**Allowable Deductions From UBIT**

Two tests must be met for an expense to be deductible:

(1) it must be allowable as a business deduction under the tax code – i.e., all the “ordinary and necessary” business expenses

(2) it must be directly connected with the carrying on of the unrelated trade or business – i.e., “proximate and primary.”

**Allocating Expenses**

Some expenses are 100% deductible – e.g., the salary of a person who spends 100% of his time on the unrelated trade or business. In many cases, however, expenses are used both in related and unrelated activities. For these assets, expenses, depreciation and similar items attributable to them must be allocated on a “reasonable basis,” and the portion allocated to the unrelated trade or business must be proximately and primarily related to the unrelated business. Allocations should be based on something that can be substantiated – gross receipts, contemporaneous labor records, records of equipment use, etc. Adequate records must also be maintained.

**Disallowed Expenses**

Indirect cost deductions were also disallowed as not based on a reasonable method. The IRS can be expected to carefully review the expense allocations of activities that result in losses because losses from an organization’s unprofitable businesses are used to offset gains from the organization’s profitable businesses. Also, if a particular activity results in losses year-after-year, the IRS may contend that the activity is not undertaken with the intent to earn a profit, and is therefore not a trade or business. The IRS could also contend that a loss activity is “related” to the University’s exempt purposes, thereby preventing the loss from being used to offset UBI.