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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: APR 4 2003

Contact Person:

Identification Number:

Telephone Number:

T:ED:B1

No Third Party Contact
SIN#:
501.03-24, 511.00-00
512.01-01

Legend:

T-
Z-

Employer Identification Number:

Dear Sir or Madam:

This is in response to your request for rulings under sections 511 and 501(c)(3) of the Internal Revenue Code.

Background:

You are exempt under section 501(c)(3) of the Code and are classified as a public charity described in sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code. You conduct scientific research in the public interest. Your scientific research involves basic biological research designed to determine how certain abnormalities in genes cause disease and what can be done to alter such genes to prevent disease. The research conducted does not include commercial or industrial operations, such as ordinary testing or inspection of materials or products. Your research is in the public interest because it is directed towards benefiting the public for the purpose of discovering a cure for a disease and for the purpose of obtaining scientific information to be published or similarly made available to the interested public.

You conduct medical research at your own facility in conjunction with several hospitals in the community that you serve. You have cooperation arrangements with these hospitals. For example, an arrangement with one hospital provides that medical research programs of common interest will be conducted that are consistent with each organization's primary mission. The arrangement provides that each organization will have access to reports, data, records, and all other information regarding research conducted in connection with the arrangement or any other research program that relates to the arrangement. Both parties facilitate and promote the intellectual dialogue and interaction among each other's scientists, researchers, and physicians at meetings and conferences.

Your facility houses 13 laboratories headed by 13 scientists which are supported by 150 combined scientific /technical staff and administrative/support staff. By the end of 2003, you

anticipate expanding by 4 to 6 laboratories and principal scientists and an additional 70 to 90 scientific/technical staff and administrative/support staff.

T as a supporting organization to you and involvement of Z

T is an organization described in section 501(c)(3) and classified as a supporting organization under section 509(a)(3). You will initially be a supported organization of T and T will manage intellectual property developed by you. You will appoint T's Board of Directors. T was formed to facilitate the development of your community into a leading center for basic biomedical research. It will also facilitate the initial development of your intellectual property.

T will establish Z, a for-profit corporation to commercialize your medical discoveries. Z will function as a technology transfer organization, and will enter into an exclusive license with you to commercialize your medical research discoveries and intellectual property. Z is completely owned by T.

Your future plan is to enter into arrangements with several tax-exempt organizations and governmental educational and research organizations in your community. Each one of these organizations will be supported organizations of T and be known as "Research Partners". The conditions for qualification as a Research Partner (and a supported organization of T) and the benefits of such qualification are outlined in a partnership arrangement between each research partner and T (the partnership arrangement), all of which is incorporated into the governing documents of T.

T will provide research support to you and also fundraise and conduct other activities, such as the promotion of endowment based research, and identify intellectual property for commercialization. The combination of the intellectual property of various Research Partners will build the critical mass necessary to ensure that scientific discoveries are made for the public good. The fundraising and commercialization of the intellectual property will build large endowments for future research. The building of significant endowments is the only way to guarantee that sufficient funds will always be available to support the medical research efforts of the Research Partners in perpetuity. Providing funds and facilities for uninterrupted research will ensure that scientific discoveries will eventually be made to cure a variety of diseases.

In consideration of receiving Research Partner status and the commercialization of the intellectual property, each supported organization must enter into an agreement with Z to transfer the intellectual property of the organization to Z. All intellectual property of the Research Partners will be exclusively licensed to Z for commercialization.

Detailed Description of the Transaction

You plan on entering into an arrangement with Z whereby Z will commercialize your intellectual property. You will exclusively license your intellectual property to Z and transfer to Z the right to a royalty interest in the intellectual property in an amount equal to its technology transfer costs plus 50% of any net income generated by the intellectual property, all pursuant to the exclusive license. The exclusive license will provide that any and all intellectual property derived from your medical research will be licensed to Z automatically upon creation of the

intellectual property subject to your retention of ultimate ownership of the intellectual property and a 50% royalty interest in any net income generated by the intellectual property (the 50% retained royalty interest). This 50% retained royalty interest will give you the right to directly receive, following Z's recovery of its technology transfer costs, 50% of any royalty paid by any sublicensee of your intellectual property, any sales proceeds from the intellectual property, or any gross receipts generated by the intellectual property.

