FEDERAL INCOME TAX DEDUCTIBILITY OF HIGHER EDUCATION EXPENSES: THE GOOD, THE BAD, AND THE UGLY

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Introduction

Deductibility of educational expenses under the Internal Revenue Code (Code) has evolved into a fairly complex issue, much more so than necessary. The rules currently in effect for the deductibility of educational expenses were promulgated by the Internal Revenue Service (IRS) in 1967 and made a part of the Treasury Regulations (Regulations). Much of the complexity of these rules relates to the deductibility of higher education expenses.

Higher education expenses are deductible, if at all (and with very limited exceptions), pursuant to section 162 of the Code, which provides a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business.² The current rules for the deductibility of

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¹ Treas. Reg. § 1.162-5 (1968).

² I.R.C. § 162(a) (2000). Other Code sections provide tax benefits for higher education expenses. *See, e.g.*, I.R.C. § 117 (2000) (allowing an exclusion from gross income under certain circumstances for scholarships and fellowships); I.R.C. § 127 (2000) (allowing an exclusion from gross income under certain circumstances for assistance provided by an employer under an educational assistance program); I.R.C. § 25A (2000) (allowing nonrefundable credits for certain higher education expenses). These are but a few examples; other Code sections provide tax benefits in other limited circumstances. All these Code sections are outside the scope of this Article.

educational expenses are much more restrictive than for the deduction of business expenses generally, and they have been criticized accordingly.³

Courts have been wrestling with these rules since 1967 and have struggled to apply them in a consistent and meaningful way. For the most part, they have been successful. In recent years, however, the United States Tax Court has misapplied the tests set forth in the Regulations, resulting in an improper decision in at least one case.⁴

This Article will discuss briefly section 162 of the Code and its requirements for the deduction of business expenses generally; discuss briefly the history of the deduction of educational expenses under the Code (specifically, higher education expenses); explain in detail the Regulations adopted in 1967 that deal with the deductibility of educational expenses under section 162 of the Code; explain in detail each of the tests set forth in those Regulations and analyze cases that have been decided pursuant to those tests; and discuss the recent cases mentioned above in which the Regulations have been misapplied.

I. GENERAL DISCUSSION OF SECTION 162

Even though a complete discussion of section 162 of the Code is outside the scope of this Article, a brief discussion is necessary to understand the intended purposes and application of the Regulations adopted in 1967 that deal with the deductibility of educational expenses under section 162. Section 162 generally provides a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business.⁵

The United States Supreme Court discussed the meaning of "ordinary and necessary" in *Welch v. Helvering*. The Court assumed that the expenditures in question were "necessary for the development of the [taxpayer]'s business, at least in the sense that they were appropriate and helpful." Thus, the Court would apparently find expenditures necessary as long as they are sufficiently connected to a taxpayer's trade or business that they are appropriate and helpful to the conduct of that business, and as

³ See Marcus Schoenfeld, The Educational Expense Deduction: The Need For a Rational Approach, 27 VILL. L. REV. 237, 311–25 (1982); Jay Katz, The Deductibility of Educational Costs: Why Does Congress Allow the IRS To Take Your Education So Personally?, 17 VA. TAX REV. 1, 3–4 (1997).

⁴ See infra Part III.C.

⁵ I.R.C. § 162(a).

^{6 290} U.S. 111 (1933).

⁷ *Id.* at 113.

long as they are not personal expenses.⁸ The Court was more obscure in its discussion of the meaning of "ordinary." The Court stated, "Ordinary in this context does not mean that the payments must be habitual or normal in the sense that the same taxpayer will have to make them often." Certain expenses "may happen once in a lifetime," but they are ordinary "because we know from experience that payments for such a purpose, whether the amount is large or small, are the common and accepted means" of accomplishing a particular business purpose.¹⁰ The Court concluded its discussion of the meaning of "ordinary" by stating, "The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." Hence, the Court treated this issue as a question of fact. ¹²

Section 162 allows a deduction only for "expenses," which means that they must not be "capital expenditures," which are specifically designated nondeductible under section 263 of the Code. INDOPCO, Inc. v. Commissioner is the United States Supreme Court decision establishing the current test to determine whether a particular expenditure is a nondeductible capital expenditure under section 263. In deciding that the expenditures incurred by the taxpayer in INDOPCO were nondeductible capital expenditures, the Court reviewed the long and often contradictory history of case law regarding capitalization of expenditures and adopted a test for capitalization that had been used by a number of Courts of Appeals. The Supreme Court stated, "Although the mere presence of an incidental future benefit . . . may not warrant capitalization, a taxpayer's realization of benefits beyond the year in which the expenditure is incurred is undeniably important in determining whether the appropriate tax treatment is immediate deduction or capitalization."

In explaining its decision, the Court was careful not to represent this test as a bright-line rule or standard. In discussing immediate deduction

⁸ See I.R.C. § 262 (2000) (denying any deduction for personal, living, or family expenses).

⁹ Welch, 290 U.S. at 114.

¹⁰ *Id*.

¹¹ *Id.* at 115.

¹² See Deputy v. Du Pont, 308 U.S. 488, 496 (1939).

¹³ I.R.C. § 263 (2000).

^{14 503} U.S. 79 (1992).

¹⁵ See id. at 83.

¹⁶ Id. at 83–88.

¹⁷ *Id.* at 87.

versus capitalization of expenditures generally, the Court enunciated a number of principles that it indicated must still be considered to resolve this question in specific cases.¹⁸ In that light, the test adopted by the Court is in reality only one factor, albeit an extremely important one, in determining whether expenditures should be capitalized or immediately deducted.

Section 162 requires that the expenses be paid or incurred in "carrying on" a trade or business. 19 This generally means that the taxpayer must be presently engaged in an active trade or business to which the expenditures relate at the time they are incurred.²⁰ This requirement paved the way for the pre-opening expense doctrine.²¹ In *Richmond Television Corp.* v. *United States*, ²² the taxpayer was attempting to deduct, under section 162 of the Code, expenditures incurred for the training of staff to operate a broadcasting business.²³ At the time such expenditures were incurred, the taxpayer had not yet acquired a license necessary to operate the business.²⁴ The court held that the expenditures were pre-opening expenses incurred before the business was commenced, and were thus nondeductible under section 162.²⁵ In making its decision, the court focused in part on the requirement under section 162 that expenses be paid or incurred by a taxpayer in carrying on a trade or business.²⁶ The court determined that a taxpayer is "not 'engaged in carrying on any trade or business' within the intendment of section 162(a) until such time as the business has begun to function as a going concern and performed those activities for which it was organized."²⁷ The court held that the taxpayer was not carrying on any trade or business because the taxpayer had vet to acquire a license necessary to operate the business.²⁸

In some cases, a taxpayer has clearly been engaged in a trade or business for a period of time and has temporarily taken a leave from the business (in some cases to pursue education). In such cases, the issue is

¹⁸ Id. at 83–86.

¹⁹ I.R.C. § 162(a) (2000).

²⁰ See Frank v. Comm'r, 20 T.C. 511, 513 (1953).

²¹ See Richmond Television Corp. v. United States, 345 F.2d 901, 905 (4th Cir. 1965).

²² 345 F.2d 901 (4th Cir. 1965).

²³ Id. at 904–05.

²⁴ *Id.* at 905.

²⁵ *Id.* at 909.

²⁶ *Id.* at 905.

²⁷ *Id.* at 907.

²⁸ *Id*.

whether the taxpayer continues to engage in the trade or business while on temporary leave so that expenses incurred in connection with the trade or business are deductible.²⁹ This issue will be discussed in detail later in this Article.³⁰

Finally, section 162 requires that the expenses be incurred while the taxpayer is carrying on a "trade or business." In *Commissioner v. Groetzinger*, ³² the Supreme Court confirmed that, for purposes of section 162, whether a taxpayer is engaged in a trade or business depends upon an examination of the facts and circumstances of each case. ³³ The Court stated, "[T]o be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and . . . the taxpayer's primary purpose for engaging in the activity must be for income or profit." The activity of managing a taxpayer's investments in other entities (e.g., stocks and bonds) is not a trade or business, no matter how actively the taxpayer is involved in the activity. Thus, an activity that would generate expenditures deductible only under section 212 of the Code does not constitute a trade or business under section 162 of the Code. ³⁶

II. DEDUCTIBILITY OF EDUCATIONAL EXPENSES UNDER SECTION 162

A. Pre-1967 Historical Discussion

As noted above, the thrust of this Article is to discuss the Regulations adopted in 1967 that deal with the deductibility of educational expenses under section 162 of the Code, to analyze cases that have been decided pursuant to those Regulations, and to explain two recent trends regarding the deductibility of educational expenses. A brief historical summary of

²⁹ See, e.g., Furner v. Comm'r, 393 F.2d 292, 295 (7th Cir. 1968) (disallowing business expense deductions for the cost of studies for a junior high teacher who left the job to pursue graduate education, even though the teacher returned to the same job after her studies were complete).

³⁰ See infra notes 386–467 and accompanying text.

³¹ I.R.C. § 162(a) (2000).

^{32 480} U.S. 23 (1987).

³³ *Id.* at 36.

³⁴ *Id.* at 35.

³⁵ See Higgins v. Comm'r, 312 U.S. 212, 218 (1941); Schoenfeld, supra note 3, at 242.

³⁶ I.R.C. section 212 (2000) allows deductions for expenditures paid or incurred in the collection or production of income, or in the management, maintenance, or conservation of property held for the production of income, where the activity engaged in by the taxpayer with respect to such expenditures is not a trade or business within the meaning of section 162.

the deductibility of higher educational expenses by courts and the IRS prior to 1967 will help one understand how the current rules apply to such expenses.

The deductibility of higher education expenses under the Code has gone through four phases.³⁷ Prior to 1950 (Phase I), virtually no higher education expenses were deductible.³⁸ Administrative pronouncements by the IRS and court decisions treated all such expenses as nondeductible personal expenditures.³⁹ In addition, it can be inferred from the United States Supreme Court's 1933 decision in *Welch v. Helvering*⁴⁰ that all educational expenses were nondeductible capital expenditures, no matter how related they were to the taxpayer's business.⁴¹ The Court stated that "[r]eputation and learning are akin to capital assets, like the good will of an old partnership,"⁴² and that "money spent in acquiring them . . . is not an ordinary expense of the operation of a business."⁴³

Phase II began in 1950,⁴⁴ with the Fourth Circuit Court of Appeals' decision in *Hill v. Commissioner*.⁴⁵ The taxpayer in *Hill* was employed as a school teacher in Virginia⁴⁶ and was required under Virginia law to hold a teaching certificate.⁴⁷ Her certificate expired, and state law required that she renew it either by providing evidence of college credits earned in certain subjects during the life of her certificate or by passing an examination on five books selected for her.⁴⁸ The taxpayer elected to acquire the college credits and enrolled in summer school at Columbia

³⁷ Schoenfeld, *supra* note 3, at 243. Schoenfeld references three different types of educational expenses, which he designates as "direct," "indirect," and "incidental." *Id.* He defines "direct" expenses as "payments made in connection with a formal course of study ranging from a four or more year degree program to a short refresher or continuing professional education course at an educational institution." *Id.* Because the focus of this Article is on higher education expenses, this brief historical summary will be limited to "direct" expenses as defined. *Id.*

³⁸ *Id*.

³⁹ See id. at 244–45.

⁴⁰ 290 U.S. 111 (1933).

⁴¹ Schoenfeld, *supra* note 3, at 246.

⁴² 290 U.S. at 115.

⁴³ *Id.* at 116. For a more complete discussion of the capital expenditure issue as it relates to educational expenses, see Schoenfeld, *supra* note 3, at 246–48.

⁴⁴ Schoenfeld, *supra* note 3, at 249.

^{45 181} F.2d 906 (4th Cir. 1950).

⁴⁶ *Id.* at 906.

⁴⁷ *Id.* at 907.

⁴⁸ *Id.* at 908.

University.⁴⁹ The Tax Court denied any deduction for her educational expenses at Columbia, holding that they were nondeductible personal expenditures.⁵⁰

The Fourth Circuit analyzed the case based on the "ordinary and necessary" language of section 162 of the Code, ⁵¹ concluding that the expenses were "incurred in carrying on a trade or business, were ordinary and necessary, and were not personal in nature." ⁵² Hill was the first case in which a court analyzed the deductibility of educational expenses incurred in connection with a trade or business in the same manner as other trade or business expenses, although the court did not consider that the educational expenses might be nondeductible capital expenditures. ⁵³

Another significant breakthrough in Phase II in favor of the deductibility of educational expenses was the Second Circuit Court of Appeals' decision in *Coughlin v. Commissioner*. The taxpayer in *Coughlin* was a lawyer who was a partner in a general practice law firm. The firm required one partner to specialize in federal tax matters, and Coughlin filled that role. To keep abreast of current tax law, Coughlin attended the annual Institute on Federal Taxation held at New York University. The IRS and the Tax Court denied any deduction for the educational expenses, holding that they were nondeductible personal expenditures.

The court analogized the taxpayer's expenses with those incurred by the taxpayer in *Hill* and held they were deductible under the same analysis.⁵⁹ Thus, the Second Circuit agreed with the Fourth Circuit that the deductibility of educational expenses incurred in connection with a trade or business should be analyzed in the same manner as other trade or business expenses. Together, *Hill* and *Coughlin* established some precedent that educational expenses were not always nondeductible personal expenses.⁶⁰

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<sup>49</sup> Id.
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⁵⁰ See id.

⁵¹ See id. at 909–11.

⁵² *Id.* at 911.

⁵³ Schoenfeld, *supra* note 3, at 249.

⁵⁴ 203 F.2d 307 (2d Cir. 1953); see Schoenfeld, supra note 3, at 252.

⁵⁵ Coughlin, 203 F.2d at 308.

⁵⁶ *Id*.

⁵⁷ Id.

⁵⁸ *Id*.

⁵⁹ *Id.* at 309.

⁶⁰ See Schoenfeld, supra note 3, at 254.

Phase III was introduced in 1958 with the IRS's issuance of Regulations (1958 Regulations) establishing detailed rules to determine whether particular educational expenses were deductible. As stated by one commentator, "The 1958 regulations constituted the first systematic analysis of many of the problems inherent in the area of educational expenditures and, in general, greatly liberalized deductibility." The lynchpin for analysis under these Regulations required a determination of the taxpayer's primary purpose for undertaking the education. The primary purpose test "had both an affirmative and a negative component."

To satisfy the affirmative component of the 1958 Regulations, a taxpayer had to prove that the education was:

[U]ndertaken primarily for the purpose of: (1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or [in the alternative] (2) Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status or employment.⁶⁵

The 1958 Regulations further provided that a determination of whether education met the first affirmative test set forth above was to be made "upon the basis of all the facts of each case."

In addition to satisfying one of the two alternatives to the affirmative component, a taxpayer was also required to prove that the education was not "undertaken primarily for the purpose of obtaining a new position or substantial advancement in position, or primarily for the purpose of fulfilling the general educational aspirations or other personal purposes of the taxpayer." The 1958 Regulations further provided, "If education is required of the taxpayer in order to meet the minimum requirements for qualification or establishment in his intended trade or business or specialty therein, the expense of such education is personal in nature and therefore is

⁶¹ Treas. Reg. § 1.162-5 (1958).

