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TO: S. ALLEN WINBORNE

Assistant Commissioner

(Employee Plans and Exempt Organizations Division)

Attention: Director, Exempt Organizations Division

In re:

Whether a nonprofit research organization affiliated with

a university is a “university" under section 512(b)(8)

so that its income is excludable from unrelated

business taxable income.

This responds to your memorandum (OP:E:EO) of January 1, 1983, requesting our concurrence or comments on a proposed ruling letter to the above organization.ISSUES

1. Whether the * * *, a separately incorporated nonprofit research organization affiliated with the * * * is a “university" for purposes of I.R.C. section 512(b)(8) so that all of its income from research activities will be excludable from unrelated business taxable income.

2. Whether certain commercially sponsored projects conducted by the * * *, including testing of medical devices, industrial hygiene testing and products toxicology studies, constitute unrelated trade or business within the meaning of section 513.

CONCLUSIONS

1. The * * * is not a “university" for purposes of section 512(b)(8) because it is not merely or solely an extension of the * * *, but rather is a separately incorporated entity with independent purposes of its own. Therefore, the * * * income from research activities cannot be excluded from unrelated business taxable income under the modification contained in section 512(b)(8).

2. In general, commercially sponsored testing undertaken to satisfy government safety or premarketing requirements or to assure compliance with environmental laws is “ordinary testing” incident to commercial or industrial operations rather than “scientific research in the public interest.” Such testing may therefore constitute unrelated trade or business.

FACTS

In * * *, the * * * authorized the * * * to establish, develop a nd administer a research institute. Pursuant to this * * * authority, on * * * the * * * was organized by the * * * as a separate non- profit corporation. The * * * primary impetus in establishing the * * * as a separate entity was its need for a financially self- sustaining organization through which applied research projects, frequently referred to as “mission-oriented" research, could be conducted. On * * * the * * * was recognized by the Service as a n organization described in section 501(c)(3).

The * * * purpose is set forth in its Articles of Incorporation:

The fundamental purpose of the corporation shall be to provide an organizational structure under the immediate and complete control of the * * * which shall be responsible for originating, developing, and performing research and related contracts with government agencies, private business, and charitable organizations. There shall be an emphasis upon research contracts not involving the student teaching function as directly as is ordinarily involved in research at the * * *

The * * * is divided into * * * operating * * *. These * * *, in turn, operate various separate laboratories. * * * administers * * * separate laboratories in the fields of * * * has * * * which han dle specialized phases of its research: the * * * and the * * *

In its letter of * * * the * * * described its relationship t o the * * * . The * * * stated that “[i]n some respects * * * resembles a research arm of the * * * because of the commonality of purpose between the two organizations.” The * * * listed several ties between the * * * and the * * *.

First, the * * * exists because the * * * created its pursuan t to enabling * * *. The * * * articles state:

The corporation’s purposes and powers are inextricably interwoven with the purposes and powers of the * * * inas- much as the corporation is being organized as an integral part of the * * * ....

Second, there are financial ties between the * * * and the * * *. The * * * initial working capital was provided through an * * * from the * * *. In addition, the * * * and the * * * have a * * * letter of credit provided by the former * * *. The * * * is also the beneficiary of any surplus funds of the * * * although to date, all net proceeds generated by the research contracts have been used, or set aside, either to provide a capital fund for future research needs or to apply to the retirement of the initial capital loan of * * *.

Third, the * * * controls the * * * Article * * * of the * * * charter helps “assure the control of the corporation by the ... * * *" by providing a Board of Trustees, consisting of 4 to 7 persons, all of whom directly or indirectly represent the * * * serve as Board members * * *

Fourth, the * * * and the * * * may operate research projects in close liaison with each other. The facilities of the * * * are available to the * * * for research on the same basis of project approval, time and remuneration as research done through the * * *. In addition, joint research projects are sometimes carried on between the * * * and the * * * which allows * * * member s and * * * to develop practical applications for their discoveries. These projects require a joint proposal in which the * * * carries out the fundamental research aspects of the project and the * * * carries out the applied research aspects of the project.