Each Research Partner must enter into a technology transfer agreement with Z, pursuant to which the Research Partner will grant to Z an exclusive license. Although some organizations, as public or quasi-public entities, will have limited flexibility in transferring their intellectual property to Z, the basic structure and purpose and goals of the form technology transfer agreement, will, to the extent possible, not be subject to material variation or negotiation. In addition, to the transfer of intellectual property by the Research Partner and payment of royalties, the technology transfer agreement will cover (i) the technology transfer (commercialization) activities to be engaged in by Z, (ii) patent prosecution or maintenance, (iii) representation and warranties of Z and the Research Partner, (iv) indemnification of the Research Partner by Z, (v) retention of ownership by the Research Partner to the licensed discoveries, (vi) confidentiality, and (vii) the term and termination of the agreement and the effects of termination.

The exclusive license issued to Z is critical to the success of the partnership. By unlocking and leveraging now the value of each Research Partner's intellectual property over time, rather than engaging in the piece meal technology transfer approach prevalent in the market, the Research Partners are assured of creating large research endowments. This arrangement will assure that large research endowments will be created up front for long-term basic biomedical research. The large endowments can be achieved because Z, following the transfer of intellectual property by the Research Partners, will be immediately worth many times the $40 million in cash and or securities contributed to Z by T. Furthermore, at some point in the future, stock of Z can be sold and the proceeds transferred by T to the Research Partners. Because the Research Partners are required to invest such proceeds and spend no more than five percent of the fair market value thereof in any given year, and then only on basic biomedical research, the Research Partners will be assured a perpetually growing endowment for such research.

The transfer by the Research Partners of all of their intellectual property in one transaction to Z will further benefit the partnership and specifically the Research Partners by, (i) avoiding the diversion of time and resources away from conducting scientific research to patenting, developing and commercializing intellectual property on a discovery by discovery basis, (ii) providing the technology transfer organization with increased access to complementary technology from other Research Partners, (iii) increasing the likelihood that a world class technology transfer organization can be developed as a result of the concentration of high quality intellectual property and concerted support, rather than attempting to achieve such success in multiple operations, and facilitating the recruiting of top scientists, technology transfer experts, and other personnel. Success in this regard will ultimately increase the quality and quantity of intellectual property created by the Research Partners, thereby further increasing the value of Z, which will result in increased funding for research--a circular and self perpetuating process that will propel the Research Partners towards their goal of conducting

biomedical research.

Your scientists responsible for producing the intellectual property will enter into incentive compensation arrangements whereby the discovering scientist will receive all of your 50% retained royalty interest received as a result of Z commercializing the intellectual property. You will retain the remaining royalty through T's ownership of all of the stock of Z. The incentive compensation is fair market value based on the standards in the industry and is negotiated at arm's-length with the scientists. You have determined that the compensation arrangement is consistent with arrangements provided by other major medical research institutions. This compensation arrangement will enable you to recruit and retain quality scientists.

T will be funded with start-up contributions of certain persons and organizations, including you. Each Research Partner will have the right to appoint one director to T's Board. In addition to appointing one Board Member, you will have the right to appoint three additional Board Members to T . The consent of the majority of the four directors appointed by you will be required for T to take certain material actions, including an amendment to T's organizational documents, termination or any material alteration of the officer's of T, entry by T into any material agreement, any transaction involving any material encumbrance of any asset of T, termination of the agreement with any Research Partner, commencement of any voluntary proceeding in respect of T seeking liquidation, reorganization, dissolution, or bankruptcy, and disposition of voting capital stock of Z held by T.

Each Research Partner agrees to commit the necessary support, facilitate and promote the partnership; establish, develop, administer and maintain continuing close cooperation with the other Research Partners and T; and facilitate and promote interaction and exchange of information between the Research Partner's personnel and representatives and those of the other Research Partners and T.

T will use the contributions it receives and contribute funds to Z in return for Z issuing all of its stock to T. T will be issued 39,994,000 shares of Class A common stock and 6,000 shares of Class B stock in exchange for an agreed upon price. Each share of Class B stock will have super voting rights but will have the same dividend and liquidation rights as a share of Class A stock. The holders of the Class B stock will control Z.

