

---

**April 1, 2022**

**To:** Contracts & Grants Community, Industry Contracts Community, and Licensing Community

**Subject:** University Guidance on Applying the Tax Reform Act of 1986 to Research Related Agreements

## Table of Contents

Introduction and Background.....	1
Definitions.....	3
Table Summary.....	3
Principles for Avoiding Private Use in Research Agreements and Frequently Asked Questions .	6
A. Licenses and Options.....	6
B. Consortiums and Multi-Project Agreements.....	8
C. Materials Transfers.....	9
D. Other Agreement Types – Clinical Trials, Visiting Researchers and Recharge Facilities...	10
E. Copyrights .....	11
Description of Safe Harbor Provisions.....	11
Additional Information and Contact.....	12

## Introduction and Background

The University finances certain facilities in whole or in part with proceeds of tax-exempt or other tax-advantaged bonds. Federal tax law, including the [Tax Reform Act of 1986](#), places limits on the [Private Business Use](#) of such bond-financed facilities. The University agrees in its tax-exempt bond financings that it will not permit financed facilities to be used in any manner that would i) violate the IRS [Private Business Use](#) rules, or ii) otherwise cause the interest to become taxable under federal tax law. More than de minimus<sup>1</sup> [Private Business Use](#) of bond

---

<sup>1</sup> Although a small amount of Private Business Use is allowed under federal tax laws, the calculations to quantify allowable amounts are complex and beyond the scope of this Guidance. Monitoring compliance with allowable Private Business Use limits presents a significant administrative burden for Capital Planning/Budget departments given the total number of facilities involved and the ever-changing mix of financing sources supporting individual campus facilities. Private Business Use limits are in effect for the

financed facilities could jeopardize the bonds' tax-exempt status retroactively. Buildings and equipment that are paid off or financed in other ways are not subject to IRS [Private Business Use](#) rules.

Under some circumstances, discussed throughout the guidance below, granting sponsors intellectual property (IP) rights in sponsored research agreements could result in [Private Business Use](#) under the federal tax law. IRS Revenue Procedures 97-14 and [2007-47](#) describe which intellectual property terms will and will not cause a research activity to result in [Private Business Use](#).

The intellectual property terms that do not cause basic research activity to result in [Private Business Use](#) are referred to as [Safe Harbor Provisions](#). While [Safe Harbor Provisions](#) are only applicable to basic research agreements, the University bond counsel has advised that all research performed by the University, including applied research, is considered “basic research” under the Tax Reform Act of 1986.

Using [Safe Harbor Provisions](#) in sponsored research agreements is the most common and efficient way for University research activities to comply with [Private Business Use](#) limits. This Guidance<sup>2</sup> includes:

- a table summary of the [Safe Harbor Provisions](#);
- answers to frequently asked questions;
- principles for avoiding [Private Business Use](#) in research agreements; and
- a description of the [Safe Harbor Provisions](#).

This Guidance is intended for University administrators, such as contract and grant personnel and licensing personnel, involved in the review, negotiation of, or approval of intellectual property terms in sponsored research agreements, material transfer agreements, visitor agreements, equipment loan agreements, collaboration agreements, or other agreements. With regard to federal tax law, the responsibilities of such personnel are to:

1. recognize when intellectual property terms in such agreements (and/or the activities proposed within such agreements) result in [Private Business Use](#);
2. negotiate intellectual property terms of such agreements to minimize and/or avoid [Private Business Use](#) issues in research agreements;
3. coordinate with campus Capital Planning / Budget departments to avoid exceeding allowable [Private Business Use](#) limits; and
4. provide input to campus Capital Planning / Budget departments for the annual private activity questionnaire (PAQ) conducted by the Office of the President Capital Markets Finance to ensure compliance with the Tax Reform Act.

---

entire duration of the bonds (typically 30 years), and cover all types of private activity taking place in the facility including research, space leases, management contracts, energy efficiency agreements, and other special entitlements like naming rights and special concessions to vendors.

<sup>2</sup> This Guidance combines, clarifies, and replaces previously issued guidance (OTT Memo 00-01 and RPAC Memo 20-02). The Tax Reform Act of 1986 is complex; this Guidance is based upon advice from UC Legal and University bond counsel and attempts to provide a synopsis of some portions of the Tax Reform Act of 1986.