Despite these significant ties with the * * * the * * * in its letter of * * * nevertheless acknowledged that it has a corporate existence separate from the * * * and maintains an arm’s-length relationship with it.

First, the * * * is financially independent of the * * *. The * * * reimburses the * * * for all funds advanced and services rendered to it by the * * *. When the * * * needs to make any substantial use of facilities, the arrangements are handled through contracts negotiated at arm’s-length. The * * * also charges the * * * for the use of its facilities (unless such use is insignificant) and for any technical services it renders to the * * *. Except for these payments and the original loan described above, the * * * receives no funds from the * * *.

Second, except for occasional use of one another's facilities, the * * * and the * * * occupy and utilize wholly separate facil ities. The * * * pays rent to the * * * for facilities it occupies in * * *. Facilities at * * * are not generally used for * * * but rather are leased to the * * * and other commercial research entities.

Third, the * * * is "technically self-sufficient." It maintains i ts own research staff separate from the * * * although * * * may, o n occasion, hold part-time research jobs with the * * *.

Fourth, in * * *, the * * * applied for, and received, its own tax exemption. According to the * * * its motivation for seeking its own tax exemption was because federal agencies sponsoring the * * * research projects tried to treat the * * * as an * * *. As such, the * * * states it would have been required to compute its overhead rate, on which payments under cost-reimbursement contracts are based, on a common basis with the entire * * *. Such a computation, according to the * * * would not have accurately reflected the * * * true overhead because it has its own separate facilities and staff, and, unlike the * * * it receives no * * *. The * * * states:

It was hoped that the separate exemption would dissuade the federal agencies from forcing an unrealistic overhead computation on * * *. The separate exemption did assure these agencies that: (1) * * * was in some respects an entity separate from the * * *; (2) * * * activities, taken by themselves, qualifies it for exemption; and (3) separate accounting records could and would be maintained by * * * to reflect actual overhead and facilities computations under the "cost-reimbursement" research contracts they sponsored.

Fifth, the * * * maintains its own separate personnel department. Its accounting and payroll are completely separate from the * * *. The * * * also negotiates and drafts its own contracts. In general, executive management of the * * * is separate from that of the * * * and none of its staff or operations officers hold positions with the * * *.

The * * * primary source of income is contractual research. The * * * performs research for many agencies, both public and private. Research contracts with private commercial sponsors generally involve restrictions on the use of data, prototypes, formulae, experimental procedures, and other information. The * * * letter of * * * contains standard contract provisions which have been used in contracts with commercial sponsors. For example, a typical contract provision provides that,

Each Party agrees to receive, maintain in confidence and to not disclose to any third party nor to any employee of or consultant to * * * who is not an AUTHORIZED EMPLOYEE and to not use for its own benefit or for that of any third party, except as authorized under this Agreement, without the express prior written approval of the other Party, any CONFIDENTIAL INFORMATION which is developed or which one Party receives from the other Party....

In practice, however, the * * * indicates that it requests permissionDH from the sponsor to publish research results which it believes to be of general scholarly interest and such permission has usually been given. Thus, the * * * estimates that * * * percent of research data and results are available for general dissemination through journals, seminars, technical papers and the like. The remaining * * * percent of such research is treated as proprietary by the sponsors. Nevertheless, in its letter of * * * the * * * indicates that it has revised its standard contract provisions to eliminate any restrictions. The revised provisions concerning publication read as follows:

* * * is authorized to make the results of this research, including all relevant information, available to the interested public within a reasonably short time after the completion of the research except that on written request such publication will be delayed pending reasonable opportunity to establish patent or copyrights. It is also agreed that neither the * * * nor its employees will make public the nature of the work performed or its results without written permission from the sponsor, which permission will not be unreasonably withheld

The * * * has requested the following rulings:

That, for purposes of sections 511 and 512, it should be classified as a "university" thereby excluding all income derived from research under the modification contained in section 512(b)(8).