⁶² See Schoenfeld, supra note 3, at 255 (citations omitted).

⁶³ See Treas. Reg. § 1.162-5.

⁶⁴ Schoenfeld, *supra* note 3, at 255.

⁶⁵ Treas. Reg. § 1.162-5(a).

⁶⁶ Id.

⁶⁷ *Id.* § 1.162-5(b).

not deductible." Thus, if a taxpayer's intent was to pursue education that would qualify him for a specialty in a trade or business in which he was currently engaged, the cost of such education was nondeductible. The IRS further explained the 1958 Regulations in Revenue Ruling 60-97, stating:

[If the cost of] education . . . is part of a complete course of study that the taxpayer intends to pursue, such as that required to obtain a Bachelor of Laws degree, and [if] such complete course of study will lead to qualifying the taxpayer in a new trade or business or specialty therein, . . . [it] will not be deductible.⁶⁹

The 1958 Regulations turned out to be very difficult for courts to apply in a fair and consistent manner. As indicated by the quote above, the 1958 Regulations made the primary purpose test a question of fact, thus requiring a purely subjective analysis of the taxpayer's primary purpose for undertaking the education. Revenue Ruling 60-97 and subsequent case law did the same. As a result, [S]ince triers of fact could differ in their findings, essentially identical situations could and did produce contrary results and these fact findings often turned on vague statements made by the taxpayer years before."

B. 1967 Regulations

The IRS promulgated new Regulations in 1967⁷⁵ to replace the 1958 Regulations (Phase IV). These Regulations are currently in effect. The 1967 Regulations, like the 1958 Regulations, have both an affirmative and a negative component, but the tests pursuant to each component were substantially modified and other significant changes were made. The substantially modified and other significant changes were made.

⁶⁸ *Id*.

⁶⁹ Rev. Rul. 60-97, 1960-1 C.B. 69, 73.

⁷⁰ Schoenfeld, *supra* note 3, at 259–60.

⁷¹ See supra note 69 and accompanying text.

⁷² Vincent G. Kalafat, *Rethinking Treasury Regulation § 1.162-5 and Slaying the Monster in the Education Tax Maze*, 80 Notre Dame L. Rev. 1985, 2001 (2005).

⁷³ Schoenfeld, *supra* note 3, at 259–60.

⁷⁴ *Id.* at 260 (citations omitted).

⁷⁵ Treas. Reg. § 1.162-5 (1968).

⁷⁶ Kalafat, *supra* note 72, at 1998.

⁷⁷ Id

⁷⁸ See Treas. Reg. § 1.162-5.

The 1967 Regulations establish two affirmative tests and two negative tests for determining the deductibility of educational expenses under section 162 of the Code. To deduct educational expenses, the taxpayer must prove that at least one of the two affirmative tests has been met and that neither of the two negative tests applies. The plain language of the 1967 Regulations clearly states that the negative tests must be applied first, and only those expenses not rendered nondeductible by those tests are subjected to the affirmative tests to determine whether one of those tests can be met to make the expenses deductible. The 1967 Regulations also make it clear that educational expenses are deductible if they pass the applicable tests, "even though the education may lead to a degree."

The first negative test (minimum educational requirements test) makes educational expenses nondeductible if the taxpayer is required to undertake the education "in order to meet the minimum educational requirements for qualification in his employment or other trade or business." The 1967 Regulations provide that "[t]he minimum education necessary to qualify for a position or other trade or business" is a question of fact and is determined by the use of several factors, such as "the requirements of the employer, the applicable law and regulations, and the standards of the profession, trade, or business involved." Thus, this test is applied using an objective standard, as are all the tests required by the 1967 Regulations. The subjective primary purpose test of the 1958 Regulations has been eliminated. The 1967 Regulations further provide:

The fact that an individual is already performing service in an employment status does not establish that he has met the minimum educational requirements for qualification in that employment. Once an individual has met the minimum educational requirements for qualification in his employment or other trade or business... he shall be

⁷⁹ *Id.* § 1.162-5(a)–(b).

⁸⁰ *Id.* § 1.162-5(a).

⁸¹ *Id*.

⁸² *Id*.

⁸³ Id. § 1.162-5(b)(2)(i).

⁸⁴ Id

⁸⁵ Id

⁸⁶ See Kalafat, supra note 72, at 2000.

⁸⁷ Schoenfeld, *supra* note 3, at 275.

treated as continuing to meet those requirements even though they are changed. 88

The second negative test (new trade or business test) makes educational expenses nondeductible if the education undertaken by the taxpayer "is part of a program of study being pursued by him which will lead to qualifying him in a new trade or business." The 1967 Regulations provide further, "In the case of an employee, a change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment." There are four examples given in the 1967 Regulations for application of the new trade or business test, two of which deny deductions for attending law school. 91

As stated above, if a taxpayer can survive the negative tests, he then must prove that his expenses satisfy at least one of the two affirmative tests. The first affirmative test (maintains or improves skills test) allows a deduction for educational expenses if the education "[m]aintains or improves skills required by the individual in his employment or other trade or business." The second affirmative test (requirements of employer or applicable law test) allows a deduction if the education "[m]eets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation."

The most significant aspect of the 1967 Regulations is that all of the tests are applied using an objective standard. The subjective primary purpose test, which the courts found most problematic in applying the 1958 Regulations, ⁹⁴ has been eliminated. ⁹⁵ In addition, the 1967 Regulations dropped any references to education that would qualify a taxpayer for a specialty in his current trade or business, ⁹⁶ thus making the cost of any such education deductible if it otherwise satisfies the tests discussed above.

⁸⁸ Treas. Reg. § 1.162-5(b)(2)(i).

⁸⁹ *Id.* § 1.162-5(b)(3)(i).

⁹⁰ Id.

⁹¹ *Id.* § 1.162-5(b)(3)(ii).

⁹² Id. § 1.162-5(a)(1). This test is briefly discussed in Treas. Reg. section 1.162-5(c)(1).

⁹³ Id. § 1.162-5(a)(2). This test is briefly discussed in Treas. Reg. section 1.162-5(c)(2).

⁹⁴ See supra notes 70–74 and accompanying text.

⁹⁵ Schoenfeld, *supra* note 3, at 275.

⁹⁶ See Treas. Reg. § 1.162-5.

The 1967 Regulations generally are directed at two important requirements of section 162 of the Code. First, if the expenses are not related to any trade or business that the taxpayer is presently engaged in, they are not deductible. Second, if the expenses relate to a trade or business that the taxpayer is preparing to engage in but is not yet engaged in at the time the expenses are incurred, they are likewise not deductible. If a taxpayer is not currently engaged in a trade or business to which the education relates, or if the education is related to a trade or business that the taxpayer is preparing to engage in but is not yet engaged in at the time he undertakes the education, he cannot be maintaining or improving skills required by him in a trade or business, and he cannot be undertaking the education as an express requirement of his employer or applicable law or regulations, as required by the 1967 Regulations. In addition, any such education he undertakes will lead to qualifying him in a new trade or business.

Unfortunately, as evidenced by the case law discussed below, courts have construed the plain language of the 1967 Regulations to extend well beyond these two requirements of section 162 and have denied deductions for educational expenses that otherwise might be fully deductible under the provisions of section 162 if the 1967 Regulations did not exist. ¹⁰¹ The 1967 Regulations have been criticized for that reason. ¹⁰²

III. DISCUSSION OF CASE LAW RELEVANT TO 1967 REGULATIONS

A. Negative Tests

1. Minimum Educational Requirements

The minimum educational requirements test makes educational expenses nondeductible if the taxpayer is required to undertake the education "in order to meet the minimum educational requirements for qualification in his employment or other trade or business." Courts have sometimes confused the minimum educational requirements test with the new trade or business test, which makes educational expenses nondeductible if the education undertaken by the taxpayer "is part of a

⁹⁹ See Treas. Reg. § 1.162-5(a).

⁹⁷ Schoenfeld, *supra* note 3, at 241.

⁹⁸ Id.

¹⁰⁰ See Treas. Reg. § 1.162-5(b)(3)(i).

¹⁰¹ See infra Part III.

¹⁰² See Schoenfeld, supra note 3, at 325; Katz, supra note 3.

¹⁰³ Treas. Reg. § 1.162-5(b)(2)(i).

program of study being pursued by him which will lead to qualifying him in a new trade or business."¹⁰⁴ The principal distinction between the two tests is that the minimum educational requirements test requires a determination of whether the taxpayer has met the minimum educational requirements for qualification in his current employment or a trade or business, in which he is *currently* engaged when the education is obtained, ¹⁰⁵ whereas the new trade or business test requires a determination of whether the education will lead to qualifying the taxpayer for a new trade or business, in which he is not currently engaged when the education is obtained. 106 In *Toner v. Commissioner*, 107 the Tax Court held that the minimum educational requirements test "clearly applies either to education which meets the minimum requirement of the taxpayer's employer or to education which meets the minimum requirement of another trade or business."108 The Third Circuit Court of Appeals rejected that determination, in part because that interpretation of the minimum educational requirements test would make the new trade or business test irrelevant. 109

The minimum educational requirements test has been discussed and applied in only a few reported cases, probably because it is not common for a position of employment or a trade or business to have minimum educational requirements. A noted exception is the teaching profession, which explains why the 1967 Regulations contain substantial detail regarding the application of the minimum educational requirements test to teachers. The minimum educational requirements for teachers is defined as "the minimum level of education (in terms of aggregate college hours or degree) which under the applicable laws or regulations, in effect at the time this individual is first employed in such position, is normally required of an individual initially being employed in such a position. If no such requirements exist for a particular position, "an individual in such a position shall be considered to have met the minimum educational requirements for qualification in that position when he becomes a member

¹⁰⁴ *Id.* § 1.162-5(b)(3)(i).

¹⁰⁵ See Schoenfeld, supra note 3, at 277.

¹⁰⁶ See id. at 281.

¹⁰⁷ 71 T.C. 772 (1979), rev'd, 623 F.2d 315 (3d Cir. 1980).

¹⁰⁸ *Id.* at 777.

¹⁰⁹ Toner v. Comm'r, 623 F.2d 315, 319 (3d Cir. 1980).

¹¹⁰ See Schoenfeld, supra note 3, at 281.

¹¹¹ Id. at 278; see Treas. Reg. § 1.162-5(b)(2)(iii) (1968).

¹¹² Treas. Reg. § 1.162-5(b)(2)(ii).

of the faculty of the educational institution." The 1967 Regulations leave it to the particular practices of each institution to determine whether an individual is a member of the faculty, but also provide some additional guidance on that issue. In addition, the 1967 Regulations provide several examples of the application of the minimum educational requirements test, all but one of which applies to teachers.

Illustrative cases applying the minimum educational requirements test teachers include Davis v. Commissioner 116 and Toner v. Commissioner. 117 In Davis, the taxpayer had a master's degree in social work from the University of Chicago, and she was employed by the University of Chicago, primarily as a teaching assistant. The taxpaver also held a position as a caseworker to prepare her for eventual enrollment in the University's Ph.D. program at the School of Social Service Administration. 119 The taxpayer enrolled in the Ph.D. program in 1967 and received her degree in 1972. From 1971 until 1973, the taxpayer was employed as a lecturer in the school of Social Service Administration, which was a nonfaculty academic position. ¹²¹ In 1973, the taxpaver accepted a position as an assistant professor in the School of Social Service Administration, which is a full-time faculty position. Faculty members at the school were required to have a Ph.D. degree, with certain exceptions. 123 The taxpayer was seeking to deduct the cost of obtaining her Ph.D. degree. 124 The court held that the taxpayer's educational expenses were nondeductible, because obtaining the Ph.D. degree enabled the taxpayer to meet the minimum educational requirements to secure a position as a permanent faculty member at the University of Chicago. 125

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<sup>113</sup> Id.
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¹¹⁴ See id.

¹¹⁵ *Id.* § 1.162-5(b)(2)(iii).

^{116 65} T.C. 1014 (1976).

¹¹⁷ 623 F.2d 315 (1980).

¹¹⁸ Davis, 65 T.C. at 1015.

¹¹⁹ Id. at 1015–16.

¹²⁰ Id. at 1016.

¹²¹ *Id*.

¹²² *Id*.

¹²³ *Id*.

¹²⁴ Id. at 1017.

¹²⁵ *Id.* at 1020; *see also* Burt v. Comm'r, 40 T.C.M. (CCH) 1164, 1167–69 (1980) (disallowing the deduction for the cost of obtaining Bachelor of Music degree because it qualified the taxpayer for a position as a public school teacher, and, notwithstanding that the (*continued*)

In *Toner*, the taxpaver was a teacher at a parochial school, teaching "both religious and secular subjects to fifth grade students." When she was initially employed at the school, she "had completed two years of a four-year college degree program." 127 The minimum educational requirement for employment as a teacher at the school was graduation from high school. 128 The taxpayer had full faculty status at all times of her employment. 129 At the time of her employment, the taxpayer was required by the school to sign an agreement that "she would take a minimum of six college credits each year until she obtained a degree." In 1973, she enrolled in fifteen credits at Villanova University and obtained her degree. 131 The taxpayer was seeking to deduct the cost of her education at Villanova. 132 In analyzing whether the taxpayer ran afoul of the minimum educational requirements test, the court reviewed section 162-5(b)(2)(ii) of the 1967 Regulations, which defines minimum educational requirements for teachers. 133 The court stated that minimum educational requirements are determined by first "looking to the state law at the time the teacher is first employed."134 The relevant state law in *Toner* provided no educational requirements for parochial school teachers. ¹³⁵ As a result, the court stated that "the taxpayer has met the minimum requirements" under the 1967 Regulations "when [s]he becomes a member of the faculty of the educational institution [where she is employed].",136 The court decided that the taxpayer met the minimum educational requirements for her

taxpayer was employed as assistant band director at a public school before obtaining the degree, the taxpayer failed to prove that he was a member of the faculty); Diaz v. Comm'r, 70 T.C. 1067, 1074–77 (1978) (disallowing the deduction for the cost of obtaining Bachelor of Science degree in education because it qualified the taxpayer for a position as a public school teacher, and the taxpayer's position at a public school prior to obtaining the degree was as an educational assistant, which did not rise to the level of teacher).

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126 Toner v. Comm'r, 623 F.2d 315, 316 (1980).

127 Id.
128 Id.
129 Id.
130 Id.
131 Id.
132 Id.
133 Id. at 319.
134 Id.
135 Id.
136 Id. (quoting Treas. Reg. § 1.162-5(b)(2)(ii)).
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position when she was initially employed at the school.¹³⁷ The school's minimum educational requirement for a faculty position was graduation from high school.¹³⁸ The taxpayer had satisfied that requirement, and in addition she had completed two years of a four-year college degree program.¹³⁹ Further, the school treated the taxpayer as a full member of the faculty from the date of her initial employment.¹⁴⁰

The lone example provided in the 1967 Regulations for application of the minimum educational requirements test that does not apply to teachers deals with a law student who has completed two years of law school. In the example, the student is hired by a law firm on a full-time basis to do legal research and is required by the firm to complete law school at night and pass the state bar exam. The costs of completing law school and for a bar review course are nondeductible because the education is required to meet the minimum educational requirements for the law student's current employment.

