

THE COST OF EDUCATION AS A DEDUCTIBLE BUSINESS EXPENSE: A REASSESSMENT

The Internal Revenue Code allows a deduction from gross income for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."¹ It permits no deduction for personal living expenses,² nor immediate deductions for capital expenditures.³ Capital expenditures are usually distinguished from current "ordinary and necessary" expenses by examining the length of time over which the taxpayer benefits from the expenditure.⁴ Expenses benefiting a single period are charged to that period as current expenses; expenses benefiting a number of periods normally are capitalized, and the cost is amortized over the periods benefited.⁵

The treatment of expenditures for education as ordinary and necessary business expenses has been one of the most litigated⁶ and confused issues in the area of business deductions. Since 1950, when *Hill v. Commissioner*⁷ allowed for the first time a business deduction for educational expenses, litigants as well as scholars have disputed the classification of the cost of education as personal expenses, capital expenditures, or current business expenses—and the tax treatment appropriate to each category.

Treasury Regulation section 1.162-5⁸ currently governs the tax treatment of educational expenses. The section allows a deduction for the cost of education which "[m]aintains or improves skills required by

THE FOLLOWING CITATIONS WILL BE USED IN THIS COMMENT:

R. GOODE, *THE INDIVIDUAL INCOME TAX* (1976), hereinafter cited as R. GOODE.

McNulty, *Tax Policy and Tuition Credit Legislation: Federal Income Tax Allowances for Personal Costs of Higher Education*, 61 CALIF. L. REV. 1 (1973), hereinafter cited as McNulty.

1. I.R.C. § 162.

2. *Id.* § 262.

3. *Id.* § 263.

4. S. DAVIDSON, C. STICKNEY, & R. WEIL, *FINANCIAL ACCOUNTING* 322-28 (1979).

5. See I.R.C. §§ 167, 263. This procedure is in accordance with the matching principle in accounting: net income is properly measured by charging expenses against the income that those expenses aid in producing.

6. Samuels & Samuels, *Current climate for deducting education expenses is quite favorable*, 11 TAX. FOR ACCOUNTANTS 226, 226 (1973).

7. 181 F.2d 906 (4th Cir. 1950).

8. Treas. Reg. § 1.162-5 (1967).

the [taxpayer] in his employment,"⁹ provided that the education does not constitute the minimum educational requirement of the taxpayer's trade or lead to qualifying the taxpayer in a new trade.¹⁰ Educational costs excluded by the latter two criteria are deemed "inseparable aggregate[s] of personal and capital expenditures"¹¹ that may not be deducted currently, or capitalized and amortized over the periods benefited by the expense. They are, in short, completely nondeductible.

The current regulation is deficient from both a practical and a theoretical viewpoint. Its excessively broad view of what constitutes a new trade operates to deny deductions when in fairness they should be allowed. Moreover, denying deductions for educational expenses that "lead to" a new trade or business ignores whether the taxpayer actually uses the education in a new trade or business. Most important, however, the regulation is theoretically unsound in both its definition and its treatment of capital educational expenditures. The regulation incorrectly defines a capital expenditure as one which satisfies minimum educational requirements of the taxpayer's trade or leads to qualifying the taxpayer for a new trade, rather than as an expenditure which benefits more than one period. Furthermore, expenditures deemed capital are forever nondeductible, because amortization of educational expenses is not allowed.

Eliminating the "lead to qualifying for a new trade" element of the current regulation would cure some of the regulation's excessive strictness. This solution, however, still falls short of a theoretically proper treatment of the cost of education by failing to provide for the capitalization and amortization of business-related educational expenses. This Comment discusses the history and development of the tax treatment of educational expenses and urges that the current regulation be rejected in favor of a capitalization and amortization approach.

I. HISTORICAL DEVELOPMENTS

A. *The Early Cases.*

The principle that an individual may not deduct the cost of education was well established in the early days of the personal income tax. Cases and Internal Revenue decisions during the 1920s premised the denial on the personal character of educational expenses.¹² In *Welch v.*

9. *Id.* § 1.162-5(a)(1).

10. *Id.* § 1.162-5(b).

11. *Id.*

12. See *Driscoll v. Commissioner*, 4 B.T.A. 1008 (1926); *Darling v. Commissioner*, 4 B.T.A. 499 (1926); O.D. 984, 5 C.B. 171 (1921); O.D. 892, 4 C.B. 209 (1921). The Board of Tax Appeals did allow a deduction for the expenses a chemistry professor incurred in attending conventions, in

Helvering,¹³ Mr. Justice Cardozo suggested in dictum a separate justification for denying deductibility for educational expenses: that the cost of education is a capital expenditure.¹⁴ *Welch*, however, actually denied the deduction on the ground that the expense was personal because there was no business custom involved in incurring the expense.¹⁵

The holding in *Welch* has unfortunately confused the subsequent discussion of whether expenditures for education are properly deductible as ordinary business expenses. Because of *Welch*, the Commissioner¹⁶ and a number of courts¹⁷ and commentators¹⁸ have classified educational costs as personal expenses unrelated to business. Courts have made this classification in some cases even though the education clearly related to the taxpayer's business activity.¹⁹ Critics, however, relying on Cardozo's dictum,²⁰ have argued that the relevant distinction is not between personal and business expenses but rather between capital and current expenditures.²¹

The classification issue was not crucial during the first four decades of the personal income tax, when the Service and the courts considered all educational costs nondeductible. The distinction became important in later years, however, once deductions were first allowed for some educational expenses. An expenditure may be of either a personal or a business nature and, if business, either current or capital. To be deductible, however, an educational expense must be neither personal nor capital. These distinctions are the foundation upon which

Silverman v. Commissioner, 6 B.T.A. 1328 (1927). *Silverman*, however, appears to have been based not on the educational value of the convention but on the convention's role as a place to advance the interests of the taxpayer's employer and keep in touch with other scientists. The case came to stand for the proposition that conventions give rise to deductible ordinary and necessary business expenses rather than for the notion that the cost of education is deductible. See *Coffey v. Commissioner*, 21 B.T.A. 1242, 1244 (1931); *Jack v. Commissioner*, 13 B.T.A. 726, 728 (1928).