Assuming, however, that the * * * is held not to be a "university," certain select projects, all of which are nongovernment contracts, do not constitute "unrelated trade or business." The * * * has classified these contracts into three categories: * * *

The * * * contracts (described in * * * of the attachments included in the * * * letter of * * * show that these projects evaluate the characteristics and performance of medical machines and instruments and prosthetic substitutes for human body parts. The tests performed are electronic, mechanical and sometimes chemical. They involve such items as * * *. About * * * percent of this type of testing is performed to satisfy a statute or regulation requiring such tests as a prerequisite to the marketing of the devices.

The * * * contracts (described in * * * of the attachments included in the * * * letter of * * * show that these projects involve the chemical testing of samples of blood and tissue, dust, liquid, air, and the structural components of buildings. The tests check for numerous toxic agents, including carcinogens, corrosive metals, pesticide residues and environmental poisons. None of these projects involve testing preparatory to marketing of a product. These tests either directly evaluate the environment at a particular location or study tissues or body fluids of persons who have, or may have, come into contact with particular environmental factors. Approximately * * * percent of these tests evaluate an “on the job" environment while the remaining * * * percent evaluate a more general environment of a larger crosssection of the public which may be affected by air and water pollution.

The contracts for * * * (described in * * * of the attachments included in the * * * letter of * * *) include tests made preliminarily to the marketing of a new product or in connection with some re-evaluation of the safety of an old product. About * * * percent of this testing activity is done to satisfy the requirements of the Toxic Substances Control Act of 1976. Products in this category cannot be marketed unless the tests are done and the results are certified to EPA.

An additional subsidiary issue presented by the * * * is whether the revised standard contract provisions concerning publication will cause the research activities subject to the provisions to be considered unrelated trade or business.

ANALYSIS

1. “University" Status

Section 511 imposes a tax on the unrelated business taxable income of certain tax exempt organizations, including charitable organizations described in section 501(c)(3).

Section 512(a)(1) defines the term “unrelated business taxable income," with certain modifications, as the “gross income derived by an organization from any unrelated trade or business ... regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business.”

Section 512(b)(7) excludes from the calculation of unrelated business taxable income all income derived from research for the United States, or any of its agencies or instrumentalities, or any State or political subdivision thereof.

In addition, section 512(b)(8), provides as follows:

“(8) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person,....”

Similarly, Treas. Reg. section 1.512(b)-1(f)(2) provides that all income derived by a college, university, or hospital from research performed for any person shall be excluded in computing unrelated business taxable income.

The proposed ruling letter holds that the * * * is a “university" for purposes of section 512(b)(8). The * * * , because of the commonality of purpose and close control by the * * * is analogous to that of “an operating division of the * * *.” Therefore, its research income is excludable from taxation. We disagree. The * * * , in our view, as a separately incorporated entity with independent purposes of its own, should not be characterized as a “university".

Although neither section 512(b)(8) nor Treas. Reg. section 1.512(b)-1(f)(2) define the term “university," the term is described in Treas. Reg. section 1.107A-9(b)(1) which provides that universities are included within the definition of educational organizations.

Specifically, Treas. Reg. section 1.170A-9(b)(1) states that, “[T]he term [educational organization] includes institutions such as primary, secondary, preparatory, or high schools, and colleges and universities.” The main characteristic of such an organization is that:

its primary function is the presentation of formal instructions and it normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

That regulation also makes it clear that an organization that does not have as its primary purpose a teaching function is not a university. Treas. Reg. section 1.170A-9(b)(1) provides as follows:

It [the educational organization] does not include organizations engaged in both educational and noneducational activities unless the latter are merely incidental to the educational activities. A recognized university which incidentally operates a museum or sponsors concerts is an educational organization within the meaning of section 170(b)(1)(A)(ii). However, the operation of a school by a museum does not necessarily qualify the museum as an educational organization within the meaning of this subparagraph. [Emphasis added.]