In a recent case, a court apparently misunderstood the minimum educational requirements test and misapplied it, although the misapplication did not prevent the court from reaching the correct result. In *Allemeier v. Commissioner*, ¹⁴⁴ the taxpayer was employed by a company to sell a particular type of product that it manufactured. ¹⁴⁵ Eventually, the taxpayer's duties expanded to include designing marketing strategies to sell company products, organizing seminars, and other similar responsibilities. ¹⁴⁶ In 1999, the taxpayer enrolled at Pepperdine University to pursue an MBA with a concentration in business management. ¹⁴⁷ He completed the degree in 2001. ¹⁴⁸ Between 1999 and 2001, while he was

¹³⁷ *Id*.

¹³⁸ *Id*.

¹³⁹ Id. at 316.

¹⁴⁰ *Id.* at 319. The court also determined that the taxpayer's education did not fail the new trade or business test. *Id.* at 320. With respect to that test, the 1967 Regulations are much more liberal in the treatment of educational expenses of teachers than other taxpayers. *See* Treas. Reg. § 1.162-5(b)(3)(i) (1968).

¹⁴¹ See Treas. Reg. § 1.162-5(b)(3)(iii) ex. 3.

¹⁴² I.J

¹⁴³ *Id*.

¹⁴⁴ 90 T.C.M. (CCH) 197 (2005).

¹⁴⁵ Id. at 198.

¹⁴⁶ *Id*.

¹⁴⁷ *Id*.

¹⁴⁸ *Id*.

pursuing the MBA degree, the taxpayer was promoted several times within the company. These promotions expanded the taxpayer's duties to include financial analysis, planning for sales and marketing campaigns, and other general management responsibilities. The taxpayer was seeking to deduct the cost of his MBA degree. The taxpayer was seeking to deduct the cost of his MBA degree.

The IRS argued that the taxpayer failed the minimum educational requirements test because even though the company did not have a minimum educational requirement for the taxpayer's initial employment, it had minimum educational requirements for the taxpayer's promotions. The IRS thus argued that the educational expenses were nondeductible. The court stated that the issue was whether the company conditioned the taxpayer's promotions on his completion of the MBA program. If the company did, the court apparently would have held in favor of the IRS on this issue. The court ultimately decided that the company did not and held against the IRS.

The court should have dismissed the IRS's argument entirely. The 1967 Regulations clearly provide, "Once an individual has met the minimum educational requirements for qualification in his employment or other trade or business (as in effect when he enters the employment or trade or business), he shall be treated as continuing to meet those requirements even though they are changed." The promotions might be evidence that the education qualified the taxpayer for a new trade or business, thus failing the new trade or business test, and the educational expenses could be nondeductible for that reason business test, and the educational requirements test.

2. New Trade or Business

The new trade or business test makes educational expenses nondeductible if the education undertaken by the taxpayer "is part of a

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<sup>149</sup> Id.
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¹⁵⁰ Id.

¹⁵¹ *Id*.

¹⁵² Id. at 199.

¹⁵³ See id.

¹⁵⁴ *Id*.

¹⁵⁵ See id.

¹⁵⁶ Id

¹⁵⁷ Treas. Reg. § 1.162-5(b)(2)(i) (1968) (emphasis added).

¹⁵⁸ See infra Part III.A.2.

program of study being pursued by him which will lead to qualifying him in a new trade or business."¹⁵⁹ Because this test, along with all the other tests required by the 1967 Regulations, is applied using an objective standard, the issue is whether the education undertaken by the taxpayer will *lead to qualifying* him for a new trade or business. ¹⁶⁰ Whether the taxpayer ever actually intends to enter the new trade or business is irrelevant. ¹⁶¹ For this reason, the 1967 Regulations have been criticized for imposing requirements on the deductibility of educational expenses under section 162 of the Code that do not exist for other types of expenses incurred in a trade or business. ¹⁶²

In 1974, the United States Tax Court decided Glenn v. Commissioner, 163 which proved to be the gold standard used by courts in subsequent cases to apply the new trade or business test. The taxpayer in Glenn had earned a bachelor's degree in accountancy and had been approved by the State Board of Accountancy of Tennessee to practice as a public accountant. 164 Between 1963 and 1970, the taxpayer was employed as a senior accountant by the national public accounting firm of Peat. Marwick, Mitchell & Co. 165 The taxpayer made numerous attempts during those years to pass the Tennessee certified public accountant examination. 166 Passing that examination would have enabled the taxpayer to hold himself out as a certified public accountant (CPA). Prior to sitting for the November CPA examination, the taxpayer enrolled in a CPA review course offered by the University of Alabama. The taxpayer was seeking to deduct the cost of that course. 169 The IRS argued that the education failed the new trade or business test and that the taxpayer's expenses were therefore nondeductible. 170

¹⁵⁹ Treas. Reg. § 1.162-5(b)(3)(i).

¹⁶⁰ See Schoenfeld, supra note 3, at 311.

¹⁶¹ Id

¹⁶² See Schoenfeld, supra note 3; Katz, supra note 3.

^{163 62} T.C. 270 (1974).

¹⁶⁴ *Id.* at 271.

¹⁶⁵ *Id*.

¹⁶⁶ *Id*.

¹⁶⁷ *Id*.

¹⁶⁸ Id. at 272.

¹⁶⁹ *Id.* at 273.

¹⁷⁰ *Id.* at 274.

The court stated the issue as whether the practice of a public accountant constitutes a different trade or business from that of a CPA.¹⁷¹ The court searched for but could not find any authority for determining when a taxpayer has qualified for a new trade or business. ¹⁷² To fill that void, the court adopted what it referred to as a "commonsense approach . . . that a comparison be made between the types of tasks and activities which the taxpayer was qualified to perform before the acquisition of a particular title or degree, and those which he is qualified to perform afterwards." ¹⁷³ If the tasks and activities are significantly different before and after the education, the court said that the educational expenses are not deductible because the education qualifies the taxpayer for a new trade or business. 174 The court found that under Tennessee law public accountants and CPAs are licensed separately by the State, each having their own separate educational and examination requirements. 175 The court also found that a CPA is authorized under Tennessee law to perform certain tasks that public accountants are not permitted to perform. ¹⁷⁶ Consequently, the court held that a CPA and a public accountant are two separate trades or businesses. and that the taxpayer's education thus led to qualifying him for a new trade or business; his educational expenses were therefore not deductible. ¹⁷⁷ The taxpayer also argued that had he passed the CPA examination he would have continued to perform the same tasks he was performing before sitting for the examination and becoming a CPA. The court correctly pointed out that the new trade or business test is stated objectively, and the only issue is whether the education will lead to qualifying the taxpayer for a new trade or business; the taxpaver's actual intention to engage in the trade or business is irrelevant. 179

The decision in *Glenn*, and the establishment of the commonsense approach for application of the new trade or business test, provided a clear standard for deciding many of the subsequent cases where taxpayers were attempting to deduct educational expenses under section 162 of the Code.

¹⁷¹ *Id*.

¹⁷² *Id.* at 275.

¹⁷³ Id.

¹⁷⁴ *Id.* This commonsense approach was first adopted in *Weiszmann v. Commissioner*, 52 T.C. 1106, 1110 (1969).

¹⁷⁵ Glenn, 62 T.C. at 275.

¹⁷⁶ *Id.* at 275–76.

¹⁷⁷ Id. at 276–78.

¹⁷⁸ *Id.* at 276.

¹⁷⁹ Id. at 276–77.

Since *Glenn*, courts can determine whether the education undertaken by the taxpayer is a step along the path to obtaining some kind of certification or license that, once obtained, authorizes the taxpayer to perform tasks that he would not be authorized to perform before obtaining the license or certification. Because of the objective nature of the new trade or business test, it is irrelevant whether the taxpayer actually intends to obtain the license or certification, or intends to perform any of the tasks he would be authorized to perform if he did obtain the license or certification, or even whether he intends to complete the educational program that would entitle him to obtain the license or certification. All such educational expenses are simply not deductible. Most cases decided subsequent to *Glenn* held against the taxpayer for that reason.

In *Antzoulatos v. Commissioner*,¹⁸³ the taxpayer was employed as an intern pharmacist and at the same time was enrolled in the School of Pharmacy at the University of Southern California.¹⁸⁴ The taxpayer was seeking to deduct the cost of his education.¹⁸⁵ The court determined that a pharmacological degree was one of the requirements to qualify for a certificate as a registered pharmacist, and that a registered pharmacist was authorized to perform tasks that an intern pharmacist could not perform.¹⁸⁶ Thus, the taxpayer's education qualified him for a new trade or business.¹⁸⁷

Cooper v. Commissioner¹⁸⁸ was somewhat similar factually to Glenn. The taxpayer in Cooper was employed as an accountant and at the same time was a candidate for a master's degree in accounting at the University of Hartford.¹⁸⁹ The taxpayer enrolled in five courses in mathematics, finance, economics, and accounting.¹⁹⁰ One reason the taxpayer pursued the master's degree was that he desired to sit for the certified public accountant examination, but he lacked the requisite number of accounting

¹⁸⁰ See infra text accompanying notes 183–221.

¹⁸¹ See Kalafat, supra note 72, at 2000–01 (tracing the "objective phase" of the treasury regulation).

¹⁸² See infra text accompanying notes 183–221.

¹⁸³ 34 T.C.M. (CCH) 1426 (1975).

¹⁸⁴ *Id.* at 1427.

¹⁸⁵ *Id*.

¹⁸⁶ Id. at 1429.

¹⁸⁷ Id

¹⁸⁸ 38 T.C.M. (CCH) 955 (1979).

¹⁸⁹ Id. at 956.

¹⁹⁰ Id.

courses to qualify.¹⁹¹ The court determined, as in *Glenn*, that CPAs are authorized under state law to perform certain tasks that accountants who are not CPAs are not permitted to perform.¹⁹² As a result, the court stated that, to the extent the five courses qualified the taxpayer to sit for the CPA examination, the cost of those courses was not deductible because they qualified the taxpayer for a new trade or business.¹⁹³ The court held that only the accounting course failed the new trade or business test; the cost of the other four courses was deductible because they otherwise satisfied the requirements of the 1967 Regulations.¹⁹⁴

In *Reisinger v. Commissioner*, ¹⁹⁵ the taxpayer was employed as a licensed practical nurse before leaving to enroll in the Johns Hopkins University School of Health Services Health Associates course of study. ¹⁹⁶ This course of study qualifies its graduates to sit for a certifying examination that, if passed, permits an individual to be registered as a certified physician's assistant by the State of Maryland. ¹⁹⁷ The court determined that a certified physician's assistant is authorized under state law to perform certain tasks that licensed practical nurses are not permitted to perform. ¹⁹⁸ Therefore, because the taxpayer's education qualified her to sit for an examination that permitted her to be registered as a certified physician's assistant, the education qualified the taxpayer for a new trade or business and her expenses were thus not deductible. ¹⁹⁹

In Siewert v. United States,²⁰⁰ the taxpayer was a licensed chiropractor and attended medical school in Mexico, where he eventually obtained a degree of Doctor of Medicine.²⁰¹ The court stated, "[T]he practice of medicine is a separate and distinct trade and business from the practice as a chiropractor. The statutes governing the licensing of these two professions are separate in the State of Texas."²⁰² The court thus held that the cost of the taxpayer's medical degree was not deductible because the education

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<sup>191</sup> Id.
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¹⁹² *Id.* at 957.

¹⁹³ *Id*.

¹⁹⁴ *Id*.

¹⁹⁵ 71 T.C. 568 (1979).

¹⁹⁶ *Id.* at 569.

¹⁹⁷ *Id.* at 570.

¹⁹⁸ *Id.* at 576–77.

¹⁹⁹ *Id.* at 577.

²⁰⁰ 500 F. Supp. 1076 (N.D. Tex. 1980).

²⁰¹ *Id.* at 1077.

²⁰² *Id*.

qualified the taxpayer for a new trade or business.²⁰³ The taxpayer argued that he never intended to become a medical doctor but planned to use his medical training in his chiropractic practice; in response the court stated, "[T]he subjective matter of intent is no longer the criterion under the regulations and is irrelevant on this point."²⁰⁴

In *Dierker v. Commissioner*, ²⁰⁵ the taxpayer was employed in the field of landscape architecture while he attended Harvard University Graduate School of Design, where he received a master's degree in landscape architecture. 206 The court determined that Massachusetts allows persons to become registered as landscape architects and prohibits persons who do not become registered from representing themselves to be landscape architects, or using the title of landscape architect on signs or other promotional materials, or using an authorized seal to be stamped on plans and specifications.²⁰⁷ The court further determined that registration as a landscape architect requires, among other things, that a person graduate from an approved college or school of landscape architecture and successfully pass an examination administered by a board established by Massachusetts law to oversee the registration process.²⁰⁸ The taxpayer took and failed the examination twice.²⁰⁹ The court decided that the taxpayer's education led to qualifying him to become a registered landscape architect in Massachusetts, and thus, because registered landscape architects are permitted to hold themselves out as such and perform tasks and activities that unregistered persons are not, it qualified him for a new trade or business.²¹⁰

In *Mason v. Commissioner*,²¹¹ the taxpayer was employed as a pilot of a C-130 aircraft with the Air National Guard while attending a flight training course that allowed him to obtain a flight engineer's certificate for turbojet aircraft.²¹² The court determined that "the duties, responsibilities, and licensing requirements for a pilot are different from those of a flight engineer," and that therefore employment as a flight engineer is a different

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<sup>203</sup> Id.
<sup>204</sup> Id.
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²⁰⁵ 68 T.C.M. (CCH) 535 (1994).

²⁰⁶ *Id.* at 536.

²⁰⁷ Id.

²⁰⁸ Id.

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²¹⁰ *Id.* at 537–38.

²¹¹ 44 T.C.M. (CCH) 365 (1982).

²¹² Id. at 366.

trade or business from employment as a pilot.²¹³ The taxpayer's expenses for the flight training course were thus held to be nondeductible.²¹⁴

In *Roussel v. Commissioner*,²¹⁵ the taxpayer was employed as a flight engineer and a ground school safety instructor to pilots.²¹⁶ The taxpayer began to take flying lessons so that he could teach the ground safety courses from a pilot's point of view, and he eventually received a commercial pilot certificate.²¹⁷ The court determined that the taxpayer's flying lessons led to qualifying him to receive a commercial pilot certificate, which in turn qualified him to perform services as a commercial pilot.²¹⁸ The cost of the taxpayer's flying lessons was thus not deductible because they qualified the taxpayer for a new trade or business.²¹⁹ The taxpayer argued that the commercial pilot certificate did not actually qualify him to become a commercial pilot because he did not possess the additional requirements to be employed by an airline, and it made "no economic sense for him to pursue the career of a commercial pilot."²²⁰ However, while sympathetic with the taxpayer's dilemma, the court stated:

[H]e could take passengers for short joy rides on sunny days and be compensated for that function, which he was not allowed to do prior to his qualification as a commercial pilot.... Unfortunately for [the taxpayer], his commercial pilot certificate enabled him to earn compensation and engage in a trade or business for which he was unqualified previously.... Therefore, even though [the taxpayer] may not intend to pursue that trade or business and even though that trade or business may be limited in scope, ... the expenses for [the taxpayer's] education are nondeductible.²²¹

²¹³ *Id.* at 369.