13. 290 U.S. 111 (1933).

14. "Reputation and learning are akin to capital assets, like the good will of an old partnership. . . . The money spent in acquiring them is well and wisely spent. It is not an ordinary expense of the operation of a business." *Id.* at 115-16.

15. *Id.* at 114-15.

16. See, e.g., *United States v. Michaelson*, 313 F.2d 668, 670 (9th Cir. 1963) (citing T.D. 6281, 1958-1 C.B. 63, 67-68); O.D. 984, 5 C.B. 171 (1921); O.D. 892, 4 C.B. 209 (1921).

17. See, e.g., *Adelson v. United States*, 342 F.2d 332, 336 (9th Cir. 1965); *Sharon v. Commissioner*, 66 T.C. 515, 525 (1976), *aff'd*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979); *Greenberg v. Commissioner*, 45 T.C. 480, 483 (Withey, J., concurring), *rev'd*, 367 F.2d 663 (1st Cir. 1966).

18. See, e.g., Note, *The Educational Paradox*, 46 CHL-KENT L. REV. 236, 237 (1969).

19. See, e.g., *Horodysky v. Commissioner*, 54 T.C. 490, 493 (1970) (legal education); *Denman v. Commissioner*, 48 T.C. 439, 446 (1967) (engineering degree).

20. See note 14 *supra* and accompanying text.

21. See, e.g., *Wolfman, Professors and the "Ordinary and Necessary" Business Expense*, 112 U. PA. L. REV. 1089, 1096 (1964).

subsequent regulations dealing with educational expenses have been based.

B. Hill and Coughlin.

Whether because of the personal nature of such expenses or their analogy to capital expenditures, the courts disallowed all business deductions for educational expenses for seventeen years following *Welch*. In the early 1950s, however, two cases did allow deductions for educational expenses and formulated the distinctions embodied in subsequent regulations governing educational expenses. In *Hill v. Commissioner*²² the Court of Appeals for the Fourth Circuit allowed a deduction to a school teacher for the cost of summer school courses she took to fulfill a requirement for recertification. The court held that the expense was ordinary and necessary and that Office Decision 892,²³ denying a deduction for summer school expenses of school teachers, should not apply when the teacher undertook the education to enable her to retain her existing position—the distinguishing factor in the case.²⁴

[N]o practical advantage would accrue to her upon a renewal of her certificate other than the privilege and power to continue as a teacher. Clearly, the very logic of the situation here shows that she went to Columbia to maintain her present position, not to attain a new position; to preserve, not to expand or increase; to carry on, not to commence.²⁵

Hill was followed shortly by *Coughlin v. Commissioner*.²⁶ *Coughlin* expanded the deductibility of educational expenses by allowing a deduction to a tax attorney for the cost of attending New York University's Institute on Federal Taxation. The *Coughlin* court narrowed the effect of the dictum from *Welch*, that education was a nondeductible capital expenditure, by arguing that in *Welch* Cardozo was speaking of "that knowledge which is obtained for its own sake as an addition to one's cultural background or for possible use in some work . . . in the future."²⁷ *Coughlin*, in contrast, incurred expenses to acquire knowledge to be used in an established business. Furthermore, even if knowledge is generally to be considered a capital asset, the knowledge *Coughlin* acquired about current trends in taxation was an exception

22. 181 F.2d 906 (4th Cir. 1950).

23. O.D. 892, 4 C.B. 209 (1921).

24. See I.T. 4044, 1951-1 C.B. 16 (the Bureau's response to *Hill*).

25. 181 F.2d at 909.

26. 203 F.2d 307 (2d Cir. 1953).

27. *Id.* at 309.

because of its "evanescent character."²⁸ The expenses were therefore properly deductible as ordinary and necessary business expenses.

The *Coughlin* court's analysis further developed the distinction between three types of educational expenses: personal, capital, and current business expenses. Under the *Coughlin* formulation deductions are disallowed for expenses incurred in acquiring knowledge "for its own sake"²⁹ because such a purpose is personal. The opinion suggests two different means of distinguishing between nondeductible capital educational expenditures and deductible current business expenses. The reference to the "evanescent character"³⁰ of an expenditure implies that the correct method is to examine the length of time over which the taxpayer will benefit from the education. This method conforms to the normal and proper method of distinguishing between current and capital expenditures;³¹ it also suggests capital treatment for nearly all educational expenses, because most expenditures for education benefit a number of periods.

Coughlin's second suggested method of distinguishing between current and capital educational expenses is to determine whether the education will be used in an established business (current) or in some future work (capital).³² This method lacks the theoretical justification underlying the periods-benefited approach because it departs from the definition of a capital expenditure as one producing income in multiple periods. Nevertheless, regulations subsequent to *Coughlin* adopted the current-business/future-business distinction between deductible and nondeductible educational expenses, thereby preserving a fundamental flaw in the treatment of the cost of education.