An example of how the principles enunciated in Treas. Reg. section 1.170A-9(b)(1) have been applied is presented in * * * G.C.M. 32196, I-220 (January 24, 1962). There, the organization in question, like the * * * was separately incorporated, and affiliated with a university. The organization also conducted research. However, unlike the * * * the organization’s primary purpose, both as stated in its formative document and in practice, was “to provide instruction at the college and post-graduate levels” in its field of specialty. Although the organization in G.C.M. 32196, like the * * * was subject in various ways to control by its affiliated university, it differed from the * * * in that it was actively involved in maintaining a faculty, student body and curriculum. G.C.M. 32196 stated that,

[A]s part of the agreement between the [organization] and the University, an Operating Committee of four members was established, which subject to the joint direction and control of the [organization] and the university, was to determine employment and compensation of the faculty for the [organization], the requirements for enrollment, the curriculum to be prescribed, the employment and compensation of the administrative staff, the purchase of equipment and supplies, and all other matters incidental to the foregoing.

It was determined that the organization in G.C.M. 32196 was a school within a university and should be recognized as a section 170(b)(1)(A)(ii) educational organization.

Here, the * * * does not carry on any of the activities enumerated in Treas. Reg. section 1.170A-9(b)(1) and therefore lacks all of the essential characteristics of a university. That is, it presents no formal instruction, maintains no regular faculty, maintains no curriculum, and has no regularly enrolled student body in attendance. In fact, the * * * Articles of Incorporation, as noted, state explicitly that “[t]here shall be an emphasis upon research contracts not involving the student teaching function as directly as is ordinarily involved in research at the * * * .” Therefore, the * * * specifically disavows teaching as its primary function; the activity which is the sine qua non of a university. Moreover, a comparison between the activities of the organization described in G.C.M. 32916 and the * * * illustrates that a radical change in its operations would be necessary before the * * * if it were to remain separately incorporated, could be considered a university under Treas. Reg. section 1.170A-9(b)(1).

The * * * nevertheless, argues that even if it does not teach per se, it should be considered a university because: (1) universities do engage in research activities thus indicating a commonality of purpose with the * * * and (2) the * * * is controlled by and closely affiliated with the * * * and thus, is merely an extension of the * * *.

As to the commonality question, in * * * G.C.M. 33412, I-2334 (January 5, 1967), we stated that “the question of whether an activity is related or unrelated to an exempt activity for purposes of section 512 necessarily depends on the definition of exempt activities under section 501(c)(3).” The regulations under section 501(c)(3) provide that university research can be a proper basis for exemption on the condition that such research is “for the purpose of aiding in the scientific education of college or university students.” See, Treas. Reg. section 1.501(c)(c)(3)- (d)(5)(iii)(c)(1).

Although the * * * letter of exemption does not recite the specific basis for exemption, other than section 501(c)(3), from the activities described in the administrative file, it is clear that the * * * exemption rests on its peformance of scientific research in the public interest. The * * * indicates that at the time it filed its exemption application, about * * * percent of its research projects were sponsored by government agencies. [1] Moreover, and as previously discussed, it is equally clear that the * * * has chosen, to the extent possible, to avoid undertaking research which has as its primary purpose the instruction of students. Therefore, it can be safely assumed that the * * * exemption is not based on subdivision (d)(5)(iii)(c)(1).

Congress, in excluding university research from taxation anticipated that the purpose of such research, as reflected in the regulations, would be related to the primary exempt purpose of a university (i.e., teaching students). If such research led to private contracts, the university would not be required to separate these out for unrelated income tax purposes. To make the opposite assumption, that Congress was not concerned with whether the research was related to the university's exempt function would allow any commercial research organization to have all its income from research excluded merely through affiliation, however tangential, with a university. We do not believe Congress intended that result.