 $^{^{214}}$ Id

²¹⁵ 38 T.C.M. (CCH) 565 (1979).

²¹⁶ *Id.* at 565.

²¹⁷ Id. at 565–66.

²¹⁸ *Id.* at 566–67.

²¹⁹ *Id.* at 567; *see also* Hinton v. Comm'r, 44 T.C.M. (CCH) 1160, 1163 (1982) (similarly holding that the taxpayer's flight training expenses were nondeductible).

²²⁰ Roussel, 38 T.C.M. (CCH) at 567.

²²¹ Id.

Gruman v. Commissioner²²² was somewhat similar factually to Roussel, yet the court, stating that it was applying the commonsense approach established in *Glenn*, held in favor of the taxpayer.²²³ Gruman, the taxpaver was employed by American Airlines as a flight engineer and copilot on Boeing 707 aircraft.²²⁴ He at no time held a certificate that would qualify him to be a pilot in command of a Boeing 707. 225 To improve his piloting skills, the taxpayer enrolled in a ground and flight course of instruction, which, upon completion and after passing the appropriate examinations, qualified the taxpayer to be a pilot in command of a Cessna Citation, a different aircraft from a Boeing 707.²²⁶ The court determined that the course of instruction taken by the taxpayer did in fact qualify him to perform tasks that he was not qualified to perform before receiving the instruction.²²⁷ Specifically, "Prior to taking the course, [the taxpayer] was qualified . . . to be a pilot in command of a Cessna Citation operated for compensation or hire . . . [;] [a]fter taking the course, [the taxpayer] was qualified to operate a Cessna Citation as pilot in command both for compensation or hire and for a common carrier."²²⁸ The court held in favor of the taxpayer, however, because:

[T]he Cessna Citation was not flown by any common carrier in . . . any . . . year up to the time of trial. As a practical matter, therefore, [the course of instruction] did not expand the scope of piloting activities open to him. . . . Common sense tells us that educational expenses are not to be disallowed on the grounds that a taxpayer's course qualified him for only a hypothetical trade or business.²²⁹

Courts in a number of cases have held that the cost of attending law school is never deductible because it always leads to qualifying the taxpayer for the trade or business of practicing law, for which the taxpayer could not have been qualified before attending law school because a law degree is a prerequisite in every state to sit for the bar examination and to be admitted to practice. Whether the taxpayer actually intends to take the

²²² 44 T.C.M. (CCH) 420 (1982).

²²³ Id. at 422.

²²⁴ *Id.* at 421.

²²⁵ Id.

²²⁶ Id.

²²⁷ Id. at 422.

²²⁸ Id.

²²⁹ Id.

bar examination or to practice law is of course irrelevant.²³⁰ The result in these cases is not surprising, given that two of the examples provided in the 1967 Regulations identifying educational expenses that fail the new trade or business test involve a taxpayer attending law school.²³¹

In *Vetrick v. Commissioner*, ²³² the taxpayer was denied a deduction for the cost of his law school education, notwithstanding that before attending law school he was already qualified to practice law in Montana and in Ohio federal courts. ²³³ The taxpayer argued that his law school expenses were deductible because the education did not qualify him for a new trade or business, as he was already a practicing attorney before attending law

²³⁰ See, e.g., Galligan v. Comm'r, 83 T.C.M. (CCH) 1859, 1859 (2002) (taxpayer was employed as a law librarian before attending law school); Rehe v. Comm'r, 40 T.C.M. (CCH) 975, 975 (1980) (taxpayer was employed as manager in the contracts department of his employer before attending law school); Grover v. Comm'r, 68 T.C. 598, 599 (1977) (taxpayer was employed by the Marine Corps as a military lawyer before attending law school); Melnik v. United States, 521 F.2d 1065, 1065 (1975) (taxpayer was employed by the IRS as a revenue agent before attending law school); O'Donnell v. Comm'r, 62 T.C. 781, 782 (1974) (taxpayer was employed as an accountant before attending law school); Weiler v. Comm'r, 54 T.C. 398, 399 (1970) (taxpayer was employed by the IRS as a revenue agent before attending law school); Weiszmann v. Comm'r, 52 T.C. 1106, 1107 (1969) (taxpayer was employed as a patent trainee before attending law school). Duecaster v. Commissioner, the taxpayer was a high school teacher before attending law school, and he argued that his law school expenses qualified as start-up expenditures and were thus amortizable under section 195 of the Code. 60 T.C.M. (CCH) 917, 918 (1990). The court disagreed, holding that the expenses did not qualify as start-up expenditures because section 195(c)(1)(B) requires generally that the expenses must be deductible under section 162 of the Code, save only for the failure of the requirement under section 162 that the expenses be paid or incurred by the taxpayer in carrying on an existing trade or business. Id. at 919. The taxpayer's expenses failed that requirement because, as discussed above, the cost of attending law school is never deductible because it always leads to qualifying the taxpayer for the trade or business of practicing law. *Id.* at 920. Similarly, in Sharon v. Commissioner, the taxpayer was attempting to amortize the cost of his New York law license as an intangible asset under section 167 of the Code. 66 T.C. 515, 525 (1976). Included in the cost basis of his law license was his cost of attending law school. Id. The court held that the cost of his law school education was nondeductible in any amount under the 1967 Regulations, thus precluding the amortization deductions that the taxpayer was seeking. Id. at 525-26.

²³¹ Treas. Reg. § 1.162-5(b)(3)(ii) (1968).

²³² 628 F.2d 885 (5th Cir. 1980).

²³³ Id. at 886.

school.²³⁴ The court disagreed, holding that the taxpayer's law school education qualified him to sit for the bar examination in any state and practice law in those states' courts.²³⁵ Because the taxpayer was not qualified to do that before attending law school, his education qualified him for a new trade or business, and the expenses were thus not deductible.²³⁶

Similarly, courts in a number of cases have held that the cost of obtaining an undergraduate college degree is not deductible if the degree leads to qualifying the taxpayer to obtain some kind of certification or license that, once obtained, authorizes the taxpayer to perform tasks that he would not be authorized to perform without the certification or license. In *Cristea v. Commissioner*, ²³⁷ the taxpayer was employed in the engineering field while pursuing a Bachelor of Science degree in electrical engineering at Northeastern University. His employment was obtained through Northeastern's cooperative education program. The court determined that the taxpayer's degree qualified him "to sit for the professional engineer's certification examination under Massachusetts law after fewer years of work experience than a person who had not [received such a

²³⁴ *Id*.

²³⁵ *Id.* at 887.

²³⁶ Id.; see also Sharon, 66 T.C. at 528–29, in which the court held that the cost of a bar review course the taxpayer took in preparation for the California bar examination was not deductible because it potentially qualified the taxpayer for a new trade or business. The taxpayer in that case was already licensed to practice law in New York when he took the bar review course, but the court held that taking the California bar exam qualified the taxpayer to practice law in the California state courts, which he was not qualified to do before taking the bar review course and passing the California bar examination. *Id.* at 528. In Ruehmann v. Commissioner, 30 T.C.M. (CCH) 675 (1971), the taxpayer was allowed to sit for the Georgia bar examination and was admitted to the Georgia bar before he completed his law degree. Id. at 676. He was seeking to deduct expenses he subsequently incurred in completing the degree. Id. at 678. The court denied deduction of such expenses because the law degree obtained by the taxpayer "was education generally required of a lawyer to meet the minimum educational requirements for qualification for employment in a law firm[,]... [and completion of the taxpayer's law degree was] part of a program of study which was being pursued by him which would lead to qualifying him as a lawyer." Id. at 679. The court stated, "Even though because of the law in Georgia at the time he was able to be admitted to the Bar before actually receiving his [law] degree, it was customary for lawyers in Georgia to obtain [a law] degree before beginning the practice of law." Id.

²³⁷ 50 T.C.M. (CCH) 1306 (1985).

²³⁸ *Id.* at 1307.

²³⁹ Id.

degree]. A certificate of registration as a professional engineer is required in Massachusetts in order to practice independently as an engineer."²⁴⁰ The court held that, before obtaining his degree, the taxpayer was not qualified as a professional engineer, and that obtaining the degree would thus lead to qualifying him in a new trade or business, thereby making the cost of his degree nondeductible.²⁴¹

As stated above, and as the above examples show, the decision in *Glenn*, and the establishment of the commonsense approach for application of the new trade or business test, provided a clear standard for deciding many of the subsequent cases where taxpayers were attempting to deduct educational expenses under section 162 of the Code. After *Glenn*, courts can determine whether the education undertaken by the taxpayer is a step along the path to obtaining some kind of certification or license that, once obtained, authorizes the taxpayer to perform tasks that he would not be authorized to perform before obtaining the license or certification. But, while that analysis resolved most of the cases arising subsequent to *Glenn*, potential qualification for a certification or license is not a prerequisite for application of the new trade or business test.²⁴² Determining whether education qualifies a taxpayer for a new trade or business for which he was not previously qualified is a question of fact.²⁴³

For example, in *Hewett v. Commissioner*, ²⁴⁴ the taxpayer had taught piano privately and had been employed as a piano teacher at various

²⁴⁰ *Id.* at 1308 (citation omitted).

²⁴¹ *Id.* at 1309–10; *see also* Browne v. Comm'r, 73 T.C. 723, 726–28 (1980) (disallowing the deduction for the cost of obtaining a bachelor's degree with a major in accounting because the taxpayer's degree was a prerequisite to qualify to take the CPA examination in Florida, and the degree thus qualified her for a new trade or business, because the taxpayer could not have qualified to be a CPA before obtaining the degree); Burt v. Comm'r, 40 T.C.M (CCH) 1164, 1167–69 (1980) (disallowing the deduction for the cost of obtaining a Bachelor of Music degree because it qualified the taxpayer for a position as a public school teacher, and the degree thus qualified her for a new trade or business, because the taxpayer could not have qualified to be a public school teacher before obtaining the degree); Diaz v. Comm'r, 70 T.C. 1067, 1074–77 (1978) (disallowing the deduction for the cost of obtaining a Bachelor of Science degree in education because it qualified the taxpayer for a position as a public school teacher, and the degree thus qualified her for a new trade or business, because the taxpayer could not have qualified to be a public school teacher before obtaining the degree).

²⁴² See supra notes 180–241 and accompanying text.

²⁴³ See infra notes 245–72 and accompanying text.

²⁴⁴ 71 T.C.M. (CCH) 2350 (1996).

universities for over twenty-five years.²⁴⁵ She also taught music theory, improvisation, sight reading, accompanying, and ensemble.²⁴⁶ In addition, she had performed extensively as a professional pianist.²⁴⁷ The taxpayer enrolled at two universities for the purpose of obtaining a master's degree in music therapy.²⁴⁸ After completing sufficient course work but before obtaining the degree, the taxpayer was employed as a music therapist.²⁴⁹ There were apparently no certification or licensing requirements to work as a music therapist; there was no discussion of any such requirements by the court anywhere in its opinion. The court stated that it was using the commonsense approach established in *Glenn* in applying the new trade or business test.²⁵⁰ The court described that approach as follows:

We compare the types of tasks and activities the taxpayer was qualified to perform before she acquired the education at issue and those she is qualified to perform afterwards. If substantial differences exist in the tasks and activities of the various occupations or employments, then each such occupation or employment constitutes a separate trade or business.²⁵¹

The court reviewed the trial record, which included extensive testimony of a professor emeritus in the music therapy program at the university in which the taxpayer was working toward her master's degree, and determined that the taxpayer's "occupation as a professional pianist and piano teacher is different from the services she performs and will perform as a music therapist." The court thus determined, as a question of fact, that the taxpayer's education qualified her for a new trade or business, and the cost of her education was therefore not deductible. 253

²⁴⁵ *Id.* at 2351.

²⁴⁶ *Id*.

²⁴⁷ Id.

²⁴⁸ *Id*.

²⁴⁹ *Id*.

²⁵⁰ Id. at 2252.

²⁵¹ *Id*.

²⁵² Id.

²⁵³ *Id.* at 2353. The court also determined that the cost of the taxpayer's education was not deductible because the education enabled her "to meet the minimum educational requirements for qualification as a music therapist." *Id.* This of course is a misapplication of the minimum educational requirements test. *See supra* notes 106–10 and accompanying text.

In *Warren v. Commissioner*, ²⁵⁴ the taxpayer decided to pursue a career as a minister in the United Methodist Church, ²⁵⁵ and he subsequently served as a local pastor from 1993 to 1996. ²⁵⁶ In 1994, the taxpayer enrolled in a university to take courses that would help him improve his ministry skills, and he received a bachelor's degree in 1995. ²⁵⁷ The court determined that the courses leading to the bachelor's degree provided the taxpayer "with a background in a variety of social issues that could have prepared him for employment with several public agencies and private nonprofit organizations outside of the ministry." The court, quoting from *Carroll v. Commissioner*, stated:

Millions of people must secure a general college education before they commence their life's employment, and it is generally accepted that obtaining such education is a personal responsibility in preparing for one's career. . . . Though his perseverance is to be admired, we do not believe that he should receive tax deductions not available to those who complete their general college preparation before beginning their career. Furthermore, a general college education has more than economic utility. It broadens one's understanding and increases his appreciation of his social and cultural environment. 259

The court thus held that the taxpayer's expenses to obtain his bachelor's degree were not deductible because the education qualified him for a new trade or business.²⁶⁰ The court further stated, "It may be all but impossible for a taxpayer to establish that a bachelor's degree program does not qualify the taxpayer in a new trade or business."²⁶¹

²⁵⁴ 85 T.C.M. (CCH) 1494 (2003).

²⁵⁵ *Id.* at 1494.

²⁵⁶ Id. at 1495.

²⁵⁷ *Id*.

²⁵⁸ Id. at 1496.

²⁵⁹ *Id.* (quoting Carroll v. Comm'r, 51 T.C. 213 (1968), *aff* d, 418 F.2d 91 (7th Cir. 969)).

²⁶⁰ *Id*.

²⁶¹ *Id.*; see also Malek v. Comm'r, 50 T.C.M. (CCH) 792 (1985). In that case, the taxpayer was employed as an office manager and management consultant and was required by her employer to obtain a bachelor's degree. *Id.* at 793. The court held that the bachelor's degree qualified the taxpayer for a new trade or business, and her expenses were thus not deductible. *Id.* at 796.