Each Research Partner will receive from T a proportionate amount of dividends paid by Z on its stock and proceeds from any resale by T of Class A stock. The proportional amount will be the ratio of the gross proceeds of the Research Partner's discoveries being commercialized by Z to the total gross proceeds of all Research Partners being commercialized by Z . Any distributions made to the Research Partners must be added to a permanent endowment required to be established by each of them. Each Research Partner's endowment must be invested and no more than five percent of the fair market value may be spent in any given year. These expenditures, which must be in the area of basic biomedical research will be monitored by T. After all start-up contributions are repaid to the founding partners, all proceeds from the resale of the Z stock must be distributed to the founding partners pro rata in proportion to their respective start up contributions. For any portion of a founding partner's start-up contribution that consists of securities, the amount of its start-up contributions will be increased to the extent that the annually compounded pre-tax rate of return on the securities in question exceeds eight

percent. The return on the founding partner's contributed securities will be determined by T based upon all dividends received, all sales proceeds received, and all unrealized appreciation. Founding partners that do not wish to be repaid their start-up contributions may waive such right at any time prior to such repayment.

Contributions received by T that designate a specific Research Partner as the recipient will be distributed to that Research Partner as so designated, subject to being placed in a permanent endowment. Otherwise, contributions received by T will be distributed to the Research Partners as determined by T's Board of Directors. Contributors may not earmark their donations to support particular research projects and will not have any right to direct the research of the Research Partners by making these contributions. In addition, contributors who make a single contribution to T of one million dollars or more (following the technology transfer) will have the right to purchase Z Class A stock, having an aggregate fair market value equal to 10% of the amount of such contribution, on behalf of, and in the name of another section 501(c)(3) organization chosen by the contributor. The fair market value of the Class A stock purchased by the large contributor on behalf of, and in the name of the designated charity, shall be determined at the time of the contribution, by an independent investment banking firm or other qualified appraiser. The large contributor will never have the right to receive title to the Class A stock. The designated charities receiving the Class A stock from T will be required to enter into an agreement with T and Z containing terms, conditions, representations and warranties as customary for a private securities offering, including provisions establishing restrictions on the resale of the shares of Class A stock and incidental registration rights. The effect of these transactions will be that the designated charities will not be able to transfer the Class A stock for an extended period and even when they are able to transfer the Class A stock, the only permitted transfer will be to section 501(c)(3) organizations absent a waiver of the requirement by Z, which could only be granted with T's consent. One additional requirement will be that if the designated charity loses its section 501(c)(3) status, the Class A stock will immediately revert back to T. It is possible that at some time in the future, T may sell and may allow the designated charities to sell, the Class A stock to private individuals or to for-profit companies, but such sales are not planned at this time.

T will support you and the Research Partners by providing research support, management of intellectual property, promotion of endowment based research, and identification of intellectual property for commercialization. Each Research Partner is required to grant an exclusive license to Z through a signed arrangement. The arrangement entered into with Z will cover the technology transfer to be engaged in by Z, patent prosecution and maintenance, representation and warranties of Z and the Research Partner, indemnification of the Research Partner by Z, retention of ownership by the Research Partner to the licensed discoveries, confidentiality, and the term and termination of the arrangement and effects of termination.

When an organization wants to be added as a Research Partner, it will enter into an arrangement with you, T and Z. The Research Partner will follow the rules set forth in the arrangement, by providing an exclusive license to Z and Z will receive the right to a royalty interest equal to its technology transfer costs plus 50% of the net income generated by the intellectual property. The exclusive license will provide that any and all intellectual property derived from you or the research partner's medical research will be licensed to Z automatically

upon creation of the intellectual property subject to your or the Research Partner's retention of ultimate ownership of the intellectual property and a 50% royalty interest in any net income generated by the intellectual property. This 50% retained royalty interest will give you and your Research Partners the right to directly receive, following Z's recovery of its technology transfer costs, 50% of any royalty paid by any sublicensee of your or your Research Partner's intellectual property, any sales proceeds from the intellectual property, or any other gross receipts generated by the intellectual property.