C. *The 1958 Regulation.*

Once *Hill* and *Coughlin* opened the door to deductibility, the problem of distinguishing between personal and business-related educational expenses eclipsed that of distinguishing between current and capital expenditures. The facts in *Coughlin* had not been difficult; the court noted that the business benefit to *Coughlin* of attending the tax institute far overshadowed any personal benefit to him.³³ Other cases, however, present a much more uncertain mix of business and personal

28. *Id.* at 309-10.

29. *Id.* at 309.

30. *Id.* at 310.

31. See note 5 *supra* and text accompanying notes 4-5 *supra*.

32. 203 F.2d at 309. This method is also supported by language in *Hill*, characterizing education as undertaken "to preserve [a current position], not to expand or increase; to carry on, not to commence." *Hill v. Commissioner*, 181 F.2d 906, 909 (4th Cir. 1950).

33. 203 F.2d at 309.

motives.³⁴ How to treat these mixed-motive educational expenditures continues to plague the case law and regulations in this area.³⁵ In response to the problem, or perhaps to ward off intervention by Congress,³⁶ the Treasury in 1958 promulgated a new regulation, section 1.162-5,³⁷ to govern business deductions for educational expenses. The major feature of the regulation was the "primary-purpose" test: A business deduction was allowed if the taxpayer undertook the education primarily for the purpose of:

- (1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or
- (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.³⁸

On the other hand, the taxpayer could not deduct expenses for education undertaken primarily for "obtaining a new position or substantial advancement in position, or . . . [for] fulfilling the general educational aspirations or other personal purposes of the taxpayer."³⁹ Nor would the Service permit a deduction if the education was necessary to meet the minimum requirements for qualification in the taxpayer's trade.⁴⁰

34. See, e.g., *Hoover v. Commissioner*, 35 T.C. 566 (1961); *Green v. Commissioner*, 28 T.C. 1154 (1957). In *Green*, a schoolteacher faced a college credit requirement similar to the one in *Hill*. Besides taking several courses that met the requirement to maintain her position, she earned additional credits and received a master's degree. The Commissioner argued that no deduction should be allowed because Green's real purpose in attending school was to earn the master's degree, not to retain her position. The court disagreed, noting that the courses for which the deduction was sought met the college-credit requirement and were thus clearly business-related. That they could be, and were, applied towards a graduate degree was merely incidental. *Id.* at 1156.

35. For a discussion noting that there is no satisfactory way to distinguish between deductible and nondeductible mixed-motive expenditures, see Bittker, *Income Tax Deductions, Credits, and Subsidies for Personal Expenditures*, 16 J. LAW & ECON. 193, 202-04 (1973).

36. See, e.g., H.R. 4662, 85th Cong., 1st Sess. (1957). This bill, which was pending at the time the Treasury promulgated the regulation, would have allowed teachers (the group most often involved in educational expense cases) a deduction from gross income for expenses incurred in further education up to \$600 over and above any amount allowable as a trade or business expense under section 162.

37. Treas. Reg. § 1.162-5, T.D. 6291, 1958-1 C.B. 63, 67.

38. Treas. Reg. § 1.162-5(a), T.D. 6291, 1958-1 C.B. 63, 67. Consistent with *Welch v. Helvering*, 290 U.S. 111 (1933), the regulation provided that custom in the industry ordinarily would establish whether the education maintained or improved the taxpayer's skills. Treas. Reg. § 1.162-5(a). In practice, however, the lack of custom was not always controlling. See *Campbell v. United States*, 250 F. Supp. 941, 945 (E.D. Pa. 1966) (forensic pathologist receives law degree); *Watson v. Commissioner*, 31 T.C. 1014, 1016 (1959) (psychoanalytic training for internist).

39. Treas. Reg. § 1.162-5(b), T.D. 6291, 1958-1 C.B. 63, 67.

40. *Id.* at 67-68. In 1960, the Service elaborated upon the provisions of section 1.162-5 in Rev. Rul. 60-97, 1960-1 C.B. 69.

The regulation was consistent with the distinction between personal, capital, and current business expenditures developed in *Coughlin*. The “maintaining or improving skills,” “requirements of . . . employer,” and “general educational aspirations” provisions related to the business-personal distinction; the “minimum requirements” and “new position” phrases were the regulation’s attempt to approximate the current-capital distinction. To distinguish current from capital educational expenditures, the regulation used the second method suggested in *Coughlin*—that of determining whether the education will be used in a current or future business⁴¹—rather than the periods-benefited approach. The regulation presumed that education undertaken to help one advance in position or obtain an altogether new position would benefit the future position and the periods in which it was held rather than the current position, thereby rendering current deductibility inappropriate.⁴² The regulation made no provision, however, for amortization of these expenses over the periods presumed to be benefited. A capital educational expenditure was simply not deductible.

The primary-purpose test created great difficulties for the courts throughout the life of the 1958 regulation. Because the primary purpose of an expenditure varies from case to case,⁴³ the courts found it impossible to develop hard and fast rules about the deductibility of a particular type of expenditure. Precedent had little value; each taxpayer could claim that his purpose differed from that of another. The amount of litigation increased⁴⁴ and the results were often inconsistent.