In Schneider v. Commissioner, 262 the taxpayer served on active duty with the United States Army for five years.²⁶³ The taxpayer's position in the Army was an infantry officer, and his duties included management and training of troops and civilians, management of over \$10,000,000 in assets. and other management and administrative responsibilities.²⁶⁴ The taxpayer resigned his position with the Army in June of 1977 and enrolled in the MBA program at Harvard University. 265 He received his degree in June of 1979. After receiving his MBA, the taxpayer immediately enrolled in Harvard University Kennedy School of Government and received a master's degree in public administration in June of 1980.²⁶⁷ Subsequently, the taxpayer worked as a business consultant, advising companies with regard to developing business strategy.²⁶⁸ The court determined that the taxpayer's education qualified him for a new trade or business. 269 The taxpayer argued that his employment with the Army and his duties and activities in that employment were similar to those required of business executives and managers, and that he was already qualified to perform the duties required of him in his current position as a business consultant before he received the two degrees from Harvard.²⁷⁰ The court rejected that argument, however, stating that prior to acquiring his education at Harvard the taxpayer had never served in the business world, and the taxpayer's "work as an Army officer is a different trade or business from the consulting business for which his course of study at Harvard prepared him ",271

These cases, which do not involve education that is a step along the path to obtaining some kind of certification or license that, once obtained, authorizes the taxpayer to perform tasks that he would not be authorized to perform before obtaining the license or certification, are troublesome. The commonsense approach requires the trial court to determine, as a fact question, what tasks and activities the taxpayer was qualified to perform before he acquired the education, and which tasks and activities the

²⁶² 47 T.C.M. (CCH) 675 (1983).

²⁶³ *Id.* at 676.

²⁶⁴ *Id*.

²⁶⁵ *Id*.

²⁶⁶ Id.

²⁶⁷ *Id.* at 677.

²⁶⁸ Id.

²⁶⁹ *Id.* at 678.

²⁷⁰ *Id*.

²⁷¹ *Id.* at 679.

taxpayer is qualified to perform after he acquired the education.²⁷² If the taxpayer is qualified to perform tasks and activities after acquiring the education that are significantly different from tasks and activities that he was qualified to perform before acquiring the education, then the education qualifies the taxpayer for a new trade or business.²⁷³ There are no clear standards in the 1967 Regulations or the case law for trial courts to make this determination, and it is apparent from the case law discussed above that they are given wide latitude in doing so.²⁷⁴ It would seem that the IRS could argue in every case that any education leading to a degree potentially qualifies a taxpayer to perform tasks and activities that are significantly different from tasks and activities that he was qualified to perform before acquiring the education.

For example, assume a practicing lawyer decides to pursue a master's of law (LLM) degree specializing in taxation. Because the lawyer has received his law degree, passed the bar examination, and is practicing law, he is already qualified to be a lawyer in the state in which he is licensed and is free to specialize in any area of law that he chooses.²⁷⁵ The LLM degree is not a step along the path that would lead the lawyer to obtain any type of certification or license that he is not already qualified to obtain.²⁷⁶ Assume, however, that the lawyer has not performed any tasks or activities related to the practice of tax law. Could the IRS argue that the LLM potentially qualifies the lawyer to perform tasks and activities that are significantly different from tasks and activities that he was qualified to perform before acquiring the LLM? Can the lawyer ensure the deductibility of his expenses merely by representing clients in a few tax matters before pursuing the LLM? It would seem that lawyers pursuing an LLM and having some knowledge of the 1967 Regulations could do some pre-LLM planning and ensure the deduction of their expenses, but lawvers

²⁷² See supra notes 163–74 and accompanying text.

²⁷³ See supra notes 163–74 and accompanying text.

²⁷⁴ See supra notes 183–271 and accompanying text.

²⁷⁵ See Judith Kilpatrick, Specialist Certification for Lawyers: What Is Going On?, 51 U. MIAMI L. REV. 273, 276 (1997) ("Once admitted to practice law in a particular jurisdiction, a lawyer is considered able to perform any type of legal work. Officially, anyone who meets the requirements can become a lawyer, and all lawyers are deemed equally competent.").

²⁷⁶ See Ruehmann v. Comm'r, 30 T.C.M. (CCH) 675, 680 (1971). In *Ruehmann*, the court held that the LLM "was not necessary to meet the minimum educational requirements of a legal position or the legal profession and was not a program of study in law which qualified [the taxpayer] in a new trade or business." *Id.*

without such knowledge might be subject to IRS attack with respect to their expenses. So far, the IRS has not challenged the deduction of expenses to obtain an LLM on the basis of the new trade or business test, but it appears as if it could in a case with the right set of facts.²⁷⁷

This issue would seem to be present in any case where a taxpayer is pursuing a degree. Because of the lack of guidance in the 1967 Regulations and the case law, a taxpayer whose deductions for educational expenses are challenged by the IRS based on this issue will have no way to predict before trial how the court will rule, and it will be nearly impossible to appeal a trial court's decision successfully because the entire issue will be decided as a question of fact. ²⁷⁸

The 1967 Regulations do contain one sentence that seems to relate to the determination of whether a taxpayer's education qualifies him for a new trade or business, as follows: "In the case of an employee, a change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment." This is known as the "same general type of work test."

In *Beatty v. Commissioner*, 280 the taxpayer was employed by McDonnell Douglas Corporation (McDonnell) as an engineer, but his career goals were in the field of technical management, where he would be

²⁷⁷ See, e.g., Goldenberg v. Comm'r, 65 T.C.M. (CCH) 2338, 2340 (1993) (parties agreed that the taxpayer's LLM in taxation "did not qualify him for a new trade or business"); Cobb v. Comm'r, 35 T.C.M. (CCH) 1480, 1480-81 (1976) (IRS did not challenge the deduction of expenses for obtaining an LLM in taxation); Ruehmann, 30 T.C.M. (CCH) at 680 (IRS conceded to the deduction of the taxpayer's expenses in obtaining a general LLM, as long as the taxpayer was engaged in the practice of law prior to enrolling in the LLM program and thus met the maintains or improves skills test). But see Johnson v. United States, 332 F. Supp. 906 (E.D. La. 1971), in which the court held that the taxpayer's expenses in obtaining an LLM in taxation were nondeductible in part because the education was undertaken by the taxpayer to meet the minimum requirements for qualification in his intended specialty of tax law, rather than merely to maintain or improve skills required of him in his trade or business of practicing as an attorney. *Id.* at 908. Although the court claimed it was applying the 1967 Regulations, it was in fact applying the intended specialty language of the 1958 Regulations, which the 1967 Regulations abandoned. See supra notes 67-68 and accompanying text. That portion of the court's decision was therefore incorrect, although the court reached the correct result in that case for reasons that will be discussed below. See infra notes 314-19 and accompanying text; see also Ruehmann, 30 T.C.M (CCH) at 680.

²⁷⁸ See supra notes 84–85, 244–74 and accompanying text.

²⁷⁹ Treas Reg. § 1.162-5(b)(3)(i) (1968).

²⁸⁰ 40 T.C.M. (CCH) 438 (1980).

responsible for supervising the work of engineers.²⁸¹ While employed at McDonnell, the taxpayer's responsibilities gradually changed to include software integration work, which included some aspects of technical management.²⁸² To further his career goals, the taxpayer enrolled at the University of California at Irvine to pursue a master's degree in administration.²⁸³ The courses taken by the taxpayer were primarily focused on management, business, and business organization.²⁸⁴ The court determined that a significant portion of the taxpayer's duties at McDonnell before pursuing the master's degree "involved management, interpersonal and administrative skills." and:

[his] course of study provided him with a broad general background in management, business and business administration. As [the taxpayer] was already engaged in work activities which combined the essential components of administration and management, the education which he obtained corresponded with, at most, a change in his duties at McDonnell. Since [the IRS]'s own regulations acknowledge that an employee's change of duties does not constitute a new trade or business, [the taxpayer]'s studies... did not correlate with any entrance by [the taxpayer] into a new trade or business. Instead, those studies merely reflected a change in his duties at McDonnell.²⁸⁵

The court also noted that the master's degree obtained by the taxpayer did not qualify him for any professional certifications for any particular trade or business or profession, and thus his situation was distinguishable from the *Glenn* line of cases. The court thus held that the taxpayer's expenses did not qualify him for a new trade or business and were therefore deductible. ²⁸⁷

In *Granger v. Commissioner*, ²⁸⁸ the taxpayer was employed as a night manager by a grocery store, and he incurred expenses attending the

²⁸¹ *Id.* at 439.

²⁸² Id.

²⁸³ *Id*.

²⁸⁴ Id

²⁸⁵ *Id.* at 441 (citations omitted).

²⁸⁶ *Id.* at 441 n.6.

²⁸⁷ Id.

²⁸⁸ 39 T.C.M. (CCH) 1158 (1980).

Southern California Marketing Management Program to obtain a Certificate in Food Marketing Management (Certificate). Subsequent to obtaining the Certificate, the taxpayer was promoted several times, finally reaching the position of daytime store manager. The court determined that the taxpayer was at all times performing duties at the grocery store as manager, and the court held that his new duties did not constitute a new trade or business because they involved the same general type of work that he was performing in his earlier position when he pursued his education. The court thus held that the taxpayer's expenses in obtaining the Certificate were deductible.

In *Blair v. Commissioner*, ²⁹³ the taxpayer was employed as a personnel representative by Sherwin Williams Company and was enrolled at Baldwin-Wallace College to obtain a master's degree in business administration. ²⁹⁴ The taxpayer was subsequently promoted to personnel manager. ²⁹⁵ The court referred to the statement in the 1967 Regulations that "[i]n the case of an employee, a change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment," ²⁹⁶ and the court held that the taxpayer's educational expenses were deductible. ²⁹⁷ The court stated that "[t]here was a substantial overlap in [the taxpayer]'s job tasks" and that the differences between the jobs were not enough to constitute the two positions being separate trades or businesses. ²⁹⁸

The existence of the same general type of work test in the 1967 Regulations is puzzling. Examples given in the 1967 Regulations only involve teachers, and they are too abbreviated to be of any general

²⁸⁹ Id. at 1158.

²⁹⁰ *Id.* at 1159.

²⁹¹ *Id.* at 1160.

²⁹² See id. at 1159-60.

²⁹³ 41 T.C.M. (CCH) 289 (1980).

²⁹⁴ Id. at 289–90.

²⁹⁵ Id. at 290.

²⁹⁶ Id. at 291.

²⁹⁷ *Id.* at 292.

²⁹⁸ *Id.* at 291 (stating the only difference is that the "personnel manager makes decisions while a personnel representative only makes recommendations"); *see also* Gilliam v. Comm'r, 51 T.C.M. (CCH) 567, 571 (1986) (allowing deductions for the taxpayer's expenses for enrollment in college level courses because the taxpayer's promotion by his employer subsequent to obtaining the education involved the same general basic skills and requirements as his earlier position, but with greater responsibilities).

assistance in ascertaining the meaning of the test.²⁹⁹ There is no explanation or rational basis for the test to apply only to employees and not to self-employed individuals.³⁰⁰ There is no definition in the 1967 Regulations and no discussion in the case law as to the meaning of the phrase "same general type of work."³⁰¹ It has been suggested by one commentator that the same general type of work test is not useful at all in applying the new trade or business test.³⁰²

This author would go further and suggest that the same general type of work test does harm to the meaning of the new trade or business test, and it potentially changes the results under that test when courts try to determine the meaning of the same general type of work test and apply it. The cases discussed above support that position.³⁰³ There was no discussion in any of those cases whether the education acquired by the taxpayer qualified him to perform tasks and activities that he was not qualified to perform before acquiring the education. Thus, the courts that have attempted to apply the same general type of work test have apparently determined that when it is applicable it totally supplants the new trade or business test. Even though the 1967 Regulations could be read in such a manner as to arrive at that conclusion, some of the cases decided under the commonsense approach to the new trade or business test should have been decided differently if that were true. For example, the taxpayer in Warren should have been able to deduct the cost of his bachelor's degree because he was employed as a local pastor before obtaining the degree, and he continued to perform the same general type of work after he obtained it.³⁰⁴

The reason that the two rules will often lead to contrary results is that the approach taken under the same general type of work test is the polar opposite of the objective approach required by the 1967 Regulations under the new trade or business test. The courts in the cases discussed above that applied the same general type of work test inquired only into the type of work the taxpayer was performing before and after he acquired the education. If the type of work performed both before and after he acquired the education was generally the same, he was deemed to pass the

²⁹⁹ Treas. Reg. § 1.162-5(b)(3)(i)(a)–(d) (1968).

³⁰⁰ See Schoenfeld, supra note 3, at 282.

³⁰¹ *Id*.

³⁰² *Id.* at 285.

³⁰³ See supra notes 288–98.

³⁰⁴ See Warren v. Comm'r, 85 T.C.M. (CCH) 1494, 1496 (2003).

³⁰⁵ *Granger*, 39 T.C.M. (CCH) at 1160; *Blair*, 41 T.C.M. (CCH) at 291–92; *Gilliam*, 51 T.C.M. (CCH) at 571.

new trade or business test.³⁰⁶ But the new trade or business test requires an objective approach. The issue is whether the education undertaken by the taxpayer will *lead to qualifying* him for a new trade or business—whether the taxpayer ever actually intends to enter that new trade or business is irrelevant.³⁰⁷

In addition, the same general type of work test has no definitions or standards in the 1967 Regulations, leaving courts to decide when and how to apply it. That of course will result in inconsistencies with regard to the types of situations to which it will be applied and to the actual application of the test when courts decide to apply it. The same general type of work test also seems to work against the interests of the IRS. In the cases discussed above where it was applied, the taxpayer was allowed to deduct his educational expenses.³⁰⁸ The IRS would do well to eliminate it from the 1967 Regulations. Having said that, however, it would probably be better from a policy perspective to keep the same general type of work test, more clearly define its terms so that it can be accurately and consistently applied, and expand it to self-employed individuals, and eliminate the new trade or business test. That would be more consistent with section 162 of the Code, which allows deductions for ordinary and necessary expenses paid or incurred by a taxpayer in carrying on a trade or business. 309 For all expenses other than educational expenses, the taxpayer simply has to prove that the expense is sufficiently related to the carrying on of a trade or business, and that the expense is not a capital expenditure. The new trade or business test imposes limitations on the deductibility of educational expenses under section 162 that are not imposed on expenses incurred in other trades or businesses. 311

B. Affirmative Tests

1. Maintains or Improves Skills

The maintains or improves skills test allows a deduction for educational expenses if the education "[m]aintains or improves skills

³⁰⁶ *Granger*, 39 T.C.M. (CCH) at 1160; *Blair*, 41 T.C.M. (CCH) at 291–92; *Gilliam*, 51 T.C.M. (CCH) at 571.

³⁰⁷ See supra notes 160–61 and accompanying text.

³⁰⁸ See Granger, 39 T.C.M. (CCH) at 1159–60; Blair, 41 T.C.M. (CCH) at 291–92; Gilliam, 51 T.C.M. (CCH) at 571.

³⁰⁹ I.R.C. § 162(a) (2000).

³¹⁰ *Id*.