Furthermore, the * * * claims that it should be considered a "university" for purposes of section 512(b)(8) because it is affiliated with and controlled by the * * *. The * * * has presented considerable evidence addressing this point, which has been previously summarized. However, there is a strong presumption in the charitable area that a separately incorporated entity, even if it has close ties with or is otherwise controlled by another organization, cannot assume the exempt status of the affiliated organization. This principle has been applied in the religious area where religious organizations, affiliated with churches, have tried to establish that they are churches either for the purpose of establishing a church pension plan or to gain other special benefits available only to churches. Chapman v. Commissioner, 48 T.C. 358 (1967); De La Salle Institute v. United States, 195 F. Supp. 891 (1961); * * *, G.C.M. 37266, I-24-77 (September 22, 1977) (revoked on other grounds, * * * G.C.M. 39007, EE-25-82, EE-26-82 (Nov. 2, 1982)). In all of these cases, the Service has denied church status unless the organization under consideration carried on church functions. In making these determinations, the Service has also accepted the organization's separate incorporation as controlling. The court, in De La Salle Institute, supported the Service's position at 901 and stated:

The purpose of forming a corporation is to establish a separate legal entity.... Under the laws of the State of California and of the United States, plaintiff, being separately incorporated, is separate and distinct from the Christian Brothers Order and from the Roman Catholic Church as a whole. For example, plaintiff's creditors can have no recourse against the property of the Roman Catholic Church in general. Assuming that the Canon law of the Roman Catholic Church considers plaintiff's income to be that of the Christian Brothers Order, or of the Church, that fact can avail plaintiff nothing in this case. Plaintiff enjoys the advantages of separate incorporation under the civil law, and it must bear the disadvantages....

In the instant case, the * * * has elected to establish the * * * as a legally distinct entity rather than as an operating division or branch of the * * *. The * * * should not be able to deny its separate status for some, but not all, purposes. Moreover, Rev. Rul. 81-19, 1981-1 C.B. 353, which is cited in the proposed ruling, is, in our view, inapposite. That ruling concerns a separately incorporated organization formed to assist a university by receiving contributions for the benefit of the university, assisting the university's academic departments in financial management, and managing vending machines on campus. The ruling holds that the organization's activities are an integral part of the exempt activities of the university, and the organization furthers the educational program of the university by operating facilities for the convenience of the university community. The * * * here, performs no activities which are an integral part of the educational activities of the * * * nor are its activities performed as a convenience to the * * * community.

An additional argument againt classifying the * * * as a university becomes apparent when the language of section 512(b)(8) is examined. Section 512(b)(8), under which the * * * argues all its income should be excluded, covers not only research conducted by universities but also research conducted by hospitals. Because the same subsection exempts both university research and hospital research, it would appear appropriate to treat the two activities alike. Section 170(b)(1)(A)(ii) draws a distinction between the terms "hospital" and "medical research organization." In preserving this distinction, Treas. Reg. section 1.170A-9(c)(1)(ii) defines the term "hospital" to mean an organization whose principal purpose or function must be "the providing of hospital or medical care" (i.e., "the treatment of any physical or mental disability"). The term “medical research organization,” on the other hand, is defined in Treas. Reg. section 1.170A-9(c)(2) to include an organization “if the principal purpose or functions of such organization are medical research and if it is directly engaged in the continuous active conduct of medical research in conjunction with a hospital.” Treas. Reg. section 1.170A-9(c)(1)(ii) also states:

An organization whose principal purpose or function is the providing of medical education or medical research will not be considered a “hospital"...unless it is also actively engaged in providing medical or hospital care to patients on its premises or in its facilities,...as an integral part of its medical education or medical research function.

In short, despite its affiliation with a hospital, a medical research organization will not be considered to be a “hospital" unless it performs hospital functions. Congressional intent is clear: (1) for purposes of section 512(b)(8) universities and hospitals should be treated similarly; and (2) as defined in section 170(b) (1)(a)(ii), the term hospital does not include medical research organizations merely affiliated with a hospital.

By analogy, a separately incorporated university research organization should not be considered to be a “university" unless it performs university functions. To reach an opposite result would require that medical research organizations affiliated with hospitals be treated differently from research organizations affiliated with universities, despite Congressional intent to the contrary.

After considering all the facts and circumstances, including the * * * separate incorporation, separate purposes, separate facilities and separate operations, it is our view that the * * * is not merely or solely an extension of the * * *. It has, by its own assertion, requested federal agencies which sponsor its research to consider it an entity separate and apart from the * * *. It has stated in its Articles of Incorporation that its primary purpose is carrying on non-instructional applied contractual research, a purpose significantly different from that of a university. It presents no formal course of instruction, maintains no faculty and has no regular student body. As a consequence, we believe it is not a “university” and its income should not be excluded from unrelated business taxable income under section 512(b)(8).