*Welsh v. United States*⁴⁵ and *Condit v. Commissioner*,⁴⁶ both decided by the Court of Appeals for the Sixth Circuit, provide a classic example of these inconsistencies. *Welsh*, an Internal Revenue Service agent who attended law school at night, left the Service after completing law school and entered a general legal practice. *Condit*, an indus-

41. See text accompanying note 32 *supra*.

42. There are several imperfections in this analysis. Not only do the benefits derived from most education last for many years regardless of whether the education is related to the presently occupied position, see text accompanying notes 31-32 *supra*, but the purpose for which the education is sought need not be related to its effect. Some judges have thus argued that education providing a new skill should be nondeductible even if it also improves skills used in the current trade, see *Greenberg v. Commissioner*, 45 T.C. 480, 483 (Withey, J., concurring), *rev'd*, 367 F.2d 663 (1st Cir. 1966), while others assert that education improving skills used in the current trade should be deductible even if it also entails the acquisition of a new skill, see *Greenberg v. Commissioner*, 45 T.C. at 485 (Fay, J., dissenting).

43. See *Treas. Reg. § 1.162-5*, T.D. 6291, 1958-1 C.B. 63, 67-69, for a discussion of the variety of purposes.

44. Nine reported cases from 1950, the date of the *Hill* case, through 1957 involved contested educational expense deductions. Courts decided an equal number of cases in 1961 alone.

45. 329 F.2d 145 (6th Cir. 1964).

46. 329 F.2d 153 (6th Cir. 1964).

trial accountant who also attended law school at night, remained at his old job following his graduation. In two per curiam opinions handed down the same day, the court affirmed both a district court judgment allowing a deduction to Welsh and a Tax Court judgment denying a deduction to Condit. The court held that each case involved an issue of fact—whether the primary purpose of the taxpayer in incurring the educational expenses was to improve his skills or to prepare for a new position—and that in neither case was the lower court clearly erroneous in its finding.⁴⁷

Frustration over the inconsistent results generated by the primary-purpose test eventually led the Tax Court, in a 1966 decision, to ignore the taxpayer's purpose and rely on prior cases involving similar objective facts in determining whether to allow a deduction.⁴⁸ The judge who had tried the facts dissented, arguing that the precedent could not control since the taxpayers' purposes differed.⁴⁹ The court of appeals agreed with the dissent and reversed.⁵⁰ The holding of the majority of the Tax Court, reflecting its dissatisfaction with the primary-purpose test, was an attempt to use precedent to remove inconsistency,⁵¹ provide certainty, and prevent taxpayers from circumventing precedent by claiming to have a different purpose than prior litigants. The confusion, the inconsistencies, the case load, and the same fear of congressional intervention that had originally inspired the 1958 regulation⁵² led the Service to amend the regulation.

47. *Id.* at 154; 329 F.2d at 146. *Condit* and *Welsh* are sometimes cited for the proposition that a taxpayer was better off in the district court than in the Tax Court under the primary-purpose test. See Note, *supra* note 18, at 241-43. Compare *Williams v. United States*, 238 F. Supp. 351 (S.D.N.Y. 1965) with *Lamb v. Commissioner*, 46 T.C. 539 (1966) (different results for IBM patent trainees who attended law school under same program). While taxpayers did have somewhat greater success in the district courts, there were numerous exceptions to this rule of thumb. See, e.g., *Huene v. United States*, 247 F. Supp. 564 (S.D.N.Y. 1965); *Markham v. United States*, 245 F. Supp. 505 (S.D.N.Y. 1965); *Charlton v. Commissioner*, 23 T.C.M. (CCH) 420 (1964); *Carlucci v. Commissioner*, 37 T.C. 695 (1962); *Watson v. Commissioner*, 31 T.C. 1014 (1959).

48. *Greenberg v. Commissioner*, 45 T.C. 480, 482-83, *rev'd*, 367 F.2d 663 (1st Cir. 1966).

49. 45 T.C. at 484-85 (Fay, J., dissenting).

50. 367 F.2d 663 (1st Cir. 1966).

51. Inconsistency in the courts caused the Commissioner problems in bargaining over audit disputes that never reached the courts. A 1966 article for accountants described the likelihood of obtaining a deduction for law school in tones reminiscent of a cross between the stock market reports and the morning line at the racetrack:

Your chances of getting at least a partial deduction for law school expenses are better now than they have ever been. In fact, we understand that the Appellate Division is presently settling such cases by allowing between 50-80% (90% in at least one case) of law school expenses claimed by accountants

Can You Deduct Your Law School Expenses?, 1 TAX. FOR ACCOUNTANTS 91 (1966). See Nagel, *Accountants, Agents especially favored in deducting law school expenses*, 22 J. TAX. 112 (1965).

52. See text accompanying notes 36-37 *supra*.

D. *The 1967 Regulation.*

On May 1, 1967, the Treasury amended section 1.162-5, replacing the primary-purpose test with an "objective test."⁵³ A finding that education serves to maintain or improve skills used in a trade or business, or that education is required by the employer, remains the touchstone of deductibility. The taxpayer's purpose in undertaking the education, however, is no longer supposed to be relevant; the finding instead must be an objective one.⁵⁴ The regulation retains the caveat that a taxpayer may not deduct expenses for education that is necessary to meet the minimum requirements for qualification in the taxpayer's trade or business.⁵⁵ In addition, no deduction is allowed for expenditures for "education which is part of a program of study being pursued by [the taxpayer] which will lead to qualifying him in a new trade or business."⁵⁶ This latter provision applies even if the education maintains or improves skills required in the current trade or is required by the employer, and (unlike the 1958 regulation) regardless of whether the taxpayer intends to enter the new trade. The amended regulation thus uses a three-step test:⁵⁷ For educational expenditures to be deductible,

53. See Treas. Reg. § 1.162-5(a) (1967) (eliminating language of the 1958 regulation as to "primary purpose").

54. See *id.*

55. *Id.* § 1.162-5(b)(2).