³¹¹ See Schoenfeld, supra note 3, at 325; Katz, supra note 3, at 9–10.

required by the individual in his employment or other trade or business."³¹² By its plain language, this test requires that the taxpayer be engaged in a trade or business at the time he is acquiring the education, and that the education be sufficiently related to the trade or business for the expenses of the education to be deductible under the basic provisions of section 162 of the Code.³¹³

In *Johnson v. United States*,³¹⁴ the taxpayer was seeking to deduct expenses incurred in obtaining a master of laws degree in taxation.³¹⁵ The taxpayer stipulated that he had enrolled in the master's degree program immediately following his admission to the bar, and he devoted all his time to obtaining the degree.³¹⁶ The court stated that, for the taxpayer to meet the maintains or improves skills test, it was necessary that he be "engaged in carrying on a trade or business" at the time he was undertaking the education.³¹⁷ Because the taxpayer had never practiced law before pursuing the education, and thus had never entered the trade or business of practicing law until after completing the degree,³¹⁸ the court held that his expenses were nondeductible.³¹⁹

In *Randick v. Commissioner*,³²⁰ the taxpayer received a Juris Doctor degree in June of 1970, enrolled in a graduate law program in taxation in September of 1970, and was admitted to the Illinois bar in November of 1970.³²¹ He was unemployed during the summer of 1970.³²² The taxpayer was seeking to deduct his educational expenses incurred from January of

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<sup>312</sup> Treas. Reg. § 1.162-5(a)(1) (1968).
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³¹³ See supra notes 19–29 and accompanying text.

³¹⁴ 332 F. Supp. 906 (E.D. La. 1971).

³¹⁵ *Id.* at 907.

³¹⁶ *Id.* at 908.

³¹⁷ *Id*.

³¹⁸ *Id*.

³¹⁹ *Id.* at 909. The court also erroneously held that the taxpayer's educational expenses were nondeductible because the education was undertaken by the taxpayer to meet the minimum requirements for qualification in his intended specialty of tax law, rather than merely to maintain or improve skills required of him in his trade or business of practicing as an attorney. *Id.* at 908. Although the court claimed it was applying the 1967 Regulations, it was in fact applying the intended specialty language of the 1958 Regulations, which the 1967 Regulations abandoned. *See id.* at 907–08.

³²⁰ 35 T.C.M. (CCH) 195 (1976).

³²¹ *Id.* at 195.

³²² *Id*.

During that period, the taxpayer performed some part-time work as a tax return preparer, received a small amount of compensation for legal research that he performed, and represented his parents for compensation in a property transaction.³²⁴ The court held that the taxpayer was not engaged in the trade or business of practicing law at any time prior to obtaining the LLM degree.³²⁵ He was not admitted to the Illinois bar until November of 1970, and his only activities relating to the practice of law between November of 1970 and June of 1971 were too insignificant to constitute a trade or business; rather, they were "properly viewed as merely incidental to [the taxpayer]'s major goal of fulfilling his general educational objectives."³²⁶ Thus, the court held that the taxpayer's educational expenses were not deductible because they were not incurred by the taxpayer in carrying on any trade or business.³²⁷

In *Weyts v. Commissioner*, ³²⁸ the taxpayer had earned a law degree in Belgium, and in May of 1998, he obtained an LLM degree in Corporate Finance from Columbia University. ³²⁹ The taxpayer was advised to obtain a JD degree to enable him to better pursue employment opportunities in New York, so he enrolled in Columbia's joint JD/MBA program in August of 1998. ³³⁰ The taxpayer passed the New York State bar examination and was admitted to the New York State Bar in July of 1999. ³³¹ The taxpayer worked as a summer associate for two different law firms in the summers of 1999 and 2000. ³³² The taxpayer was seeking to deduct his educational expenses incurred in the JD/MBA program in the year 2000. ³³³ The court determined that, even though the taxpayer was a member of the New York State Bar while employed as a summer associate in the summers of 1999

³²³ *Id*.

³²⁴ *Id.* at 195–96.

³²⁵ *Id.* at 198.

³²⁶ Id.

³²⁷ *Id.* at 197–98; *see also* Wassenaar v. Comm'r, 72 T.C. 1195, 1203 (1979) (disallowing deductions for the taxpayer's expenses in obtaining a master's degree in taxation because the taxpayer had not practiced law before pursuing the education and thus had never entered the trade or business of practicing law until after completing the degree).

^{328 85} T.C.M. (CCH) 999 (2003).

³²⁹ Id. at 1000.

³³⁰ Id.

³³¹ *Id*.

³³² *Id*.

³³³ *Id*.

and 2000, "the arrangement of being a summer associate is more indicative of an educational pursuit, rather than being engaged in a trade or business of practicing law," and the taxpayer was thus not engaged in the trade or business of being an attorney when he undertook the education and incurred the expenses. The expenses of his education were thus not deductible. The expenses of his education were thus not deductible.

In Ruehmann v. Commissioner, 336 the taxpayer successfully proved that he was engaged in the trade or business of practicing law before enrolling in an advanced program in law. 337 The taxpayer received his law degree in June of 1967.³³⁸ Georgia law allowed him to sit for the Georgia bar examination after two years of law school; he passed and was admitted as a member of the State Bar of Georgia in December of 1966. 339 During the summer of 1967, the taxpayer was employed at a law firm as a lawyer. 340 He was paid and otherwise treated the same as other beginning lawyers who were members of the Bar; those employed as law clerks were paid and treated differently.³⁴¹ The taxpayer was employed by the law firm for three months, from June of 1967 until September of 1967, at which time the taxpayer left the firm to enroll in the LLM degree program in taxation at Harvard University.³⁴² The taxpayer was seeking to deduct his expenses in obtaining the LLM degree from Harvard.³⁴³ The court held that the taxpayer was engaged in the trade or business of practicing law during the summer of 1967 before enrolling at Harvard, and his educational expenses were thus deductible.³⁴⁴

³³⁴ *Id.* at 1001. The court did not even mention the maintains or improves skills test, but rather rested its decision on the taxpayer's failure to meet the carrying on requirement of section 162 of the Code, effectively holding that the taxpayer was not carrying on the trade or business of being an attorney at the time the expenses were incurred. *See id.* at 1000–01. As discussed above, the primary purpose of the maintains or improves skills test is to determine whether the carrying on requirement has been satisfied. *See supra* notes 97–99 and accompanying text.

³³⁵ Weyts, 85 T.C.M. (CCH) at 1001.

³³⁶ 30 T.C.M. (CCH) 675 (1971).

³³⁷ Id. at 680.

³³⁸ *Id.* at 679.

³³⁹ *Id.* at 676.

³⁴⁰ *Id.* at 677.

³⁴¹ *Id*.

³⁴² *Id*.

³⁴³ *Id.* at 678.

³⁴⁴ *Id.* at 680.

Link v. Commissioner³⁴⁵ was quite similar factually to Ruehmann, but the results were different. In Link, the taxpayer received a bachelor's degree in operations research in May of 1981. From June of 1981 until September of 1981, the taxpayer was employed by Xerox Corporation to develop market research analytic procedures. 347 In September of 1981, the taxpayer enrolled at the University of Chicago to pursue an MBA degree.³⁴⁸ The taxpayer was seeking to deduct his expenses of obtaining the MBA degree. 349 The court stated that "[i]mplicit in both section 162 and the regulations is that the taxpayer must be established in a trade or business before any expenses are deductible,"350 and the court determined that the taxpayer "was not established in a trade or business prior to enrolling in the MBA program, [because his]... employment at Xerox was merely a temporary hiatus in a continuing series of academic endeavors."351 The court thus held that the taxpayer's educational expenses were not deductible.³⁵² The taxpayer encouraged the court to reach the same result as in Ruehmann, but the court stressed that whether a taxpaver is engaged in a trade or business is a question of fact, and each case must be analyzed independently of any other. 353 The court stated that only three months of employment is a relatively short period to find that a taxpayer has established himself in a trade or business. 354 The court declined to set any minimum period of time for such purpose, but stated that a short period is at least relevant evidence. Such evidence, together with the other facts in the case, required a different result from that in Ruehmann.

One court was rather extreme in holding against the taxpayer on the basis of the maintains or improves skills test. In *Reisine v*. *Commissioner*, 356 the taxpayer received a degree of Bachelor of Electrical

^{345 90} T.C. 460 (1988).

³⁴⁶ *Id.* at 461.

³⁴⁷ *Id*.

³⁴⁸ *Id.* at 462.

³⁴⁹ *Id*.

³⁵⁰ Id. at 463.

³⁵¹ *Id.* at 464.

³⁵² *Id*.

³⁵³ *Id.* at 463–64.

³⁵⁴ Id. at 464-65.

³⁵⁵ *Id.* at 464.

^{356 29} T.C.M. (CCH) 1429 (1970).

Engineering in June of 1966.³⁵⁷ From July of 1966 until June of 1967, the taxpayer was employed as an engineer by the Bendix Corporation.³⁵⁸ In June of 1967, the taxpayer resigned from Bendix and enrolled in the New York University Graduate School of Engineering to pursue a master's degree.³⁵⁹ The taxpayer was seeking to deduct the expenses of obtaining the master's degree.³⁶⁰ The court held that the taxpayer, by June of 1967, was not sufficiently established in his profession so as to be in a trade or business under section 162 of the Code, and his expenses were thus not deductible.³⁶¹ It seems preposterous that a taxpayer who has been employed as an engineer for one year is not sufficiently established in his profession to be carrying on the trade or business of being an engineer. In that regard, the result in this case must be wrong. But the court also stated that the taxpayer's projected educational program "was for an indefinite rather than a limited period of time," and noted:

Even if we were to conclude that [the taxpayer]'s brief employment at Bendix was sufficient to constitute a trade or business for purposes of this case, we think that his expenses would at best be considered as having been made, not currently to carry on a trade or business, but in order to *resume* a trade or business at some future date.³⁶²

The court apparently thought that the taxpayer's educational pursuits beginning in June of 1967 were of such an uncertain duration that he terminated any trade or business in which he might have been engaged at that time, and thus he was not carrying on any trade or business while obtaining the education.³⁶³ The fact that the taxpayer had not yet returned to work by the time this case was decided, but was undertaking a Ph.D. at Purdue University,³⁶⁴ probably encouraged that conclusion by the court. There is substantial case law holding that a taxpayer taking a temporary leave from his trade or business to pursue education related to it is carrying on his trade or business while doing so, as long as the taxpayer can prove

³⁵⁷ *Id.* at 1429.

³⁵⁸ *Id*.

³⁵⁹ *Id*.

³⁶⁰ See id. at 1429-30.

³⁶¹ *Id.* at 1430. As in *Weyts*, the court did not mention the maintains or improves skills test. *See id.* at 1429–30; *supra* note 334.

³⁶² Reisine, 29 T.C.M. (CCH) at 1430.

³⁶³ *Id*.

³⁶⁴ Id. at 1429.

intent to continue the carrying on of the trade or business upon the completion of the temporary leave. The court in *Reisine* may well have decided that the taxpayer's intent to resume his trade or business as an engineer was too tenuous due to the uncertain duration of the taxpayer's educational pursuits. This issue is discussed below. 366

A taxpayer engaged in a trade or business must also be careful not to discontinue the trade or business prior to undertaking education related to it for a sufficiently long period such that he will be held to have abandoned the trade or business and thus not to have been engaged in it while pursuing the education. In Reisinger v. Commissioner, 367 the taxpayer had been employed as a licensed practical nurse (LPN) until 1969. After 1969, the taxpayer unsuccessfully sought employment as an LPN.³⁶⁹ Between 1974 and 1976, the taxpayer enrolled in the Johns Hopkins University School of Health Services Health Associates Course and received a bachelor's degree.³⁷⁰ The court held that the taxpayer's "period of unemployment [before commencing the education] was for personal reasons and constituted an abandonment of her previous trade or business."371 Thus, because the taxpayer's education was undertaken during a period when she was not engaged in any trade or business, her educational expenses were not deductible.³⁷²

In many cases, taxpayers have been held not to have met the maintains or improves skills test, even though they were clearly established in a trade or business before beginning to acquire education, because the education was not sufficiently related to the particular trade or business in which they were engaged. In *McIlvoy v. Commissioner*, ³⁷³ the taxpayer had worked for several companies as a geophysical engineer, and then he became

³⁶⁵ See infra notes 386–467 and accompanying text.

³⁶⁶ See infra notes 386–467 and accompanying text.

³⁶⁷ 71 T.C. 568 (1979).

³⁶⁸ *Id.* at 569.

³⁶⁹ *Id*.

³⁷⁰ *Id*.

³⁷¹ *Id.* at 573.

³⁷² *Id.* at 574. Even though the court mentioned the maintains or improves skills test, the court did not discuss it. *Id.* at 571, 574. The court also discussed whether the taxpayer's unemployment after 1969 was a temporary leave of absence from her trade or business to pursue related education. *Id.* at 573–74. The court decided that was not the case under these facts. *Id.* at 574. See *infra* notes 386–467 and accompanying text for a discussion of this issue.

³⁷³ 38 T.C.M. (CCH) 987 (1979).

employed as a senior electronics technician at an electronics firm.³⁷⁴ The taxpayer's job responsibilities were technical, while decisionmaking and supervision of other employees were only a minor part of his duties.³⁷⁵ The taxpayer's employment at the electronics firm was terminated, and he subsequently enrolled in the MBA program at the University of Santa Clara.³⁷⁶ The taxpayer was seeking to deduct the cost of the MBA program.³⁷⁷ The court held that the taxpayer did not satisfy the maintains or improves skills test because the MBA program was not sufficiently related to his employment at the electronics firm.³⁷⁸ The court determined that the taxpayer's employment was technical rather than managerial, stating:

We see no relationship between [the taxpayer]'s technical duties and his courses in accounting, marketing, financial and organizational management, and economic analysis. Put simply, [the taxpayer]'s M.B.A. course taught him new skills; the courses had no relationship to the skills which, as an engineer, he possessed and used in his employment.³⁷⁹

In *Mason v. Commissioner*,³⁸⁰ the court used a similar analysis. In *Mason*, the taxpayer was employed as a pilot of a C-130 aircraft with the Air National Guard while attending a flight training course that allowed him to obtain a flight engineer's certificate for turbojet aircraft.³⁸¹ The court observed that the taxpayer's expert witness "did not elucidate how flight engineer training would improve [the taxpayer]'s skills as a pilot."³⁸² The court stated that "the duties of a flight engineer are quite different from those of a pilot," and it held that the taxpayer "failed to prove either that [his] flight engineer training was helpful to him in his work as a pilot or that there was a direct and proximate relationship between such training and such work."³⁸³

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<sup>374</sup> Id. at 987.
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³⁷⁵ Id. at 988.

³⁷⁶ *Id*.

³⁷⁷ *Id*.

³⁷⁸ *Id.* at 989.

³⁷⁹ Id

^{380 44} T.C.M. (CCH) 365 (1982).

³⁸¹ *Id.* at 366.

³⁸² *Id.* at 368.

³⁸³ *Id*.

The issue as to whether education is sufficiently related to a particular trade or business is a question of fact. There are many other examples where courts have denied taxpayers deductions for educational expenses using this analysis. 385

As mentioned above, there is substantial case law holding that a taxpayer taking a temporary leave from his trade or business to pursue education related to it is carrying on his trade or business while doing so, as long as the taxpayer can prove an intent to continue the carrying on of such trade or business upon the completion of the temporary leave. Furner v. Commissioner³⁸⁶ is an early case under the 1967 Regulations dealing with this issue. In Furner, the taxpayer was employed as a junior high school teacher in Minnesota, teaching eighth grade social studies.³⁸⁷ The taxpayer desired to pursue graduate study in her subject and enrolled at Northwestern University as a full-time graduate student in the fall of 1960.³⁸⁸ Because her employer did not customarily grant leaves of absence to pursue graduate study, she resigned her position in June of 1960 before commencing her degree program. She received a Master of Arts degree in August of 1961.³⁹⁰ In September of 1961, she began employment at a junior high school in Illinois, teaching two history courses.³⁹¹ She was seeking to deduct the cost of her master's degree. The Tax Court held that the expenses were nondeductible, in part because the taxpayer was not carrying on the trade or business of teaching at the time she was pursuing her education.³⁹³ The court reviewed the trial record and determined, "[I]t is not unusual, and is becoming more usual, for teachers to enroll in full time graduate study for an academic year in order to keep up with expanding knowledge and improve their understanding of the subjects they teach."³⁹⁴ The court decided that it was irrelevant whether the taxpayer was granted a leave of absence from her job to pursue graduate study. 395

³⁸⁴ See Schoenfeld, supra note 3, at 290.