2. “Ordinary Testing”

Anticipatiang the possibility of the conclusion reached above, the * * * has taken the position that even as an independent entity separate and apart from the * * *, it is not subject to the unrelated business income tax. The * * * argues that the * * * are related to the attainment of its exempt purposes (i.e., performance of scientific research in the public interest).

Subsequent to its conference in the National Office, the * * * submitted additional material which states that the testing undertaken is concerned with new applications of products or drugs in order to improve the ability to treat various diseases and conditions. Thus, despite explicit statements to the contrary in its initial ruling request, the * * * now maintains that the studies are not merely quality control programs or ordinary testing for certification purposes as a final procedural step before marketing. Because of this contradictory record, the proposed ruling states that the * * * has agreed to the issuance of an advisory opinion only with respect to testing activities in general. The ruling, therefore, does not decide whether specific tests undertaken constitute unrelated trade or business within the meaning of section 513.

As to this advisory portion of the ruling, the position is taken that testing performed for commercial entities either for premarket clearance or for compliance with environmental laws (e.g., the Toxic Substances Control Act), should be considered unrelated business activity. The ruling states that, “[s]uch activity may not be considered scientific research but rather the performance of a service for the commercial entities to assure that the products manufactured meet quality standards or that the environment in which their employees work is environmentally safe.” We are in agreement with this portion of the ruling.

The * * * position, that its testing is related to its exempt purposes, fails to take into account the distinction between research of any kind and “scientific research” in the “public interest.” Only scientific research in the public interest serves an exempt purpose within the meaning of section 501(c)(3). Thus, income-producing activities outside the scope of scientific research in the public interest may properly be subject to the tax on unrelated business income.

Treas. Reg. section 1.501(c)(3)-1(d)(5)(iii) identifies the types of scientific research which are carried on in the public interest and thus serve as a proper basis for exemption:

(iii) Scientific research will be regarded as carried on in the public interest--

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

(b) If 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) If such research is directed toward benefiting the public. The following are examples of scientific research which will be considered as directed toward benefiting the public, and, therefore, which will be regarded as carried on in the public interest: (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 publicaton, or in any other form that is available to the interested public; (3) scientific research carried on for the purpose of discovering a cure for a disease; or (4) scientific research carried on for the purpose of aiding a community or geographical area by attracting new industry to the community or area or by encouraging the development of, or retention of, an industry in the community or area. Scientific research described in this subdivision (c) 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 formula resulting from such research.

However, both Treas. Reg. sections 1.501(c)(3)-1(d)(5)(ii) and 1.512(b)-1(f)(4) use identical language in excluding from these activities “activities of a type ordinarily carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc.”

Under the standards articulated in the above regulations, each questioned activity must be examined on its own merits to determine, first, whether it is “scientific research" (rather than ordinary testing or another activity incident to commercial operations) and second, whether it serves the “public interest.” Only after such an analysis can income from these activities be determined to be subject to unrelated business income tax.

In Rev. Rul. 68-373, 68-2 C.B. 206, the Service held that a nonprofit organization primarily engaged in testing drugs for commercial pharmaceutical companies pursuant to the companies’ marketing applications to the Food and Drug Administration (FDA) did not qualify for exemption. The revenue ruling stated:

The clinical testing of a drug for safety and efficiency in order to enable the manufacturer to meet FDA requirements for marketing...is merely a service performed for the manufacturer.

There is, therefore, a presumption that a project is “ordinary testing” if the work is performed to satisfy a federal or state regulation requiring such an evaluation before a product may be marketed.