56. *Id.* § 1.162-5(b)(3).

57. This discussion assumes that the taxpayer is in the relevant trade or business, a prerequisite to any section 162 deduction. Whether an individual is actually in the trade or business has been a major issue in many educational expense deduction cases, because the expenditure often occurs while the taxpayer is going to school full time rather than actively working. Two types of cases involve disputes as to whether the taxpayer is in the particular trade: those in which it is asserted that the taxpayer has abandoned the trade, and those in which the taxpayer allegedly has not yet become established in the trade.

In the abandonment cases, the courts have rejected the Commissioner's proposed one-year absence rule in favor of a case-by-case determination whether the taxpayer's absence from work is temporary (so that he is still in the trade) or indefinite (so that he has abandoned it). See *Sherman v. Commissioner*, 36 T.C.M. (CCH) 1191, 1194 (1977) (deduction allowed for two year M.B.A. program). This approach has occasionally placed the courts in the role of unemployment-benefits counselors, analyzing how hard an unemployed taxpayer looked for work in order to determine if his absence from work was temporary or indefinite. See, e.g., *Reisinger v. Commissioner*, 71 T.C. 568, 573-74 (1979); *Picknally v. Commissioner*, 36 T.C.M. (CCH) 1292, 1294 (1977).

The issue in the "not yet established" cases is whether, when an individual has worked sporadically or for only a short time prior to undertaking educational expenses, that individual should be treated as not yet "carrying on any trade or business." I.R.C. § 162. The Tax Court has decided these cases inconsistently. Compare *Reisine v. Commissioner*, 29 T.C.M. (CCH) 1429 (1970) (engineer employed for one year not yet established) with *Ruehmann v. Commissioner*, 30 T.C.M. (CCH) 675 (1971) (deduction allowed attorney employed for one summer prior to entering LL.M. program). The presence or absence of an official certification may be an important factor. See *Haseltine v. Commissioner*, 38 T.C.M. (CCH) 1259, 1264 (1979) (deduction allowed for course taken after receiving license but denied for course taken before licensing). Although this factor is an objective criterion, it provides no assistance in cases such as *Reisine* that involve

the education must maintain or improve relevant skills or be required by the employer, not constitute part of the minimum requirements for employment, and not lead to qualifying the taxpayer for a new trade or business.⁵⁸ Each of these factors is to be determined objectively, so as to avoid the "mire of the no-man's land of subjective intent"⁵⁹ encountered under the primary-purpose test.

Many commentators considered the 1967 regulation more liberal than its predecessor,⁶⁰ and some predicted that the amount of litigation would decline.⁶¹ These predictions, however, have proved to be inaccurate.⁶² Despite the hopes for a simpler and more liberal treatment of educational expenses, the 1967 regulation has produced as much controversy and litigation as its predecessor. It preserves the old regulation's definition of a capital educational expenditure as one which fulfills minimum requirements or is to be used in a different trade, instead of adopting a proper definition based on the number of periods benefited.⁶³ Expenditures deemed capital still provide no tax benefit through amortization. Furthermore, the elimination of the primary-purpose test and addition of the "lead to qualifying . . . in a new trade" language have restricted deductibility even more than the 1958 regulation did.

II. PROBLEM AREAS IN THE CASES

Consideration of the problems that have arisen under section 1.162-5 is helpful in analyzing the desirability of alternative treatments of educational expenses. Each of the three elements of the test for determining deductibility has caused difficulties. The following discus-

businesses in which certification or licensing is not customary. Furthermore, licensing alone, without actual employment, should not constitute establishment in the trade if establishment is to be a meaningful prerequisite to the deductibility of educational expenses. See *Randick v. Commissioner*, 35 T.C.M. (CCH) 195, 197-98 (1976). A determination on the facts of each case, focusing on the amount of time worked as the major factor, or, in the alternative, use of a flat time requirement, would be preferable. Although the courts have rejected the latter approach in abandonment disputes, a flat time requirement would presumably be acceptable in reaching the more objective determination whether a taxpayer is established in the trade or business.

58. For alternative verbal and graphic assessments of the test, see STAND. FED. TAX REP. (CCH) ¶ 1360.01; Note, *Taxation: Deductibility of Educational Expenses for Fulltime Graduate Study*, 25 OKLA. L. REV. 584, 585-86 (1972).

59. *Helms v. Commissioner*, 27 T.C.M. (CCH) 1020, 1023 (1968).

60. E.g., Gage, *New Educational Expense Deduction Cases Exhibit a Liberalizing Trend*, 34 J. TAX. 66, 66 (1971); Goggans & Leftwich, *What is the present climate for the educational expense deduction?*, 31 J. TAX. 236, 240 (1969).

61. E.g., *Final education expense regs contain guidelines for obtaining deductions*, 27 J. TAX. 28, 30 (1967).

62. See note 125 *infra*.

63. See notes 5 & 42 *supra* and text accompanying notes 4-5, 41-42 *supra*.

sion will outline the major issues and problems under the 1967 regulation and will suggest, as solutions to these problems, preferable interpretations of the “maintains-or-improves” and “minimum-requirements” tests and urge elimination of the “new-trade-or-business” test.

A. *Maintains or Improves Skills.*

The first requirement for deductibility—that the expenditure be made for education that “[m]aintains or improves skills required by the individual in his employment or other trade or business”⁶⁴—distinguishes those expenditures undertaken for business purposes from those made in acquiring education of a personal nature.⁶⁵ The 1967 regulation thus looks at the relationship between the education and the duties performed and allows a deduction if the effect of the education is to maintain or improve business skills, regardless of the taxpayer’s primary purpose. With the exception of cases involving travel,⁶⁶ the maintains-or-improves-skills requirement presently figures in a relatively small number of cases. The minimum-requirements test and the new-trade-or-business test often present simpler means of deciding cases that could otherwise be decided under the maintains-or-improves-skills test.