## Definitions

**Private Business Use<sup>3</sup>:** The direct or indirect use of tax-exempt bond proceeds in a trade or business of an [External User](#). Use of facilities paid for through tax-exempt bond proceeds is an example of indirect use of tax-exempt bond proceeds.

**Safe Harbor Provisions:** Intellectual property terms that do not cause a research activity to result in [Private Business Use](#). See also [Description of Safe Harbor Provisions](#).

**External User/Sponsor:** Any user/sponsor other than the University or another California state (e.g., California State University personnel) or local government user. An External User/Sponsor includes the federal government, for-profits, other 501(c)(3) organizations (including universities that are not considered a state or government agency) and any private individual, including a University faculty member or staff using the facility for that individual's personal and/or business use.

## Table Summary

IRS Revenue Procedures classify research agreements into three types: single-sponsor research agreements, multi-sponsor research agreements<sup>4</sup>, and federally sponsored research agreements. One set of [Safe Harbor Provisions](#) apply to research supported by a single, non-federal sponsor, and a second set of [Safe Harbor Provisions](#) apply to research supported by multiple sponsors or by a federal sponsor. The tables below organize information for both sets of [Safe Harbor Provisions](#) and for related research activities (material transfers, visiting researchers, and clinical trials). Additional details and frequently asked questions are available following the tables.

---

<sup>3</sup> Private Business Use for the purposes of tax-exempt and tax-advantaged bond financing is distinct from “private benefit,” which applies to all organizations qualified under Section 501(c)(3) of the Internal Revenue Code. Please contact UC Legal for further guidance.

<sup>4</sup> The IRS Revenue Procedures use different terminology. Single-sponsor research agreements are referred to as “corporate sponsored research agreements” and multi-sponsor research agreements are referred to as “cooperative research agreements”. The IRS terminology is rarely used in research administration contexts, and can cause confusion. Using the terms single-sponsor and multi-sponsor research agreements in this guidance aligns the definition with terminology familiar to research administrators.

**Table 1: Single-Sponsor Research Agreement**

<b>Within Safe Harbor Provisions</b> (must meet all 4 criteria)	<b>Outside Safe Harbors Provisions/ Private Business Use</b>
1. Single sponsor funds basic/applied research.	Recharge facilities serving <a href="#">External Users</a> , unless short-term use exemptions apply (see <a href="#">FAQ 16</a> ).
2. UC must solely own any technology created using bond-financed facility (e.g., patents, data, materials).	Sponsor given sole or joint ownership of technology created using tax-exempt bond financed facility or equipment.
3. UC controls the manner in which research is performed at the bond-financed facility.	
4. Sponsor IP Rights <ul style="list-style-type: none"> <li>a) Except for non-exclusive royalty-free (NERF) licenses, sponsor must pay a fair, competitive price for use of resulting technology.</li> <li>b) Price paid for sponsor's use of resulting technology is determined at the time the license or other resulting technology is available for use.</li> </ul>	<p>Except for NERF licenses, pre-negotiated financial terms of a license to future technology or a present grant of a license may trigger <a href="#">Private Business Use</a> that needs to be monitored, unless the pre-negotiated financial terms (e.g., royalty range) reflect "fair market value" of an anticipated, pre-identified technology as of the time the technology is available for use.</p> <p>Sponsor dictates to UC what it can or cannot charge third parties for a non-exclusive license to UC resulting technology.</p>
<p>Exclusive licensing of resulting technology is permitted, including subject inventions resulting solely from federal sponsorship.</p> <p>Federal sponsorship (and the government's resulting free NERF) does not constitute <a href="#">Private Business Use</a> by the federal government.</p>	

**Table 2: Multi-Sponsor Research Agreement and Federally Sponsored Research Agreement**

<b>Within Safe Harbor Provisions</b> (must meet all 4 criteria)	<b>Outside Safe Harbors Provisions/ Private Business Use</b>
1. Multiple, independent sponsors or a federal sponsor funds basic research.	Recharge facilities serving <a href="#">External Users</a> , unless short-term use exceptions apply (see <a href="#">FAQ 16</a> ).
2. UC must solely own any technology created using bond-financed facility.	Sponsor given sole or joint ownership of technology created using tax-exempt bond financed facility or equipment.
3. UC controls the manner in which research is performed at the bond-financed facility.	A group or committee not majority controlled by UC determines the research to be performed and/or the manner in which the research is performed by UC.
4. Sponsor IP Rights: Sponsors are entitled to no more than a NERF license to use the resulting technology.	One sponsoring entity retains an exclusive option or license to UC resulting technology.  Sponsor(s) dictates to UC what it can or cannot charge third parties for a non-exclusive license to UC resulting technology.

