Internal Revenue Service

Department of the Treasury

Washington, DC 20224

141.01-00
149.02-00

199914045

Person to Contact:

Telephone Number:

Refer Reply to:
CC:DOM:FI&P:5/PLR-113807-98

Date: JAN 8 1999

LEGEND:

Authority =

State =

Corporation =

Agencies =

Bonds =

a =

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Date 1 =

Dear

This letter is in reply to your request for rulings that (1) use of the Facility to provide services to the federal government pursuant to research contracts (the "Research Contracts") with the Agencies, which are all federal agencies, will not constitute private business use within the meaning of §§ 141(b) or 145(a) of the Internal Revenue Code, and (2) payments by the federal government under the Research Contracts will not cause the Bonds to be federally guaranteed within the meaning of § 149(b).

Facts and Representations

You make the following factual representations. The Authority is a political subdivision of the State, and has been granted the authority to issue revenue bonds to finance facilities for use by § 501(c)(3) organizations.

The Corporation is a § 501(c)(3) organization, with the primary exempt purpose of performing "scientific research in the public interest." The Corporation is organized and operated to work with federal, state, and local governments, and other non-profit organizations on technology-based research and development programs that are in the public interest. Substantially all of the Corporation's research enters the public domain through scientific and technical publications and presentations or through use by the Corporation in providing services to its clients.

The Corporation currently has approximately a scientific research contracts, including the Research Contracts, with terms ranging from six months to five years. The typical contract has a term of one year, and no research contract contains any provision requiring the client to renew the contract. The funding necessary to pay for research under any specific contract with the federal government may be reduced at any time by the federal government. Accordingly, all of the Corporation's research contracts with the federal government allow the federal government to terminate the contract at any time.

Although the Corporation conducts much of its research activity for clients that are federal agencies, the Corporation itself has no affiliation with the federal government, nor is it controlled in any way by the federal government. In fiscal 1997, approximately b percent (by revenue) of the Corporation's business was with governmental entities, whether federal, state, or local; and c percent of its governmental business was with federal agencies.

The Research Contracts do not grant clients ownership of any intellectual property developed or discovered in the course of its research (the "New Property"). Under applicable federal government contracting principles that apply to all of the Research Contracts, certain rules apply. First, the Agencies receive a non-exclusive, royalty-free license in certain New Property (technical data, software, patents) generated in the course of performing research on behalf of the Agencies. In general, the purpose of such a license is to ensure that federal agencies other than the contracting Agency may use the New Property without the federal government paying the Corporation a second time. Second, the Corporation retains publication rights

in any New Property and the right to utilize the New Property in any future work performed for other clients without requiring the approval of the federal government. Third, the Corporation may register copyrights and trademarks and apply for patents with respect to New Property, without federal government consent.

The Corporation represents that the price paid by any of the Agencies for the use of any New Property developed or discovered in the course of a Research Contract will not be less than the price that will be payable to the Corporation by any non-federal government party for the right to use the New Property. The price referred to in this representation refers only to any amount payable at the time the New Property is available for use. The Corporation has further represented that the use of the New Property by any federal government department or agency will be subject to the same terms as those that would apply to the use of the New Property by any non-federal government party.

Pursuant to an inducement resolution passed by the Authority on Date 1, the Authority proposes to issue the Bonds and loan the proceeds to the Corporation. The Corporation will use the Bond proceeds to acquire, construct, and equip a headquarters and scientific research facility (the "Facility") for the Corporation which will be used to perform the aforementioned research.

Law and Analysis

Private business use

Section 103(a) of the Internal Revenue Code provides that gross income does not include interest on a State or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond, unless it is a qualified bond under § 141.

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue (1) which meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or (2) which meets the private loan financing test of § 141(c).

Section 141(b)(1) provides in general that an issue 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. Private business use is defined in § 141(b)(6) as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For this purpose, any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(b)(2) provides in general that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is (under the terms of the issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(e) provides that a qualified bond includes a qualified 501(c)(3) bond.

Section 145(a) provides that, except as otherwise provided in § 145, the term "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if all of the property that is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and such bond would not be a private activity bond if § 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying § 513(a). For this purpose, paragraphs (1) and (2) of § 141(b) are applied by substituting "5 percent" for "10 percent" each place it appears and "net proceeds" for "proceeds" each place it appears.

Section 1.141-3 of the Income Tax Regulations provides rules pertaining to the definition of private business use. Section 1.141-3(a) states, in part, that the use of financed property is treated as the direct use of proceeds. In determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of the proceeds. Use of proceeds by all nongovernmental persons is aggregated.