When the courts do address the maintains-or-improves-skills issue, however, they permit the deduction if there is a “proximate” relationship⁶⁷ between the education and the skills to be improved. The Tax Court developed this test in *Carroll v. Commissioner*,⁶⁸ a case disallowing a policeman’s deduction for the cost of his liberal arts education.

64. Treas. Reg. § 1.162-5(a)(1) (1967).

65. See text following note 21 *supra*.

66. The regulation allows a deduction for expenses of educational travel when “the major portion of the activities [while traveling] is of a nature which directly maintains or improves skills required by the individual in [his] employment” Treas. Reg. § 1.162-5(d) (1967). Most of the cases involve teachers who travel during summer vacations or while on sabbatical and seek deductions based on the increased knowledge they pass on to their students or the techniques they learn from other school systems. See, e.g., *Allison v. Commissioner*, 36 T.C.M. (CCH) 1114 (1977), *aff’d*, No. 78-1277 (9th Cir. Dec. 6, 1979); *Marchionni v. Commissioner*, 35 T.C.M. (CCH) 1342 (1976). The courts require that particularly identified job skills be improved; general cultural broadening through normal tourist activities is insufficient. See *Krist v. Commissioner*, 483 F.2d 1345, 1348 (2d Cir. 1973). Generally, the taxpayer must put forth a strong, well-documented case to obtain a deduction. See, e.g., *Haynie v. Commissioner*, 36 T.C.M. (CCH) 1326 (1977); *Marlin v. Commissioner*, 54 T.C. 560 (1970). *But see Johnson v. Commissioner*, 39 T.C.M. (CCH) 630 (1979).

67. *Carroll v. Commissioner*, 51 T.C. 213, 219 (1968), *aff’d*, 418 F.2d 91 (7th Cir. 1969). The concurring opinion, discussing the 1958 regulation, describes the required relationship as one of a “reasonable nexus.” 51 T.C. at 220 (Tannenwald, J., concurring).

68. 51 T.C. 213 (1968), *aff’d*, 418 F.2d 91 (7th Cir. 1969).

The court has also applied the test to deny deductions for the cost of education that is clearly business-oriented, but that develops skills more appropriate to a position of greater authority than the one occupied by the taxpayer.⁶⁹

B. *Minimum Educational Requirements.*

The minimum-educational-requirements test is intended to separate current, ordinary, and necessary expenses from expenditures of a capital nature.⁷⁰ The courts have grappled with two major problems in connection with the minimum-requirements test. The first of these problems involves determining whether minimum requirements have been met in cases in which individuals are already employed but face additional educational requirements. The courts have decided these cases by distinguishing between apprentices and established employees. If the taxpayer is performing the full scope of duties of one in the profession, he has met the profession's minimum educational requirements, and the cost of any additional required education is deductible.⁷¹ If, on the other hand, the taxpayer is performing some duties but needs further schooling to enable him to perform more advanced duties, he is like an apprentice who has not met the minimum educational requirements of his trade⁷² and expenditures for the additional schooling are not deductible.⁷³ For example, college teaching

69. See *Heffernan v. Commissioner*, 39 T.C.M. (CCH) 86, 87 (1979) (accounting clerk denied deduction for M.B.A. expenses); *McIlvoy v. Commissioner*, 38 T.C.M. (CCH) 987, 989 (1979) (electronics technician denied deduction for M.B.A. expenses); *Hogue v. Commissioner*, 37 T.C.M. (CCH) 126, 127 (1978) ("wide disparity between the scope of duties performed by an orderly or ward clerk and a hospital administrative assistant").

70. See *Hering v. Commissioner*, 33 T.C.M. (CCH) 1329, 1331 (1974). Although the regulation speaks of the expense of meeting minimum educational requirements as "an inseparable aggregate of personal and capital expenditures," Treas. Reg. § 1.162-5(b) (1967), the expenditure is clearly of a business rather than personal nature if it pays for education that is a minimum requirement for qualification in a trade.

71. See, e.g., *United States v. Michaelson*, 313 F.2d 668, 671-72 (9th Cir. 1963).

72. See, e.g., *Rombach v. United States*, 440 F.2d 1356 (Ct. Cl. 1971) (patent trainee); *Johnston v. Commissioner*, 37 T.C.M. (CCH) 1112 (1978) (law clerk); *Jungreis v. Commissioner*, 55 T.C. 581 (1970) (graduate teaching assistant).