**Table 3: Material Transfer Agreements (MTAs), Visiting Researchers, and Clinical Trials**

<b>Within Safe Harbor Provisions</b>	<b>Outside Safe Harbors Provisions/ Private Business Use</b>
MTA IP Rights:  a) if material provider is considered a single party sponsor, see Table 1  b) if material provider is considered a multi-party sponsor, see Table 2	Material provider given sole or joint ownership of technology created using bond-financed facilities.  If material provider is considered a multi-party sponsor, the grant/option to exclusive access to resulting technology to either a) the material provider or b) a sponsor of the activity.
Penalty clauses are not subject to Tax Act requirements.	
	Visiting Researchers <a href="#">External Users</a> of bond-financed UC facilities cause <a href="#">Private Business Use</a> regardless of how intellectual property is treated.
Clinical Trials Patient care activities conducted by the University at its facilities are treated differently from research activities and are not considered <a href="#">Private Business Use</a> .	

## Principles for Avoiding Private Use in Research Agreements and Frequently Asked Questions

University bond counsel developed Principles for Avoiding Private Business Use in Research Agreements that establish parameters for ensuring that research agreements remain within Safe Harbor Provisions. Frequently Asked Questions (FAQs) supplement these Principles.

University administrators may also use this universal carve-out:

*“All licenses granted are subject to University’s ability to retain the tax-exempt status of revenue bonds under IRS procedures regarding the use of facilities/equipment financed with such bonds. In the event of a conflict between obligations to the IRS and the terms of this Agreement, University agrees to grant the rights contemplated herein to the maximum extent permissible while meeting its obligations to the IRS.”*

### A. Licenses and Options

**Principle 1:** The University can always agree to a non-exclusive royalty-free license (a “NERF”, for research and/or commercial use) with an individual sponsor or group of sponsors, including the federal government. Contracts with federal entities that contain standard, Bayh-Dole invention rights do not cause [Private Business Use](#).

**FAQ 1:** Does it matter if the NERF license referenced in Principle 1 is commercial or an internal research use license?

No. The fact that a sponsor is granted a commercial NERF license does not constitute [Private Business Use](#) of the bond financed facility where the research is being conducted.

**Principle 2:** Only in single sponsor circumstances are exclusive licenses to the sponsor (or an entity specified by it) allowed and then only if fair market value is charged. Fair market value is determined at the time of the license in question. We believe that exclusive licenses are much more likely than non-exclusive licenses to result in [Private Business Use](#) and, therefore, extra care should be taken to make sure that exclusive licenses satisfy these principles. In determining whether an agreement (defined by its scope of work) has only a single sponsor, contributions by the University to the research project can be ignored.

**FAQ 2:** Does agreeing to an upfront royalty range, technology fee, license fee, or royalty cap for an exclusive license in the research agreement cause the activity to result in [Private Business Use](#)?

If the campus, through consultation with its respective Authorized Licensing Office (“ALO”), agrees that the royalty range (or other consideration) in the research agreement represents the “fair market value” of the anticipated and pre-identified invention at the time the technology becomes available, then the royalty range (or other consideration) in the research agreement likely does not cause the activity to result in [Private Business Use](#). The “fair market value” should be justified and documented by the campus accordingly.

**FAQ 3:** Is a present grant of a NERF license in a research agreement (e.g. “University hereby grants sponsor”) considered pre-pricing of the invention?

According to Principle 1, a NERF license is always within [Safe Harbor Provisions](#). The pre-pricing guidelines apply to licenses that are more exclusive than NERF licenses. Present grants of NERF licenses are subject to applicable University policies and guidelines even though they are within [Safe Harbor Provisions](#).

**FAQ 4:** Does agreeing to a time-limited, fixed-fee option agreement or letter of intent in the research agreement cause the activity to result in [Private Business Use](#)?

