whether or not the organization is of the class specified in section 422(a)(8)(A) and (B) above and whether or not the income from such activities is derived from a source specified in section 422(a)(7) above.

Whether the research or other activities not excluded from unrelated trade or business by the foregoing specific provisions constitute a trade or business unrelated to the organization's tax-exempt purposes is dependent on the facts of each case.