³⁸⁵ *Id.* at 290–91.

^{386 393} F.2d 292 (7th Cir. 1968).

³⁸⁷ *Id.* at 293.

³⁸⁸ *Id*.

³⁸⁹ Id.

³⁹⁰ *Id*.

³⁹¹ *Id*.

³⁹² *Id*.

³⁹³ *Id*.

³⁹⁴ Id. at 294.

³⁹⁵ *Id.* at 295.

Further, the court determined that the record "would not support a finding that [the taxpayer] did not reasonably expect to return to teaching activity after her year of study." As a result, the court reversed the decision of the Tax Court and held that the taxpayer's expenses were deductible. 397

The rules applicable to this issue were further developed in *Sherman v. Commissioner*. In *Sherman*, the taxpayer was employed with the Army and Air Force Exchange Service (AAFES). His position involved formulating and monitoring management, preparing contingency and emergency plans, and reviewing and evaluating policies and procedures dealing with inventory control, procurement, distribution, and personnel management. In May of 1971, the taxpayer requested a leave of absence for two years to pursue an MBA degree from Harvard University. That request was denied. Subsequently, the taxpayer resigned his position, enrolled in the MBA program, and received the MBA in June of 1973. In August of 1973, the taxpayer became employed by Radix Corporation as Director of Planning and Research. The taxpayer was seeking to deduct the cost of his MBA.

where a taxpayer, in order to undertake education or training to maintain or improve skills required in his employment or other trade or business, temporarily ceases to engage actively in employment or other trade or business. Ordinarily, a suspension for a period of a year or less, after which the taxpayer resumes the same employment or trade or business, will be considered temporary.

Rev. Rul. 68-591, 1968-2 C.B. 73, 73. The IRS further stated that it did not agree with *Furner* to the extent that it could be construed to mean that a taxpayer could meet the carrying on requirement of section 162 of the Code with respect to educational expenses "merely because (1) the study might be a 'normal incident' of carrying on a trade or business and (2) the taxpayer subjectively intends to resume that trade or business at some indefinite future date." *Id.*

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<sup>398</sup> 36 T.C.M. (CCH) 1191 (1977).
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³⁹⁶ In

³⁹⁷ *Id.* Subsequent to the *Furner* decision, the IRS issued Revenue Ruling 68-591, in which it stated that it would follow *Furner* in cases

³⁹⁹ *Id.* at 1192.

⁴⁰⁰ Id.

⁴⁰¹ *Id*.

⁴⁰² Id.

⁴⁰³ *Id*.

⁴⁰⁴ *Id*.

⁴⁰⁵ *Id*.

the case was whether the taxpayer was carrying on a trade or business at the time he incurred his educational expenses. The court first determined that the taxpayer had been employed by AAFES for two years before enrolling at Harvard, and that such a period of time was sufficient for the taxpayer to be carrying on the trade or business "of being an employee who was an administrator and planner (i.e., business manager)." The court then turned to the issue raised by the fact that the taxpayer was not employed while he was pursuing the MBA. The court, citing *Furner*, stated the rules as follows:

[A] taxpayer who leaves his position temporarily to attend school full time may be "carrying on" a trade or business while in school. . . . [A] leave of absence is not essential to carry on a trade or business while attending school, nor is it essential to return to the same position after completing the course of study undertaken.

However, when a taxpayer leaves his trade or business for a prolonged period of study with no apparent continuing connection with either his former job or any clear indication of an intention to actively carry on the same trade or business upon completion of study, the taxpayer is not "carrying on" his trade or business while attending school.⁴⁰⁹

The court applied these rules to the facts and held that the taxpayer was continuing to carry on his trade or business of being a business manager while attending Harvard. Central to the court's analysis was that the taxpayer "was engaged in business administration before he went to Harvard, and stayed in the field after his graduation." The IRS argued, as it stated in Revenue Ruling 68-591, that a taxpayer's suspension from his trade or business for longer than one year to attend school should not be considered temporary, and thus he should not be treated in that event as

⁴⁰⁶ Id.

⁴⁰⁷ *Id.* at 1193.

⁴⁰⁸ *Id*.

⁴⁰⁹ Id.

⁴¹⁰ *Id*.

⁴¹¹ *Id*.

⁴¹² Rev. Rul. 68-591, 1968-2 C.B. 73.

carrying on his trade or business while in school. But the court rejected a hard and fast one-year rule in favor of a more flexible facts and circumstances approach. The court thus held that the taxpayer's expenses were deductible.

Other examples of cases in which the taxpayer was successful in showing that he was carrying on his trade or business while in school, although he had resigned his position and was unemployed at that time, include *Picknally v. Commissioner*⁴¹⁶ and *Hitt v. Commissioner*.⁴¹⁷ In *Picknally*, the taxpayer resigned his position as an elementary school principal effective in July of 1968 and ultimately enrolled in a Ph.D. program at Boston College.⁴¹⁸ He completed the course requirements for the degree in September of 1971, at which time he accepted a position for one month as a temporary lecturer at the University of Maine.⁴¹⁹ Subsequently, he attempted to locate a full-time teaching position but was unable to find one, and he was still unemployed at the time of trial.⁴²⁰ The court reviewed the trial record and held that the taxpayer was carrying on his "trade or business of teacher or educational administrator" while attending school.⁴²¹ Important facts that persuaded the court to hold in favor of the taxpayer included the following:

Prior to pursuing a Ph.D. in educational administration, [the taxpayer] worked in the field of education for about ten years. He resigned in 1968 to continue his education and expand his skills fully intending and expecting to resume work in education as either an instructor or administrator. . . . He actively sought a position in his line of work. . . . [H]e worked at the University of Maine as an instructor for one month. 422

⁴¹³ Sherman, 36 T.C.M. (CCH) at 1194.

⁴¹⁴ *Id*.

⁴¹⁵ See id. at 1193–94.

⁴¹⁶ 36 T.C.M. (CCH) 1292 (1977).

⁴¹⁷ 37 T.C.M. (CCH) 333 (1978).

⁴¹⁸ Picknally, 36 T.C.M. (CCH) at 1293.

⁴¹⁹ *Id*.

⁴²⁰ Id.

⁴²¹ Id. at 1294.

⁴²² *Id*.

In *Hitt*, the taxpayer had been employed in the field of nursing and nursing education for approximately twenty years. In 1971, she resigned her position as a consultant for a nursing education organization to enroll in a doctoral program in nursing education at Columbia University. She completed the requirements of the doctoral program in late 1974. Although she had no intention to return to her previous position when she resigned to pursue the doctoral program, she did return in 1974 after completing the program. The court reviewed the trial record and held that the taxpayer was carrying on her trade or business as a nursing educator while attending school. The court found that the three-year period which she took in order to complete her doctoral degree was an appropriate period in which to accomplish her educational objective.

Corbett v. Commissioner⁴²⁹ is an example of a case in which the taxpayer resigned her position to pursue education and was not successful in showing that she was carrying on her trade or business while in school. In Corbett, the taxpayer had been employed by various educational institutions teaching Germanic languages.⁴³⁰ Her last position terminated in June of 1966.⁴³¹ In September of 1966, the taxpayer enrolled at New York University to pursue a Ph.D. degree in Germanic languages.⁴³² She completed the course work requirements for her degree in June of 1968.⁴³³ Subsequently, the taxpayer attempted to locate a full-time teaching position in her field but was unable to find one, and she was still unemployed at the time of trial.⁴³⁴ She was seeking to deduct the cost of the Ph.D. program.⁴³⁵ The court reviewed the trial record and held that the taxpayer was not carrying on the business of teaching while attending school.⁴³⁶ Important

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424 Id. at 333–34.
425 Id. at 334.
426 Id.
427 Id.
428 Id.
429 55 T.C. 884 (1971).
430 Id. at 885.
431 Id.
432 Id.
433 Id.
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434 *Id.* at 886.
435 *Id.*436 *Id.* at 890.

423 Hitt v. Comm'r, 37 T.C.M. (CCH) 333, 333 (1978).

facts that persuaded the court to hold against the taxpayer included the following:

Two relatively recent cases focused on the requirement in the rules quoted above from *Sherman* that the taxpayer, when he leaves his trade or business for a period of study, must show a clear indication of an intention to carry on the *same* trade or business upon completion of the study. These two cases will result in even more difficulty for taxpayers attempting to deduct their educational expenses.

In *Goldenberg v. Commissioner*, 438 the taxpayer had been employed by the IRS as a revenue agent and by two different accounting firms for several years and passed the CPA examination. 439 By 1986, the taxpayer was employed by the IRS as an appeals officer and had graduated from law school. 440 The taxpayer was admitted to the California Bar in July of 1988. 441 In August of 1988, the taxpayer resigned his position with the IRS and enrolled in the graduate tax program at the University of

⁴³⁷ *Id.* at 889; *see also* Schneider v. Comm'r, 47 T.C.M. (CCH) 675 (1983). In that case, the taxpayer served on active duty in the United States Army as an officer, and resigned his position to pursue MBA and MPA degrees from Harvard University. *Id.* at 676–77. Three years later, when he had received both degrees, he worked as a business consultant, advising companies with regard to developing business strategy. *Id.* at 677. The court held that the taxpayer's period of study was not a temporary leave of absence from his trade or business of being employed by the Army, and thus he was not carrying on that trade or business while attending school at Harvard. *Id.* at 678.

⁴³⁸ 65 T.C.M. (CCH) 2338 (1993).

⁴³⁹ Id. at 2338-39.

⁴⁴⁰ Id. at 2339.

⁴⁴¹ *Id*.

Florida. 442 The taxpaver received a Master of Laws degree in taxation in May of 1989 and immediately was employed by a New Mexico law firm as an associate. 443 In 1991, the taxpayer left the law firm and became employed again with the IRS as a revenue agent. 444 The taxpayer was seeking to deduct the cost of his Master of Laws degree. 445 The court stated that it must determine, as a threshold question, whether the taxpayer was carrying on a trade or business when he was in school. 446 In analyzing this question, the court focused first on determining in which trades or businesses the taxpayer was engaged before enrolling at the University of Florida. 447 The taxpayer argued that he was engaged in the practice of law prior to 1988, but the court rejected that argument, stating that employment as a revenue agent and as a CPA is not the practice of law. 448 As for the taxpayer's employment as an IRS appeals officer, the court pointed out that he held that position before graduating from law school, and it was not a condition of his employment to have a law degree or be qualified in any jurisdiction to practice law. 449 After he received his law degree, his duties as an appeals officer did not change in any way. 450 Thus, the court held that the taxpayer's employment by the IRS as an appeals officer did not constitute the practice of law. 451

The taxpayer was clearly practicing accounting before enrolling in the Master of Laws program, and he argued that he was carrying on the trade or business of accounting while he was in school. The court also rejected that argument, applying the rule from *Sherman* that, when a taxpayer leaves his trade or business for a period of study, to prove that he is carrying on that business during that period, he must show a clear indication of an intention to carry on the *same* trade or business upon completion of the study. The taxpayer's problem was that he practiced law for two years after receiving his degree, which is not the same trade or

⁴⁴² Id.

⁴⁴³ *Id*.

⁴⁴⁴ Id.

⁴⁴⁵ *Id*.

⁴⁴⁶ Id.

⁴⁴⁷ *Id.* at 2339–40.

⁴⁴⁸ *Id.* at 2340.

⁴⁴⁹ *Id*.

⁴⁵⁰ *Id*.

⁴⁵¹ *Id*.

⁴⁵² *Id*.

⁴⁵³ *Id.* at 2340–41.

business as accounting.⁴⁵⁴ Thus, the court held that the taxpayer's educational expenses were not deductible because he was not carrying on the trade or business of accounting while he was in school.⁴⁵⁵ The taxpayer also argued that he should be treated the same as the taxpayers in *Sherman* and *Picknally*, but the court distinguished those two cases on their facts, stating that the taxpayer in *Sherman* carried on the same trade or business both before and after obtaining the education, and that the only positions held by the taxpayer in *Picknally* were in the same profession.⁴⁵⁶

In *Hudgens v. Commissioner*, 457 the taxpayer was employed by Arthur Andersen & Company as a tax accountant. 458 He resigned his position with Arthur Andersen in March of 1990, worked for a temporary accounting firm for four weeks, and then went on active duty with the National Guard. 459 In August of 1990, the taxpayer enrolled at Emory University to obtain an LLM degree in taxation. 460 After graduating from Emory, he became employed by the Southeastern Trust Company (STC) as a trust officer. 461 The taxpayer's duties at STC included account administration and new business development, preparation of fiduciary tax returns, and the rendition of some tax advice. 462 The taxpayer was seeking to deduct the cost of his LLM. 463 The court cited Sherman for the rule that, when a taxpayer leaves his trade or business for a period of study, to prove that he is carrying on that business during that period, he must show a clear indication of an intention to carry on the same trade or business upon completion of the study. 464 The court borrowed from the jurisprudence dealing with the new trade or business test and the minimum educational requirements test, stating, "If substantial differences exist in the tasks and activities of the employments undertaken before and after the period of education, then each employment constitutes a separate trade or business."465 The court concluded, "[T]he duties [the taxpayer] performed

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<sup>454</sup> Id. at 2341.
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⁴⁵⁵ *Id*.

⁴⁵⁶ *Id*.

⁴⁵⁷ 73 T.C.M. (CCH) 1790 (1997).

⁴⁵⁸ *Id.* at 1790.

⁴⁵⁹ Id. at 1790-91.

⁴⁶⁰ *Id.* at 1791.

⁴⁶¹ *Id*.

⁴⁶² *Id*.

⁴⁶³ *Id*.

⁴⁶⁴ *Id*.

⁴⁶⁵ *Id.* at 1791–92.

at Arthur Andersen differed substantially from the duties [the taxpayer] performed at STC.... [Thus, the taxpayer's] employment at STC did not constitute the same trade or business as his employment at Arthur Andersen...." The court therefore held that the taxpayer's educational expenses were not deductible. 467

2. Requirements of Employer or Applicable Law

The requirements of the employer or applicable law test allows a deduction if the education "[m]eets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation."

This test is self-explanatory, has caused no problems in the reported cases, and warrants no further discussion.