Option agreements and letters of intent are short-lived arrangements intended to allow a potential licensee to evaluate its interest in a license agreement. Option agreements and letters of intent in research agreements that do not pre-price the full value of an exclusive license would not cause the activity to result in [Private Business Use](#).

**Principle 3:** Where the only licenses provided are non-exclusive, it is fine to charge different sponsors differently. The key language point in the IRS guidance is that the [Safe Harbor Provisions](#) apply so long as no one is allowed anything BETTER than a NERF. Non-exclusive licenses that cost something are not better than a NERF. There is no requirement that multiple sponsors or any non-sponsors be treated consistently in terms of cost, but any different or inconsistent treatment of non-sponsors has to be entirely at the discretion of the University. (See the fifth Principle below.)

**FAQ 5:** What if the University grants a funding sponsor a NERF license and also grants a non-sponsor a royalty-bearing, non-exclusive license? Would this cause the activity to result in [Private Business Use](#)?

If the terms of the non-sponsor’s license are controlled entirely by the University and not the sponsor, the answer is no. Under Principles 3 and 4, there is no requirement that non-sponsors be treated consistently in terms of the financial provisions of a license if the non-sponsor’s terms are controlled by the University.

**Principle 4:** Consistent treatment among all licensees, whether sponsors or non-sponsors, is not required. There are no limitations on the terms of individual licenses granted to non-sponsors. However, the IRS has ruled in some cases that an agreement granting broad rights to a research institution’s present and future intellectual property may cause the licensee to be a private user of the facilities in which the research developing the intellectual property was performed. This does not impact agreements with invention management organizations (such as [WARE](#)) relating to existing inventions.

**FAQ 6:** Does a provision in a single sponsor research agreement granting the sponsor a time-limited option to negotiate an exclusive license to all fields of use for inventions conceived and reduced to practice in the performance of the research agreement constitute “granting broad rights” as described in Principle 4?

No. A broad grant of rights refers to the grant of rights to inventions made outside the performance of the research agreement. Pipelining of future inventions or the grant of

licenses to background intellectual property are examples of broad grants of invention rights.

**Principle 5:** The University must be careful to guard against contractual provisions with sponsors which limit the University's discretion over what to charge non-sponsors. Sponsors will know what they will be charged when they license technology, but sponsors cannot dictate to the University what the University will charge others.

**FAQ 7:** Does a "most favored nations clause" or "right of first refusal" (e.g., requiring the University not to license an invention to a non-sponsor on financial terms more favorable to the non-sponsor than the terms last offered to the sponsor without first providing the sponsor the right to elect such more financially favorable terms) run afoul of Principle 5?

So long as the financial terms last offered to the sponsor are determined by the cognizant ALO to be "fair market" value, the most favored nations clause should not cause the research activity to result in [Private Business Use](#). The "fair market" value of the invention must be justified as being reasonable under the specific facts and circumstances of each case as of the date the technology is available and documented by the campus.

## **B. Consortiums and Multi-Project Agreements**

**Principle 6:** It is important for the University to be in control of the manner in which the research is performed. For this purpose, the University will be treated as in control, even in the context of a committee or board with industry members, so long as the University decides how (materials, methods, instruments) the research is conducted, and by whom (students, staff).

**FAQ 8:** Will a research consortium agreement fail to meet the requirements of the [Safe Harbor Provisions](#) if one of the consortium members receives an exclusive license, subject to all consortium members providing their consent?

Yes. Only in single sponsor circumstances are exclusive licenses allowed without causing the research activity to result in [Private Business Use](#). Granting an exclusive (or co-exclusive) license to one (or several) sponsor(s) in a multi-sponsor consortium agreement falls outside the [Safe Harbor Provisions](#), even if all other members in the consortium consent to the arrangement. The determining factor is not whether consortium members provide consent, but whether the agreement explicitly enables any member to receive a license that is more exclusive than a NERF license.

**FAQ 9:** Does the establishment of an Advisory Board that is tasked with setting up the overall technical agenda for the work to be performed and overseeing the research progress cause the activity to result in [Private Business Use](#)?

As long as the University controls which experiments are conducted, how the experiments are conducted, which personnel are used, and other day to day decisions, the establishment of an Advisory Board will not likely cause the activity to result in [Private Business Use](#).



