

Unrelated income; commercially sponsored research. Commercially sponsored research otherwise qualifying as scientific research under section 501(c)(3) of the Code, the results of which, including all relevant information, are timely published in such form as to be available to the interested public, constitutes scientific research carried on in the public interest. Research, the publication of which is withheld or delayed significantly beyond the time reasonably necessary to establish ownership rights, however, is not in the public interest and constitutes the conduct of unrelated trade or business within the meaning of section 513.

Advice has been requested whether the commercially sponsored scientific research in the situations described below is scientific research carried on in the public interest within the meaning of section 501(c)(3) of the Internal Revenue Code of 1954; and, if it is not, whether the carrying on of such sponsored research by an organization exempt from Federal income tax under section 501(c)(3) is the conduct of unrelated trade or business within the meaning of section 513.

The organization that performs the research is one that otherwise qualifies as a scientific organization exempt from Federal income tax under section 501(c)(3) of the Code. As part of its activities, the organization regularly undertakes what is termed 'commercially sponsored scientific research,' which is scientific research undertaken pursuant to contracts with private industries. Under the contracts for such research, the sponsor pays for the research and receives the right to the results of the research and all the ownership rights in patents resulting from work on the project.

#### Situation 1.

The results of the commercially sponsored projects, including all relevant information, are generally published in such form as to be available to the interested public either currently, as developments in the project warrant, or within a reasonably short time after completion of the project. If patent rights are involved, publication is delayed pending reasonable opportunity to establish such rights, such as through the filing of application for patents.

#### Situation 2.

On occasion, however, the organization will agree, at the request of the sponsor to forego publication of the results of a particular project in order to protect against disclosure of processes or technical data which the sponsor desires to keep secret for various business reasons. In other instances, the organization may agree to extend delay in the publication of results in cases in which the sponsor, for business reasons,

desires to protect its patent rights under the project, but desires to defer initiation of patent procedures so as to delay or control the timing of public disclosure of the results of the project.

Section 501(c)(3) of the Code provides for exemption from Federal income tax of organizations organized and operated exclusively for scientific purposes.

Under section 1.501(c)(3)-1(d)(5)(i) of the Income Tax Regulations, an organization may meet the requirements of section 501(c)(3) of the Code only if it serves a public rather than a private interest. Because a 'scientific' organization must be organized and operated in the public interest, the regulations further provide that the term 'scientific,' as used in section 501(c)(3), includes the carrying on of scientific research in the public interest.

Section 1.501(c)(3)-2(d)(5)(iii) of the regulations provides that scientific research will be regarded as carried on in the public interest if (a) the results of such research (including any patents, copyrights, processes, or formulae resulting therefrom) are made available to the public on a nondiscriminatory basis; (b) such research is performed for the United States, or any of its agencies or instrumentalities, or for a State or political subdivision thereof; or (c) such research is directed toward benefiting the public.

This section of the regulations further provides that scientific research will be considered as directed toward benefiting the public, and, therefore, regarded as carried on in the public interest if it is carried on for the purpose of obtaining scientific information, which is published in a treatise, thesis, trade publication, or in any other form that is available to the interested public. In addition, the regulations explicitly provide that such research will be regarded as carried on in the public interest even though such research is performed pursuant to a contract or agreement under which the sponsor or sponsors of the research have the right to obtain ownership or control of any patents, copyrights, processes, or formulae resulting from such research.

Thus, commercially sponsored scientific research that otherwise qualifies as scientific research under section 501(c)(3) of the Code and that meets the publication test of the regulations constitutes scientific research carried on in the public interest.

To meet the test, the publication must be adequate and timely. Some public disclosure beyond that which flows naturally from the issuance of a patent is required. In addition, the publication must disclose substantially all of the information concerning the results of the research which would be useful or beneficial to the interested public.

Although the timing of the publication may vary depending

upon the circumstance, the publication must be reasonably prompt because the public disclosure as an addition to the body of useful scientific knowledge is the reason for considering the activity as directed toward benefiting the public. It should be noted that section 102 of Title 35 of the United States Code provides, in effect, that the right to a patent may be lost by publication of a description of the invention in a printed publication more than twelve months prior to the date of the application for the patent.

Since the regulations recognize the right of the sponsor to obtain patents or copyrights resulting from the research, publication is not required in advance of the time at which it can be made public without jeopardy to the sponsor's right by reasonably diligent action to secure any patents or copyrights resulting from the research. However, adequate publication of the results of the research should be made as promptly after the completion of the research as is reasonably possible without jeopardizing the sponsor's right to secure patents or copyrights necessary to protect its ownership or control of the results of the research.

The 'publication test' is satisfied in Situation 1 because the results of the commercially sponsored research, including all relevant information, are not withheld beyond the time reasonably necessary to obtain patents or copyrights. Therefore, the scientific research is carried on for the purpose of obtaining scientific information which is published in some form available to the interested public. Since such research is regarded as carried on in the public interest even though it is performed pursuant to a contract under which the sponsor has the right to obtain ownership of the patent, it constitutes scientific research in the public interest within the meaning of section 501(c)(3) of the Code.

With respect to Situation 2, however, in which publication of the results of commercially sponsored scientific research is withheld entirely or delayed significantly beyond the time reasonably necessary to establish patent or other ownership rights in the results of the research in order to accommodate the sponsor's business interest in maintaining the secrecy of certain processes or to control the timing of public disclosure of the results, the requirements of the publication test are not met. The research connected with such projects, therefore, is not scientific research carried on in the public interest within the meaning of section 501(c)(3) of the Code.

The term 'unrelated trade or business' is defined in section 513 of the Code to mean, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purposes or functions.

Section 1.513-1(d)(2) of the regulations provides that trade

or business is substantially related to purposes for which exemption is granted if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of those purposes.

The organization, by agreeing to undertake commercially sponsored scientific research in the manner described above in Situation 2, is engaging in activity which is not exclusively scientific within the meaning of section 501(c)(3) of the Code and the regulations. Such activity, other than through the production of income, does not contribute importantly to the purposes for which exemption is granted to the organization.

Accordingly, the carrying on of the sponsored research in the manner described in Situation 2 is the conduct of unrelated trade or business within the meaning of section 513.