A Research Partner's status may be terminated by the Research Partner at any time for any reason upon 120 days prior written notice or by T at any time if T determines that the Research Partner is in material breach or default under such agreement and such material breach or default is not cured with 60 days after written notice, or reasonable action to cure has not been diligently initiated and pursued in the event that a cure cannot be effected within 60 days. Upon termination of a Research Partner's status for any reason, (a) all rights and obligations of the Research Partner and T under the partnership agreement, except as otherwise provided will terminate, the Research Partner must pay to T an amount equal to the then current value of the permanent endowment established pursuant to such agreement to receive distributions from T, and the technology transfer agreement between the Research Partner and T will terminate except with respect to any intellectual property created prior to such termination.

You request the following rulings:

1) Your grant to Z of the exclusive license, including the Z royalty interest, in exchange for Z commercializing your intellectual property will not adversely affect your tax-exempt status under section 501(c)(3) of the Code.

2) The royalties you plan to receive under the technology transfer agreement will not be taxable as unrelated business taxable income under section 511 of the Code.

3) The research activities conducted in your facility are and will be substantially related to the furtherance of your exempt purposes and will not constitute an unrelated trade or business.

Law

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for scientific purposes and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations states that an organization will be regarded as operated exclusively for one or more exempt purposes specified in section 501(c)(3) only if it engages primarily in activities that accomplish such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations states that an organization is not operated

exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(c)(3)-1(d)(1)(i) provides that exempt purposes includes scientific purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(d)(5)(i) of the regulations provides that a scientific organization must be organized and operated in the public interest. The term "scientific" includes the carrying on of scientific research in the public interest. Research has various meanings and is not synonymous with scientific, and the nature of the particular research depends upon the purpose which it serves. The determination as to whether research is scientific does not depend on whether such research is classified as fundamental or basic as compared with applied or practical.

Section 1.501(c)(3)-1(d)(5)(ii) of the regulations explains that scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations. For example, scientific research does not include the ordinary testing or inspection of materials or products or the designing or construction of equipment or buildings.

Section 1.501(c)(3)-1(d)(5)(iii) of the regulations states that scientific research will be regarded as carried on in the public interest if

(a) the results of the research (including any patents, copyrights, processes or formulae resulting from such research) are made available to the public on a nondiscriminatory basis;

(b) the research is performed for the United States or any of its agencies or instrumentalities or for a state or political subdivision thereof; or

(c) the research is directed toward benefiting the public. Examples of scientific research directed toward benefitting the public include

1) scientific research carried on for the purpose of aiding in the scientific education of college or university students;

2) scientific research 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

3) scientific research carried on for the purpose of discovering a cure or disease; or

4) scientific research carried on for the purpose of aiding a community or geographic area or attracting new industry to the community or area or by encouraging the development of, or retention of, an industry in the community or area.

Section 1.501(c)(3)-1(d)(5)(iii) of the regulations provides research that is otherwise directed toward benefiting the public will be regarded as such even though the research is performed pursuant to a contract or agreement whereby 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.

Section 1.501(c)(3)-1(d)(5)(iv) of the regulations provides that an organization will not be regarded as organized and operated for the purpose of carrying on scientific research in the public interest if:

1) Such organization will perform research only for persons which are (directly or indirectly) its creators and which are not described in section 501(c)(3); or

2) Such organization retains the ownership or control of more than an insubstantial portion of the patents, copyrights, processes, or formulae resulting from its research and does not make such patents, copyrights, processes or formulae available to the general public.

Section 1.501(c)(3)-1(d)(5)(iv)(b) provides that a patent, copyright, process, or formula should be made available to the public on a nondiscriminatory basis. In addition, although one person is granted the exclusive right to use a patent, copyright, process, or formula, such patent, copyright, or formula shall be considered as made available to the public if granting such exclusive right is the only practicable manner in which the patent, copyright, process or formula can be utilized to benefit the public. In such case, however, the research from which the patent, copyright, process or formula resulted will be carried on in the public interest only if it is carried on for a person described in section 1.501(c)(3)-1(d)(5)(iii)(b) or it is scientific research directed towards benefiting the public (within the meaning of section 1.501(c)(3)-1(d)(5)(iii)(c).

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" to mean gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the allowable deductions directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

Section 512(b)(2) of the Code provides that all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income, are excluded from unrelated business taxable income.