73. Courts decide many of these apprentice/established-employee cases, however, by using the new-trade-or-business test. See text accompanying notes 100-08 *infra*. See, e.g., *Weiszmann v. Commissioner*, 483 F.2d 817, 819-20 (10th Cir. 1973); *Lamb v. Commissioner*, 46 T.C. 539, 544-45 (1966), *appeal dismissed*, 390 F.2d 157 (2d Cir. 1968). The results often hinge on semantic arguments about whether the taxpayer has in fact entered a new trade or business. See, e.g., *Weiler v. Commissioner*, 54 T.C. 398, 401 (1970), in which the taxpayer, an accountant who became a lawyer, unsuccessfully asserted that he could deduct the cost of law school because he had been an "income tax professional" all along. See also *Weiszmann v. Commissioner*, 483 F.2d at 819-20 (education qualified patent trainee for new profession as patent attorney). Conceptually, the more accurate distinction in such cases is between apprentices and established employees, and it is therefore more appropriate that these cases be decided under the minimum-requirements test.

assistants,⁷⁴ law clerks,⁷⁵ and patent trainees⁷⁶ are treated as apprentices; teachers are normally considered to have met the minimum requirements of their profession even if they are required to take additional courses.⁷⁷

The apprentice/established-employee test does have important limitations, however. Although the test is easily applied to teachers, law students, and teaching assistants, it raises some troublesome questions when there are a number of steps in the job hierarchy, as in *Josephs v. Commissioner*.⁷⁸ Josephs held three positions—technician, senior technician, and assistant engineer—at various times, and each position required a different amount of engineering education. The Tax Court denied a deduction for the cost of courses that qualified the taxpayer for advancement beyond the position of technician, because the courses were part of the minimum requirements for employment as an assistant engineer.⁷⁹

The case indicates that the courts, in determining the minimum educational requirements of the taxpayer's employment, often apply the requirements of a higher-level position upon a full range of lower-level jobs.⁸⁰ This application of the minimum-requirements test is not justified, however, when the lower positions on the hierarchy are employment goals in themselves and not mere waystations through which everyone passes on the path to a single, ultimate position. Although "students do not enroll in law school to get a job as a law clerk [but rather to] . . . become a lawyer,"⁸¹ many engineering technicians remain engineering technicians of different grades and do not become engineers. Courts should consider the nature of the duties performed in the lower-level positions, the percentage of occupants who move on,⁸² and the amount of time spent in each position before designating

74. See, e.g., *Jungreis v. Commissioner*, 55 T.C. 581 (1970).

75. See, e.g., *Johnston v. Commissioner*, 37 T.C.M. (CCH) 1112 (1978).

76. See, e.g., *Weiszmann v. Commissioner*, 483 F.2d 817 (10th Cir. 1973); *Sandt v. Commissioner*, 303 F.2d 111 (3d Cir. 1962); *Rombach v. United States*, 440 F.2d 1356 (Cl. Ct. 1971); *Lamb v. Commissioner*, 46 T.C. 539 (1966), *appeal dismissed*, 390 F.2d 157 (2d Cir. 1968).

77. See, e.g., *United States v. Michaelsen*, 313 F.2d 668 (9th Cir. 1963).

78. 39 T.C.M. (CCH) 138 (1979); cf. *Diaz v. Commissioner*, 70 T.C. 1067, 1070 n.3 (1978), *aff'd*, No. 79-4040 (2d Cir. June 25, 1979) (illustrating several levels of public school teaching assistant).

79. 39 T.C.M. (CCH) at 139.

80. The *Josephs* court borrowed the notion that the minimum-requirements test is to be applied separately to each position within a given trade from the opinion in *Davis v. Commissioner*, 65 T.C. 1014, 1020 (1976). See 39 T.C.M. (CCH) at 139.

81. *Johnston v. Commissioner*, 37 T.C.M. (CCH) 1112, 1113 (1978).

82. See *Jungreis v. Commissioner*, 55 T.C. 581, 586 (1970).

any one position to control the minimum educational requirements of an entire trade.

The second problem of the minimum-requirements test is encountered in answering the question "required by whom?" The regulation provides that the minimum requirements "must be determined from a consideration of such factors as the requirements of the employer, the applicable law and regulations, and the standards of the profession, trade, or business involved."⁸³ The troublesome cases typically involve individuals qualified for and actually practicing a profession who are required to obtain additional training upon moving to a new state or position;⁸⁴ the question is what standards represent the minimum education required of the "foreigner."⁸⁵ In practice, courts have looked at three distinct but irreconcilable sources to determine the minimum education required of a particular taxpayer: the requirements of the old place or employer, the requirements of the new place or employer, and the requirements normally found in the trade. *Laurano v. Commissioner*⁸⁶ illustrates the focus on the original employer or place of employment. In that case, the court allowed a teacher already certified in Toronto to deduct the cost of a course required for certification in New Jersey, her new home. Although the case may be based in part on a misreading of the regulation,⁸⁷ there is significant logical force in the proposition that once an individual has been deemed a member of the profession, satisfying the applicable requirements, any educational expense incurred afterward is undertaken "to preserve, not to expand or increase; to carry on, not to commence."⁸⁸ On the other hand, focusing on the old employer subsidizes individuals who initially become certi-

83. Treas. Reg. § 1.162-5(b)(2)(i) (1967).

84. See, e.g., *Sharon v. Commissioner*, 591 F.2d 1273 (9th Cir. 1978), cert. denied, 442 U.S. 941 (1979); *Laurano v. Commissioner*, 69 T.C. 723 (1978); *Antuna v. Commissioner*, 36 T.C.M. (CCH) 1778 (1977); *Horodysky v. Commissioner*, 54 T.C. 490 (1970); Rev. Rul. 71-58, 1971-1 C.B. 55. In some cases, however, the taxpayer has not moved. See *Toner v. Commissioner*, 71 T.C. 772 (1979), rev'd, 623 F.2d 315 (3rd Cir. 1980).

85. Several of these "foreigner cases" have been decided under the qualification-for-new-trade-or-business requirement. See, e.g., *Sharon v. Commissioner*, 591 F.2d 1273 (9th Cir. 1978), cert. denied, 442 U.S. 941 (1979). They are discussed at this point because the factual problem involved is the same.

86. 69 T.C. 723 (1978).

