

Allocating Expenses to an Unrelated Trade or Business

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The Internal Revenue Code imposes an income tax on an exempt organization's unrelated business taxable income ("UBTI"). UBTI is gross income from the unrelated trade or business, less deductions which are directly connected with carrying on that trade or business.

Direct Expenses

The Treasury Regulations provide that where facilities or personnel are used in the conduct of both the organization's exempt activities and the unrelated trade or business, an allocation between the two is required. This allocation is to be made on a reasonable basis. For example, where personnel perform services in conjunction with both the organization's exempt activities and the unrelated trade or business, an allocation based on the amount of time devoted to each would be appropriate. Likewise, where facilities are used for both exempt and taxable purposes, an allocation based upon the relative use of those facilities would be appropriate.

Advertising

For many exempt organizations, a primary source of UBTI is advertising revenue generated in conjunction with the organization's publications. The Treasury Regulations contain specific rules which allow the deduction of some costs which are not specifically related to generating the advertising revenue.

The steps necessary to calculate the UBTI for advertising are as follows:

1. Gross advertising revenues are reduced by those expenses directly related to generating that revenue to arrive at tentative advertising net income or loss. If this is a loss, no taxable income results from the advertising activity, and the loss is used to offset any other UBTI recognized by the organization. In this case, the following steps are disregarded.
2. The total circulation income for the publication is determined. This is the subscription revenue received directly from the sale of subscriptions, and the portion of the dues paid by members which is allocable to subscriptions. The Treasury Regulations contain detailed rules on how to determine the amount of a member's dues which are allocable to subscriptions.

3. Readership costs are determined. These are all costs related to the publication of the periodical other than those which are related to obtaining advertising.
4. The readership costs are subtracted from the total circulation income to arrive at editorial income or loss. If there is income, the UBTI for advertising is the amount determined in step 1, and the following steps are disregarded.
5. If there is an editorial loss, then that loss is used to reduce the tentative advertising net income determined in step 1. However, the amount deductible is limited to the amount of the tentative advertising net income. In other words, the editorial loss can be used only to reduce the tentative advertising net income to zero; it cannot be used to generate a loss which could be used to offset other UBTI.

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