C. Recent Cases Misapplying the 1967 Regulations

The United States Tax Court has, in two recent cases, misapplied the tests set forth in the 1967 Regulations, resulting in an improper decision in one of those cases. In *Allemeier v. Commissioner*, 469 as discussed above, the court apparently misunderstood the minimum educational requirements test and misapplied it, although the misapplication did not prevent the court from reaching the correct result. The court also misapplied the commonsense approach to the new trade or business test. In *Allemeier*, the taxpayer was employed by a company to sell a particular type of product that it manufactured. Eventually, the taxpayer's duties expanded to include designing marketing strategies to sell company products, organizing seminars, and other similar responsibilities. In 1999, the taxpayer enrolled at Pepperdine University to pursue an MBA with a concentration in business management. He completed the degree in 2001. Between 1999 and 2001, while he was pursuing the MBA degree,

⁴⁶⁶ Id. at 1792.

⁴⁶⁷ *Id*.

⁴⁶⁸ Treas. Reg. § 1.162-5(a)(2) (1968).

⁴⁶⁹ 90 T.C.M. (CCH) 197 (2005).

⁴⁷⁰ See supra notes 144–56 and accompanying text.

⁴⁷¹ Allemeier, 90 T.C.M. (CCH) at 198.

⁴⁷² *Id*.

⁴⁷³ *Id*.

⁴⁷⁴ *Id*.

the taxpayer was promoted several times within the company. These promotions expanded the taxpayer's duties to include financial analysis, planning for sales and marketing campaigns, and general management responsibilities. The taxpayer was seeking to deduct the cost of his MBA degree. The court purported to be applying the commonsense approach to the new trade or business test as established by the *Glenn* line of cases. As provided in *Glenn*, the commonsense approach requires that a comparison be made between the types of tasks and activities which the taxpayer was qualified to perform before the acquisition of a particular title or degree, and those which he is qualified to perform afterwards. If the tasks and activities are significantly different before and after the education, then the educational expenses are not deductible because the education qualifies the taxpayer for a new trade or business.

The court in *Allemeier*, applying the commonsense approach, compared the taxpayer's actual activities before enrolling in the MBA program with his actual activities after receiving the degree, and determined that they were not significantly different. The court thus determined that the taxpayer's educational expenses were deductible. However, as the above quote from *Glenn* makes clear, the required comparison of tasks and activities is between those the taxpayer is *qualified* to perform both before and after acquiring the education, not those the taxpayer is *actually* performing. This is a very important distinction. A taxpayer could actually be performing different activities after acquiring the education than he was performing before and still be able to pass the new trade or business test, because he was already *qualified* to perform those new activities before he acquired the education. Thus, the court achieved the right result, but for the wrong reason.

⁴⁷⁵ *Id*.

⁴⁷⁶ *Id*.

⁴⁷⁷ *Id*.

⁴⁷⁸ *Id.* at 199–200; see supra notes 163–241 and accompanying text.

⁴⁷⁹ Glenn v. Comm'r, 62 T.C. 270, 275 (1974).

⁴⁸⁰ Id.

⁴⁸¹ Allemeier, 90 T.C.M. (CCH) at 200.

⁴⁸² *Id.* at 201.

⁴⁸³ See Katz, supra note 3, at 60–61.

Zhang v. Commissioner⁴⁸⁴ is another case where the court misapplied the 1967 Regulations, but this time it also reached the wrong result.⁴⁸⁵ In Zhang, the taxpayer was employed by Andersen Consulting in its Beijing office as a consultant in the strategic services group.⁴⁸⁶ His duties included assisting foreign companies in developing joint venture strategies and financial structures for operations in China, advising foreign companies on Chinese tax policies, and assisting companies in developing sales marketing strategies.⁴⁸⁷ In 1999, the taxpayer enrolled as a full-time student in the MBA program at Massachusetts Institute of Technology.⁴⁸⁸ After receiving his degree in 2000, the taxpayer became employed as an associate in the investment banking division of Morgan Stanley.⁴⁸⁹ The taxpayer was seeking to deduct the cost of the MBA program.⁴⁹⁰ The court determined that the taxpayer did not meet the maintains or improves skills test because:

[The] M.B.A. program in this case served to improve [the taxpayer]'s "general understanding and competency", rather than to improve specific skills required in [the taxpayer]'s employment... While the M.B.A. program did focus on "business administration", it was nonetheless a generalized field of study which provided an education in a number of areas not necessarily applicable to [the taxpayer]'s employment prior to or after the year in issue.⁴⁹¹

The court also determined that, when the taxpayer resigned his position with Andersen Consulting to pursue the MBA program,

he did not express an intent to return to that position after he earned the M.B.A., nor did he know where he would be employed following the completion of the program. The

 $^{^{484}}$ No. 2117-02S, T.C. Summ. Op. 2003-58, 2003 WL 21180763, at *1 (U.S. Tax Ct. May 20, 2003).

⁴⁸⁵ Because this is a Tax Court summary opinion, it fortunately cannot be used as precedent in any other case.

⁴⁸⁶ Id.

⁴⁸⁷ Id.

⁴⁸⁸ *Id*.

⁴⁸⁹ *Id.* at *2.

⁴⁹⁰ Id.

⁴⁹¹ *Id.* at *3 (quoting Coughlin v. Comm'r, 28 T.C.M. (CCH) 459, 464 (1969)).

connection between the M.B.A. program and [the taxpayer]'s potential employment following the program was too tenuous at that time for the education to be considered as having maintained or improved skills required in that employment. 492

The court thus held that the taxpayer's educational expenses were not deductible. 493

The Zhang court apparently completely misunderstood the maintains or improves skills test in the 1967 Regulations. If the court is correct that an MBA degree serves to improve a taxpayer's "general understanding and competency" rather than to improve specific skills required in a taxpayer's employment, then the cost of an MBA degree, like a bachelor's degree, would almost always be nondeductible under the new trade or business test. 494 We know that this is not true based on the cases discussed above that allow a taxpayer to deduct the cost of an MBA degree. 495 There is also no precedent for that approach under the maintains or improves skills test. 496 No court has held that an MBA is too generalized a field of study to maintain or improve skills required by a taxpayer in any trade or business, 497 and such a holding would be absurd. Yet, that is what the Zhang court seems to imply. The court is also wrong in denying the taxpayer deductions for his education because he did not express intent to return to his former position and did not know where he would be employed after completing the program. 498 Neither of those facts have anything to do with whether the taxpayer can show that he is carrying on his trade or business while attending school. The taxpayer simply needs to show that he is taking a temporary leave from his trade or business to attend school, and that he intends to return to that trade or business after completing his education.⁴⁹⁹

The taxpayer in *Zhang* should have been allowed to deduct his educational expenses. There was no issue in the case as to whether he satisfied either the minimum educational requirements test or the new trade

⁴⁹² Id.

⁴⁹³ *Id*.

⁴⁹⁴ See supra notes 258–61 and accompanying text.

⁴⁹⁵ See, e.g., Allemeier v. Comm'r, 90 T.C.M. (CCH) 197, 201 (2005).

⁴⁹⁶ See supra Part IV.B.1.

⁴⁹⁷ Research has not revealed any courts that have held so.

⁴⁹⁸ See Zhang, T.C. Summ. Op. 2003-58, 2003 WL 21180763, at *3.

⁴⁹⁹ See supra notes 387–467 and accompanying text.

or business test.⁵⁰⁰ As to the maintains or improves skills test, he was clearly carrying on the trade or business of being employed as a consultant because he was performing development, financial, marketing and tax services prior to enrolling in the MBA program.⁵⁰¹ He was engaged in that trade or business for over two years.⁵⁰² There would seem to be no question that the MBA program was sufficiently related to that trade or business to allow the taxpayer to satisfy the maintains or improves skills test.⁵⁰³

As to the issue of whether the taxpayer was continuing to carry on his trade or business while in school, the MBA program was only one year in duration, after which the taxpayer immediately became employed with Morgan Stanley. The only question would be whether the taxpayer's position with Morgan Stanley would constitute the same trade or business as his position with Andersen Consulting. The court failed to perform any analysis of that question because of its lack of understanding of the 1967 Regulations, but it would seem that the tasks and activities performed by the taxpayer at Andersen Consulting would be substantially similar to the tasks and activities performed at Morgan Stanley. That of course would be a fact question, but if true the taxpayer should have been allowed to deduct his educational expenses.

CONCLUSION

Deductibility of educational expenses under section 162 of the Code is very complex, and the current rules for such deductibility are much more restrictive than for deduction of business expenses generally. A taxpayer hoping to deduct his educational expenses must traverse a virtual minefield of intricate rules, all potentially eliminating his right to a deduction. Courts have struggled with the application of these complex rules and have made some glaring errors.

While the minimum educational requirements test rarely applies, and the requirements of employer or applicable law test is straightforward and easy to apply, both the maintains or improves skills test and the new trade or business test are loaded with challenges for the taxpayer. Of those latter two tests, the maintains or improves skills test is easier for the taxpayer to

⁵⁰⁰ See Zhang, T.C. Summ. Op. 2003-58, 2003 WL 21180763, at *3.

⁵⁰¹ *Id.* at *1.

⁵⁰² *Id*.

⁵⁰³ See supra notes 373–83 and accompanying text.

⁵⁰⁴ Zhang, T.C. Summ. Op. 2003-58, 2003 WL 21180763, at *1–2.

⁵⁰⁵ See supra notes 438–67 and accompanying text.

meet, at least if he is aware of all the detailed rules he must follow and can plan around the potential pitfalls.

First, the taxpayer must be certain that he is engaged in a trade or business before he begins pursuing his education. In addition, the taxpaver must be engaged in the trade or business for a sufficient period of time to avoid a challenge by the IRS that he was not firmly established in the trade or business before beginning his education. Second, the education pursued by the taxpayer must be sufficiently related to the particular trade or business in which the taxpayer was engaged. Third, if the taxpayer takes a temporary leave from his trade or business to pursue education, and thus does not continue to carry on the trade or business while in school, he must be careful to indicate a clear intention to carry on the same trade or business upon completion of study, so that he will be treated as carrying on his trade or business while acquiring his education. The safest way for the taxpayer to indicate such an intention would be to return to the same position that he left to pursue his education, although that is not necessary under these rules. But if the taxpaver does not return to the same position. he must be careful to at least return to the same trade or business after completing his education. Because of the difficulty in forecasting whether the IRS might argue or a court might determine that a particular position, trade, or business is different from the position, trade, or business in which the taxpayer was engaged before pursuing his education, the taxpayer must be careful to accept a new position or otherwise engage in a new trade or business after pursuing his education that is as similar as possible to the position, trade, or business previously held or engaged in by the taxpaver. Finally, the taxpayer must be careful not to pursue his education for too long while on leave from his trade or business, such that a court could determine that the taxpaver's leave was not temporary.

As difficult as the maintains or improves skills test can be for taxpayers to meet, the new trade or business test is much worse. Under the *Glenn* line of cases, if the education pursued by the taxpayer is a step along the path to obtaining some kind of certification or license that, once obtained, authorizes the taxpayer to perform tasks that he would not be authorized to perform before obtaining the license or certification, the taxpayer will automatically fail the new trade or business test, because the education undertaken by the taxpayer will *lead to qualifying* him for a new trade or business. Whether the taxpayer ever actually intends to enter that new trade or business is irrelevant. Consequently, the expenses of

⁵⁰⁶ See supra notes 163–243 and accompanying text.

many types of education that a taxpayer might pursue are simply not deductible in any event. Examples include enrolling in pharmacological school, law school, medical school, a certified physician's assistant program, and many other types of programs or courses.

It is not difficult to understand why the IRS included the new trade or business test in the 1967 Regulations, and why it created an objective standard for its application. In the absence of an objective test, taxpayers would always testify that they had no intention at any time to engage in any new type of trade or business than the type they were engaged in before acquiring the education. A taxpayer employed as an accountant could, for example, enroll in law school, take the necessary precautions to meet the maintains or improves skills test (arguing that law school will enable him to practice accounting more effectively), and return to the practice of accounting after receiving his law degree for a "safe" period of time (maybe two or three years). All the while, the taxpayer could be planning to take the bar examination at some future time and then practice law. There is probably no other effective way, as a practical matter, to prevent taxpayers from deducting their educational expenses in those situations than the new trade or business test, applied objectively.

It is more difficult, however, to justify application of the new trade or business test to cases that do not involve education that is a step along the path to obtaining some kind of certification or license that, once obtained, authorizes the taxpayer to perform tasks that he would not be authorized to perform before obtaining the license or certification. Those cases must be decided under the commonsense approach, and involve questions of fact. There are no clear standards in the 1967 Regulations or the associated case law for trial courts to make this determination, and it is apparent from the case law that they are given wide latitude in doing so. 507 Because of the lack of guidance in the 1967 Regulations and the case law, a taxpayer whose deductions for educational expenses are challenged by the IRS based on this issue will have no way of predicting before trial how the court will rule, and it will be nearly impossible to appeal a trial court's decision successfully because the entire issue will be decided as a question of fact. It would do no great harm to the 1967 Regulations or to the treasury to limit the application of the new trade or business test to cases like Glenn and its progeny and not to apply it to cases like Hewett, Warren, Carroll, Schneider, Malek, or any other case. 508 In those cases, the

⁵⁰⁷ See Katz, supra note 3, at 4; see also supra notes 244–78 and accompanying text.

⁵⁰⁸ See supra notes 244–77 and accompanying text.

maintains or improves skills test and the requirements of employer or applicable law test will be adequate to prevent taxpayers from deducting educational expenses in inappropriate circumstances. For example, the taxpayers in *Hewett* and *Schneider* most likely failed the maintains or improves skills test because they did not return to the same trade or business after completing their education, ⁵⁰⁹ and thus their educational expenses were not deductible anyway. The taxpayer in *Warren* probably passed the maintains or improves skills test, ⁵¹⁰ and the taxpayer in *Malek* passed the requirements of the employer or applicable law test, ⁵¹¹ so the taxpayers in those cases should have been allowed to deduct their educational expenses.

The same general type of work test, as part of the new trade or business test, is at best not useful and at worst harmful. That test has no definitions or standards in the 1967 Regulations, leaving courts to decide when and how to apply it. 512 That of course will result in inconsistencies with regard to the types of situations to which it will be applied, and to the actual application of the test when courts decide to apply it. The test From a policy should be eliminated from the 1967 Regulations. perspective, however, it would be better to keep the same general type of work test, better define its terms so that it can be accurately and consistently applied, and expand it to self-employed individuals, and then eliminate the new trade or business test. That would be more consistent with section 162 of the Code, which allows deductions for ordinary and necessary expenses paid or incurred by a taxpayer in carrying on a trade or business. 513 For all expenses other than educational expenses, the taxpaver simply has to prove that the expense is sufficiently related to the carrying on of a trade or business, and that the expense is not a capital expenditure. 514 The new trade or business test imposes limitations on the deductibility of educational expenses under section 162 that are not imposed on expenses incurred in other trades or businesses. 515

⁵⁰⁹ See supra notes 244–53, 262–71 and accompanying text.

⁵¹⁰ See supra notes 254–61 and accompanying text.

⁵¹¹ See supra note 261.

⁵¹² See Katz, supra note 3, at 4; supra notes 244–78 and accompanying text.

⁵¹³ I.R.C § 162(a) (2000).

⁵¹⁴ *Id*

⁵¹⁵ See Schoenfeld, supra note 3, at 325; Katz, supra note 3.