In differentiating between research and testing, it may also be helpful to look at how the distinction is made in a slightly different context. Treas. Reg. section 1.174-2 defines “research and experimental expenditures” as follows:

[E]xpenditures incurred in connection with the taxpayer’s trade or business which represent research and development costs in the experimental or laboratory sense. The term includes generally all such costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention, or similar property, and the improvement of already existing property of the type mentioned. The term does not include expenditures such as those for the ordinary testing or inspection of materials or products for quality control or those for efficiency surveys, management studies, consumer surveys, advertising, or promotion. [Emphasis added]

Thus, for example, testing blood samples or other samples for trace elements lacks the uniqueness or originality which is inherent in the concept of research. Projects of this type have all the indicia of ordinary testing: a standard procedure is used, no intellectual questions are posed, the work is routine and repetitive and the procedure is merely a matter of quality control. As such these studies cannot be considered “scientific research.”

As to the question of “public interest," Rev. Rul. 78-426, 1978-2 C.B. 175, considered an organization whose activities included the inspection, testing, and safety certification of cargo shipping containers and the research, development, and reporting of information in the field of containerization. The ruling held that such an organization is not operated exclusively for the purpose of testing for public safety or for scientific purposes. In addition, the revenue ruling stated that the safety and efficiency of shipping containers are closely allied to successful commercial operation because manufacturers and shippers must protect themselves against losses due to spoilage, leakage, delays in transit, and employee injuries. Thus, the organization’s testing and research activities were of a type ordinarily carried on as an incident to commercial or industrial operations.

Thus, for example, projects that evaluate an “on the job" environment are closely allied to the successful commercial operations of the organization for which the services are performed and lack the requisite element of public interest. The “public interest" requirement of the regulation is more fully described in * * * G.C.M, 34325, I:A-624118 (Aug. 12, 1970) (Appendix C) as follows:

Projects or studies concerned with the elimination or reduction of air or water pollution which are carried on for the purpose of improving the public health of a community or area rather than for the purpose of improving the conditions at the plant or plants of the sponsor are considered as meeting the public interest requirement of the regulations. The crucial factor is the primary interest to be served, that is, the interest of the community or area or that of the sponsor. An indirect benefit or benefits to the community will not satisfy the public interest requirement of the regulations.

Accordingly, we concur in your conclusion that commercial testing for premarket clearance and compliance with environmental laws may be considered unrelated business activity because such activities are neither “scientific research" nor in the “public interest" under Treas. Reg. section 1.501(c)(3)- 1(d)(5). Such activities, other than through the production of income, do not, therefore, contribute importantly to the purposes for which exemption may be granted.

We also concur in your conclusion concerning the * * * revised standard contract provisions. Rev. Rul. 76-296, 1976-2 C.B. 142, held that commercially sponsored research otherwise qualifying as scientific research under section 501(c)(3), 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. However, research, the publication of which is withheld or delayed significantly beyond the time reasonably necessary to establish ownership rights is not in the public interest and constitutes the conduct of unrelated trade or business within the meaning of section 513.

The revised standard contract provisions, furnished by the * * * in its letter of * * * and previously set out, will be made a part of research contracts with commercial entities. These provisions appear to remove the obstacles found in the prior provisions which apparently foreclosed “timely publication.” This conclusion does not, however, negate our previous discussion concerning the requirement that commercially sponsored research must otherwise qualify as “scientific research" under section 501(c)(3). That is, the revised standard contract provisions, by removing the publication issue, will not per se cause the activities to be considered unrelated trade or business. Neither, of course, will they cause the activities to be related.

In conclusion, although we agree with the advisory portion of the ruling concerning testing activities in general and with the portion which discusses publication, we do not believe the * * * qualifies as a “university" for purposes of section 512(b)(8). Accordingly, we do not concur in the issuance of the proposed ruling.

JONATHAN P. MARGET

Acting Director

By: HARRY BEKER

Assistant Branch Chief,

Branch No. 2

Employee Plans and Exempt

Organizations Division

Attachment:

Adm. files (3)

FOOTNOTE:

1 Treas. Reg. section 1.501(c)(3)-1(d)(5)(iii)(b) provides exemption for scientific research “performed for the United States, or any of its agencies or instrumentalities, or for a State, or political subdivision thereof” and income therefrom is excludable from unrelated business income under section 512(b)(7).