## C. Materials Transfers

**FAQ 10:** Is a material provider considered a single or multi-party sponsor, where the underlying research is funded by another party?

In most cases, the material provider and funding sponsor are two different parties. Each would be considered an independent sponsor and the rules for research supported by multiple sponsors apply to both parties (i.e., neither party can receive a license more exclusive than a NERF license without creating [Private Business Use](#)). However, University bond counsel has advised that there may be less risk of creating a Private Business Use when there is a very close nexus between the material provider's material and the invention to which the material provider will receive exclusive rights (e.g., inventions that "necessarily use or necessarily incorporate" the provided material).

In some cases, if the funding sponsor does not require use of a specific third-party's material and the University determines which third party material will enhance or improve the outcome of the activity, then the material provider may be considered a single sponsor with respect to the material transfer agreement, and the funding sponsor may be considered a single sponsor with respect to the funding agreement. Thus, the option to negotiate an exclusive license to the material provider (or to the funding sponsor) under this scenario may not cause the MTA (or the funding agreement) and related research activities to fall outside [Safe Harbor Provisions](#).

If the sponsor of the research agreement and the material provider are the same entity, such entity would also be treated as a single sponsor.

**FAQ 11:** Can the University agree to assign joint title to a material provider for an invention made solely by the University and still be within [Safe Harbor Provisions](#)?

No. A specific requirement under the [Safe Harbor Provisions](#) is that title to any patent or other product incidentally resulting from the basic research lies exclusively with the qualified user (e.g., University). (See Rev. Proc. 2007-47, §6.03(3)). Agreeing to joint title in a MTA for a sole University invention made in a bond-financed facility puts the research activity outside the [Safe Harbor Provisions](#). If a material is jointly owned because it is jointly created, such joint ownership under property law does not constitute [Private Business Use](#).

**FAQ 12:** Does giving up title to inventions under a penalty clause, for example, in an MTA constitute [Private Business Use](#)?

No. A penalty clause granting the material provider either title or an exclusive license option to a resulting University invention is considered a separate arrangement triggered by a breach of contract on the part of the University. The granting of such rights are not considered part of the research activity and thus not subject to the Tax Act requirements.

**FAQ 13:** Sometimes a material provider becomes a joint owner because their material is incorporated into the technology. Does this constitute [Private Business Use](#) since the University is not the sole owner?

No it does not constitute [Private Business Use](#) because ownership has been determined by property law and/or intellectual property law. If joint ownership was determined by agreement, then the research activity governed by the agreement is considered [Private Business Use](#).

#### **D. Other Agreement Types – Clinical Trials, Visiting Researchers and Recharge Facilities**

**FAQ 14:** Sponsor-initiated clinical trials involve protocols that are written by the sponsor. Would lack of control over a clinical trial protocol cause the activity to result in [Private Business Use](#)?

Patient care activities conducted by the University at its facilities are treated differently from research activities and are not considered [Private Business Use](#).

**FAQ 15:** Do a visitor's research activities on campus constitute [Private Business Use](#) if the University solely owns all inventions made by the visiting researcher while using bond financed facilities?

If the visitor is an External User, the visitor's research activities using bond-financed facilities constitute [Private Business Use](#) regardless of how inventions are handled. Actual/physical use of bond financed property for research by any External User is treated as [Private Business Use](#). The campus will need to identify all such visitor research activities for reporting in the PAQ.

**FAQ 16:** Is use of bond financed facilities for bona fide "recharge activities" covered under [Safe Harbor Provisions](#)?

Because the use of any facility or equipment by an [External User](#) is actual or physical use, the [Safe Harbor Provisions](#) that apply to basic research are not applicable. The Tax Reform Act of 1986 also contains short term use exceptions. Some uses of University recharge facilities/equipment may qualify for the short-term use exceptions.

To qualify for the short-term use exceptions, the University must be the primary user of the financed recharge space/equipment, and the recharge space/facility must not have been developed with any specific significant [External User](#) in mind. Second, the external use rate must be negotiated or determined at arm's length. Third, use of the recharge facility/equipment must meet one of the following time limit requirements:

1. The use is for 50 days or less; or
2. The use is for 100 days or less (but more than 50) *and* all [External Users](#) are charged the same rate.