Section 512(b)(13)(A) of the Code provides that if an organization (the "controlling organization") receives or accrues (directly or indirectly) a specified payment from another entity which it controls (the controlled entity), notwithstanding paragraphs (1), (2), and (3) (of section 512(b)), the controlling organization shall include such payment as an item of gross

income derived from an unrelated trade or business to the extent such payment reduces the net unrelated income of the controlled entity (or increases any net unrelated loss of the controlled entity). Section 512(b)(13)(C) of the Code provides that a "specified payment" means any interest, annuity, royalty or rent. Section 512(b)(13)(D)(i)(I) of the Code provides that control means, in the case of a corporation, ownership (by vote or value) of more than 50% of the stock in such corporation.

Section 513(a) of the Code defines the term unrelated trade or business as 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 of such organization of its charitable, educational, or other purpose or function constituting the basis of its exemption under section 501.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is related to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income) and is substantially related only if the causal relationship is a substantial one.

Rev. Rul. 70-186, 1970-1 C.B. 128, provides that an organization organized and operated primarily to preserve and improve a lake used extensively as a public recreational facility qualified for exemption under section 501(c)(3) because it would be impossible for the organization to benefit the public without also benefiting lake front property owners.

Rev. Rul. 76-296, 1976-2 C.B. 141, provides that commercially sponsored research otherwise qualifying as scientific 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.

Your activities of conducting basic biological research designed to determine how certain abnormalities in genes cause disease and how to manipulate genes to prevent disease are considered scientific research in the public interest under section 1.501(c)(3)-1(d)(5)(i) of the regulations because the biological research is being used for the purpose of discovering cures for diseases and obtaining scientific information that is published for the interested public.

Your exempt purposes will not change by having an exclusive license with Z. You will still continue to engage in research for the purpose of both discovering cures for diseases and obtaining scientific information that is published for the public interest. You will publish your findings as soon as developments on a project warrant publication or within a reasonably short time after completion of the project. If patents are being obtained for the discovery in question, publication will be made within a reasonable period after such rights are established such as the filing of applications for patents. Any delay will be for you to protect your ownership rights in the patent. Your research will continue to meet the requirements for scientific research carried out in the public interest under section 501(c)(3).

Your activities are consistent with Rev. Rul. 76-296, which holds that scientific research can be regarded as carried on in the public interest even when a commercial sponsor has the right to obtain ownership or control of the intellectual property resulting from the research if the results of the research are published without reasonable delay, other than delay needed to secure patent rights arising from the research. Even assuming that Z could be considered a sponsor even though Z does not direct or control the research in any way, and even assuming that Z could be considered a commercial sponsor even though Z will be wholly owned by section 501(c)(3) organizations for the foreseeable future, the publication policies that you will follow will ensure that your research continues to be carried out in the public interest.

Under the exclusive license, Z and any sublicensee of any portion of the intellectual property will not have control over the direction of your research. Z only has the right to receive progress reports and access to the research results to know when the intellectual property is ready to be marketed. Your arrangement with Z will therefore not result in more than incidental private benefit to Z, even without considering the fact that Z is wholly owned by a section 501(c)(3) organization and will be owned by section 501(c)(3) organizations in the foreseeable future.

The research you conduct will not be an unrelated trade or business because it is substantially related to the furtherance of your scientific purposes, and the research qualifies as scientific research carried on in the public interest under section 501(c)(3) and so furthers your exempt purposes.

The royalties you receive are excluded from unrelated business income tax under section 512(b)(2). There is no unrelated business income under section 512(b)(13) relating to payments received from controlled entities because the payments are not from Z, but from the payor of the income derived from the commercialization of your intellectual property. Neither T nor Z have any right to your 50% retained royalty interest.

Based on the foregoing facts, we rule as follows

1. Your grant to Z of the Exclusive License, including the royalty interest to Z, in exchange for Z commercializing your intellectual property, will not cause you to lose your exempt status under section 501(c)(3).

2. The royalties that you will receive under the technology transfer agreement will not be taxable as unrelated business taxable income under section 511 of the Code.

3. The research activities conducted in your facility are and will be substantially related to the furtherance of your exempt purposes, and will not constitute an unrelated trade or business.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, EO Technical
Group 1