Section 1.141-3(b)(1) generally provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

Section 1.141-3(b)(6)(i) 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.

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.

Revenue Procedure 97-14, 1997-1 C.B. 634, sets forth certain operating guidelines for agreements to conduct research in bond-financed facilities which, if satisfied, allow research to be conducted under the agreement without causing the facilities to be treated as used in a private business use.

Section 5.01 of Rev. Proc. 97-14 provides that a research agreement that is described in either § 5.02 or § 5.03 of the revenue procedure does not result in private business use. Section 5.02 of Rev. Proc. 97-14 applies to a research agreement relating to property used for basic research (hereafter defined) supported or sponsored by a sponsor (hereafter defined). Under § 5.02, 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), with the price paid for that use of the technology determined at the time the 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.

Section 3 0f Rev. Proc. 97-14 contains the definitions of certain relevant terms:

.01 "Basic research" means, for purposes of § 141, any original investigation for the advancement of scientific knowlege 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 § 1.103-1 or any instrumentality thereof. The term also includes a § 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a). 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.

In this case, the Research Contracts meet § 5.02 of Rev. Proc. 97-14. Thus, the use of the Facility to provide services to the federal government through the Agencies pursuant to the

Research Contracts will not constitute private business use within the meaning of §§ 141(b) or 145(a).

First, the Research Contracts are for basic research as that term is defined in § 3.01 of Rev. Proc. 97-14. The Corporation's research under the Research Contracts is conducted in the public interest and has no specific commercial objective. The Corporation's purpose is to perform scientific research in the public interest. All of the Corporation's research under the Research Contracts enters the public domain. Either the Corporation will disclose to the public the results of its research under the Research Contracts through scientific and technical publications and presentations, or the Corporation will use the research results to enhance its knowledge base to the benefit of the next client (typically the federal government or another state or local government).

Second, The Corporation has represented that the price paid by any of the Agencies for the use of any New Property developed or discovered in the course of a Research Contract will not be less than the price that will be payable to the Corporation by any non-federal government party for the right to use the New Property. The price referred to in this representation refers to any amount payable at the time the New Property is available for use. The Corporation has further represented that the use of the New Property by any federal government department or agency will be subject to the same terms as those that would apply to the use of the New Property by any non-federal government party. Since any license received by the Agencies to use the New Property will be non-exclusive and royalty-free, the effect of the Corporation's representation is that either the contracting Agency or any non-sponsoring party may use the New Property on a non-exclusive, royalty-free basis. The Research Contracts do not grant the Agencies ownership of any of the New Property.

Federal guarantee

Section 149(b)(1) provides, generally, that § 103(a) does not apply to any State or local bond that is federally guaranteed.

Section 149(b)(2) provides that a bond is federally guaranteed if:

(a) The payment of principal or interest with respect to the bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof),

(b) The bond is issued as part of an issue and 5 percent or more of the proceeds of the issue is to be used in making loans the payment of principal or interest with respect to

which are to be guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or invested (directly or indirectly) in federally insured deposits or accounts, or

(c) the payment of principal or interest on the bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof).

Payments by the federal government under the Research Contracts will not cause the Bonds to be federally guaranteed. Unlike a guarantee, the availability of federal revenue from sales by the Corporation of its services is wholly dependent upon the continued activity and viability of the Corporation rather than its default in debt service payments. The obligations of the federal government to purchase the Corporation's services are dependent upon the Corporation's performance of those services to contract specifications. All of the Research Contracts are made subject to the contingency that funding levels may be reduced at any time. Finally, there are no circumstances in which a default by the Corporation with respect to the Bonds will trigger an obligation of any client of the Corporation, including the federal government, to make payments with respect to the Bonds. The Corporation has no affiliation with the federal government other than the Research Contracts, and is not controlled in any way by the federal government.

Conclusion

Based on the foregoing analysis we conclude that (1) use of the Facility to provide services to the Agencies pursuant to the Research Contracts will not constitute private business use within the meaning of §§ 141(b) or 145(a) of the Internal Revenue Code, and (2) payments by the federal government under the Research Contracts will not cause the Bonds to be federally guaranteed within the meaning of § 149(b).

Except as specifically ruled above, no opinion is expressed concerning this transaction under any provision of the Code or regulations thereunder. Specifically, no opinion is expressed concerning whether interest on the Bonds is excludable from gross income under § 103(a). Neither is any opinion expressed on the effect of any subsequent action or event that is inconsistent with the facts and representations stated herein.

This ruling letter is addressed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions & Products)

By: Timothy L. Jones
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Enclosure:
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