To determine whether the external use meets the time limit requirements, count the days of use permitted in the recharge facility/equipment use contract. For example, a contract to use the facility or equipment every Wednesday for a year is a 52-day

contract. Each contract is treated separately. If a contract allowed for 50 days of use and, near or at the end of its term, a new contract is executed that allows for 50 days of use, short term use requirement #1 is satisfied because the two contracts are separate. This would not apply, however, to a single contract that renews for multiple terms. In other words, campuses would need enter into a new contract for each successive period of use to stay within the 50 or 100 day limit.

Importantly, for requirement #2 to apply, all [External Users](#) must be charged the same rate. This means that any [External User](#), whether a 501(c)(3) organization, a private individual or a for-profit entity, are all charged the same rate.

If an external use of a recharge facility/equipment does not meet the short-term use requirements above, then it will be considered [Private Business Use](#) and would need to be reported in the PAQ.

## **E. Copyrights**

**FAQ 17:** Is assignment of copyright ownership to an [External Sponsor](#) allowed under [Safe Harbor Provisions](#)?

Most assignments of copyright are not considered [Private Business Use](#). Assignments of copyright are subject to applicable University policies and guidelines even if they are within [Safe Harbor Provisions](#).

## **Description of Safe Harbor Provisions**

### *Single-Sponsor Research Agreements*

When research is 100% supported or sponsored by a single [External Sponsor](#), the applicable [Safe Harbor Provisions](#) state that sponsored research activity will not result in [Private Business Use](#) if the intellectual property terms (including but not limited to patents, data, and materials) meet all three of these conditions:

- 1) Title to any patent or other product resulting from the research lies exclusively with the University.
- 2) The sponsor must pay a fair, competitive price for the license or other use of any resulting technology. IRS Revenue Procedures describe a fair, competitive price as being the price that an “unrelated, non-sponsoring party” would need to pay.
- 3) The price paid for the license or use is determined at the time the license or other resulting technology is available for use.

### *Multi-Sponsor Research Agreements and Federally Sponsored Research Agreements*

When research is supported or sponsored by more than one [External Sponsor](#) and/or the federal government, the applicable [Safe Harbor Provisions](#) state that sponsored research activity will not result in [Private Business Use](#) if the intellectual property terms (including but not limited to patents, data, and materials) meet all three of these conditions:

- 1) Title to any patent or other product resulting from the research lies exclusively with the University.

- 2) The research to be performed and the manner in which it is to be performed is determined by the University. For example, the University can select the personnel who will perform the research and University personnel performing the research are not controlled by an [External Sponsor](#).
- 3) Sponsors are entitled to no more [exclusive] than a non-exclusive, royalty-free license to use the product resulting from the research. Exclusive licenses are outside the [Safe Harbor Provisions](#) for multi-sponsor research agreements and federally sponsored research agreements, but are within the [Safe Harbor Provisions](#) when the research is supported 100% by a single sponsor.

IRS Revenue Procedures 2007-47 clarify that the rights of the federal government and its agencies mandated by the Bayh-Dole Act will not cause a research activity to result in [Private Business Use](#), even though some federal government's rights under the Bayh-Dole Act do not meet conditions 1-3 above. Federal government march-in rights are specifically cited as an example of a Bayh-Dole mandated right that will not cause a research activity to result in [Private Business Use](#). The federal government's right to receive title if the University chooses not to elect title would be another such Bayh-Dole mandated right.

#### **Additional Information and Contact**

If there is uncertainty regarding whether a research activity constitutes [Private Business Use](#), the best approach is to report the activity as [Private Business Use](#) in the annual PAQ for further review. Capital Markets Finance will coordinate with the campus contract administrator, RPAC, and possibly University bond counsel to determine whether the research activity constitutes [Private Business Use](#).

For questions about this Guidance or assistance in applying this Guidance to your proposed research activity, please contact:

Felice Lu, Ph.D.  
Research Policy Analysis and Coordination  
[Felice.Lu@ucop.edu](mailto:Felice.Lu@ucop.edu)  
(510) 987-0348

cc: Michael Linder, Capital Markets – Finance  
Meghan Gutekunst, Capital Markets – Finance  
Charles Robinson, General Counsel and VP Legal Affairs



Deborah Motton, Ph.D.  
Executive Director  
Research Policy Analysis and Coordination