

DAY **ONE** **PROJECT**

Reforming Federal Rules on Corporate-Sponsored Research at Tax-Exempt University Facilities

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Summary

Improving university/corporate research partnerships is key to advancing US competitiveness. Reform of the IRS rules surrounding corporate sponsored research taking place in university facilities funded by tax-exempt bonds has long been sought by the higher education community and will stimulate more public-private partnerships. With Congress considering new ways to fund research through a new NSF Technology Directorate and the possibility of a large infrastructure package, an opportunity is now open for Congress to address these long-standing reforms in IRS rules.

Challenge and Opportunity

Research partnerships between private companies and universities are critical to U.S. technology competitiveness. China and other countries are creating massive, government-funded research centers in artificial intelligence, robotics, quantum computing, biotechnology, and other critical sectors, threatening our nation's international technology advantage. The United States has responded with initiatives such as the corporate research and development (R&D) tax credit, the SBIR and STTR programs, Manufacturing USA institutes, and numerous other programs and policies to assist tech development and encourage public-private collaborations. States and cities have mirrored these efforts, helping to build a network of innovation hubs in communities across the nation.

The U.S. Innovation and Competition Act recently passed by the Senate is designed to build on this progress. A key provision of the Act is the establishment of a National Science Foundation (NSF) Directorate for Science and Technology that would “identify and develop opportunities to reduce barriers for technology transfer, including intellectual property frameworks between academia and industry, nonprofit entities, and the venture capital communities.”

One such barrier is the suite of “private use” rules surrounding corporate research taking place in university facilities financed with tax-exempt bonds. Tax-exempt bonds are a preferred financing option for university research facilities as they carry lower interest rates and more favorable terms. But the Internal Revenue Service (IRS) prohibition on “private business use” of facilities financed using tax-exempt bonds have the unfortunate consequence of hamstringing the U.S. research enterprise. Current IRS rules place universities wishing to avoid concerns about sponsoring research from outside organizations to hold the rights to almost all intellectual property (IP) generated within their research facilities, even when the research is sponsored by private corporations. This can lead U.S. corporations wishing to retain IP rights to partner with universities overseas instead of U.S. universities institutions. Small technology companies whose business plans depend on their claim to IP rights may similarly avoid partnerships with universities.

Though the IRS has issued policies that aim to address these problems (e.g., Revenue Procedure 2007-47), such policies are so narrow in scope that most research partnerships between companies and universities are still considered private uses. As a result, universities engaged in cutting-edge, industry-relevant research face an unenviable choice: they must either (i) forego promising partnerships with the many companies unwilling to completely cede claims to IP rights, (ii) dedicate substantial time and administrative resources to track and report all specific instances of corporate-sponsored research occurring in facilities financed by tax-exempt bonds, or (iii) use funding that would otherwise be available for research to finance facilities through taxable bonds.

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Forcing this choice upon universities further exacerbates a system of “haves” and “have-nots”. Large and/or well-endowed universities may have the financial resources to avoid relying on tax-exempt financing for research facilities, or to hire sophisticated and expensive legal expertise for help structuring financing in a way that complies with IRS rules. But for many — perhaps most — universities, the more viable solution is to avoid corporate-sponsored research altogether.

Complex federal rules governing intellectual property and private business use are widely acknowledged as an issue. A memo from the Association of American Universities (AAU), which represents the leading research universities in North America, notes that [“\[m\]any universities believe that the remaining \[IRS\] private use regulations are overly restrictive”](#) and [“\[limit\] their ability to conduct certain cooperative research.”](#) Similarly, [the website of the Carnegie Mellon University Office of Sponsored Programs warns:](#)

“While colleges and universities have lobbied the Internal Revenue Service to reconsider its position with respect to sponsored research in bond financed facilities, they have not, as yet, been successful. Consequently, if the University does not receive fair market royalties from the sponsors of sponsored research, it risks having its tax-exempt bonds become taxable, with all of the concomitant consequences.”

At a 2013 hearing on [“Improving Technology Transfer at Universities, Research Institute and National Laboratories”](#) before the U.S. House of Representatives Committee on Science, Space and Technology, several university witnesses and members of Congress commented on the complications that federal rules present for cooperative research conducted by universities working in partnership with corporations.

In 2014, Congress introduced H.R. 5829 to amend the Internal Revenue Code to provide an exception from the “business use” test for certain public-private research arrangements, but it did not pass as a stand-alone bill.

In June 2021, the American Council of Education and Association of American Universities released a [letter](#) to Congress on behalf of over 20 higher education organizations asking Congress to modernize rules on tax exempt bond financing.

Overly restrictive federal rules may hamstring bipartisan efforts by the new administration and Congress to accelerate tech commercialization and enhance U.S. competitiveness in science and technology (S&T). The recent U.S. Innovation and Competition Act, passed by the Senate, for instance, aims to support public-private partnerships, cross-sectoral innovation hubs, and other multistakeholder initiatives in priority S&T areas. But such initiatives may run afoul of rules on facilities financed by tax-exempt bonds...unless reforms are adopted.

Plan of Action

The administration should implement the following two reforms to clarify and update rules governing use of facilities financed by tax-exempt bonds:

- (1) **Eliminate the requirement that universities must retain ownership to all IP generated in university-owned facilities financed by tax-exempt bonds.** Instead, universities and corporations should be allowed to negotiate their own terms of IP ownership before entering a research partnership.
- (2) **Broaden applicability of IRS safe-harbor provisions.** IRS revenue procedures include safe-harbor provisions that exempt “basic research agreements” from restrictions on private business use. The IRS defines basic research as [“any original investigation for the advancement of scientific knowledge not having a specific commercial objective.”](#) This definition is too narrow. But especially today, the lines between “basic” and applied research are blurry — and virtually nonexistent when it comes to cutting-edge fields such as digitalization, biosciences, and quantum computing. The IRS should broaden the applicability of its safe-harbor provisions to include all research activities, not just 'basic research'.

Together, these reforms would support new public-private initiatives by the federal government (such the research hubs funded under the U.S. Innovation and Competition Act); help emerging research universities (including minority-serving institutions such as historically black colleges and universities (HBCUs) and Hispanic-serving institutions (HSIs)) grow their profiles and better compete for talent and resources; and repatriate corporate research to the United States. Moreover — since other countries do not have similarly onerous restrictions on research activities conducted in facilities financed with tax-exempt bonds — these reforms are needed for the U.S. tech economy to remain competitive on an international scale.

These reforms require changes to tax laws, but do not require a direct outlay of federal appropriations. Reforms could be implemented as part of several tech-commercialization legislative packages expected to be considered by this Congress, including the U.S. Innovation and Competition Act or the proposed US Infrastructure bill.

Conclusion

As the Congress and the Administration explore ways to make the U.S. more technologically competitive, ensuring robust university-industry partnerships should be a key factor in any strategy. Reforming the current rules concerning corporate research performed in university facilities needs to be considered, given that the IRS rules have not been updated in over 30 years. The debate over the infrastructure bill or other competitiveness initiatives provides such an opportunity to make these reforms. Now is the time.

About the Authors



Brian Darmody is CEO of the Association of University Research Parks (AURP), a global nonprofit representing research parks and innovation districts sponsored by universities, federal laboratories, hospital systems, and communities. Brian previously served in many roles at the University of Maryland, College Park, including Associate Vice President for Research and Economic Development and Assistant to the President for State and Federal Government Affairs. He serves on the Maryland Venture Authority Board, among other board positions. Brian holds a B.A. from UMD, College Park, and a J.D. from University of Baltimore Law School.



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About the Day One Project



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