87. The court relied on the following sentence in the regulation: "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." See *id.* at 728 (quoting Treas. Reg. § 1.162-5(b)(2)(i) (1967)). This language, however, was intended to refer to changes made over time rather than to changes of location. See Treas. Reg. § 1.162-5(b)(2)(iii)(Ex. (1)) (Sit. 4) (1967); cf. *Robertson v. Commissioner*, 37 T.C. 1153 (1962) (decided under 1958 regulation).

88. *Hill v. Commissioner*, 181 F.2d 906, 909 (4th Cir. 1950).

fied or employed in the state or position invoking the fewest requirements, thereby gaining the tax advantage of a deduction for the cost of education subsequently undertaken to qualify elsewhere.

Focusing on the new location or employer eliminates the subsidization incentive, but introduces another problem in deciding who the new standard-setter is. Only when the taxpayer actually changes employment prior to audit or litigation would the minimum requirement be clear. In other cases, a fact-finder applying a "new place or employer" minimum-requirements test would have to guess where the taxpayer intends to work and whether he plans to change jobs.⁸⁹

Focusing on the third test, that of the normal educational requirements of the trade or profession, avoids the problems raised by the other two alternatives.⁹⁰ Under this test, an individual desiring to teach would not be able to deduct the cost of college by initially taking a job as a teacher in a parochial school that required teachers to have only a high school diploma, as is possible under the "old place or employer" alternative.⁹¹ Moreover, any speculation as to the taxpayer's intent would be avoided. The regulation itself⁹² encourages consideration of the normal requirements of the trade or profession; this approach represents the most sensible interpretation of the minimum-educational-requirements test in situations of changed employer or place of employment.

C. *Qualification for New Trade or Business.*

Section 1.162-5(b)(3), which disallows a deduction for any education "which will lead to qualifying [the taxpayer] in a new trade or business,"⁹³ is probably the most controversial and most litigated provision of the 1967 regulation. The section replaces language in the old

89. *Antuna v. Commissioner*, 36 T.C.M. (CCH) 1778 (1977), illustrates this problem. The taxpayer was a pediatric social worker, initially employed by Stanford University. She moved to Miami and took a position there, also as a pediatric social worker. Her new employer required a Master's Degree in Social Work for employment as a pediatric social worker and conditioned hiring Antuna on her receiving this degree. The court denied a deduction for the cost of the degree, holding that the determinant for the minimum-requirements test as "the requirements of a particular employer for a particular job." *Id.* at 1780. If Antuna had received her degree while employed at Stanford, the case, on its own reasoning, would have come out the other way.

90. Judge Chabot advocated this approach in his concurring opinion in *Toner v. Commissioner*, 71 T.C. 772, 784 (1979), *rev'd*, 623 F.2d 315 (3rd Cir. 1980), which denied a deduction for college courses to a parochial school teacher. Her employer's minimum requirement was a high school diploma, but the public schools required a college degree. 71 T.C. at 775, 778-79.

91. *Id.* Nor could an individual deduct the cost of law school by first practicing in a state such as Montana, where law school is not required to pass the bar. *See Vetrick v. Commissioner*, 37 T.C.M. (CCH) 392 (1978).

92. See text at note 83 *supra*.

93. Treas. Reg. § 1.162-5(b)(3) (1967).

section 1.162-5(b) that denied a deduction for the cost of "education undertaken primarily for the purpose of obtaining a new position or substantial advancement in position."⁹⁴ The new section seeks to preserve the practice of defining capital educational expenditures as those that benefit a new trade, instead of asking whether the expenditure will benefit more than one year. Treatment of expenses under the new regulation, however, indicates a departure from the current-trade/new-trade distinction as applied prior to the 1967 amendment. Two factors have contributed to this departure. The courts have been excessively strict in distinguishing between different "trades" that are in fact parts of the same trade. Furthermore, by adding the "lead to" language to the new-trade test and eliminating consideration of the taxpayer's purpose, the new regulation prohibits deductions in many cases in which the taxpayer neither leaves nor intends to leave his current trade.

The major formulation of what constitutes a new trade occurred in *Glenn v. Commissioner*⁹⁵ and *Davis v. Commissioner*.⁹⁶ The Tax Court held in these two cases that the activities the taxpayer was qualified to perform before attaining a particular degree, certificate, or title must be compared with his qualifications after receiving the degree. If a substantial difference exists, any education leading to the degree is nondeductible under the new-trade-or-business test.⁹⁷ *Glenn*, which denied a deduction for the expenses of a certified public accountant examination review course, held that uncertified public accountants and certified public accountants are engaged in different trades;⁹⁸ similarly, *Davis* implied that a social worker undertaking education that would qualify her to be a professor of social work was entering a new trade.⁹⁹

The *Glenn-Davis* test, as formulated, presents a sensible approach to determining what constitutes a new trade. In applying the test, however, the courts too often have found substantial differences between duties even though the positions are essentially within the same trade. *Glenn* exemplifies this approach.¹⁰⁰ The test has created particular dif-

94. T.D. 6291, 1958-1 C.B. 63, 67.

95. 62 T.C. 270 (1974).

96. 65 T.C. 1014 (1976). *Davis*, which denied a social worker a deduction for the cost of a degree required to become a professor of social work, was decided under the minimum-requirements test, but courts have relied on it in new-trade-or-business cases for its succinct restatement of the *Glenn* test: "If substantial differences exist in the tasks and activities of various occupations or employments, then each such occupation or employment constitutes a separate trade or business." *Id.* at 1019.

97. *Id.* at 1019; 62 T.C. at 275.

98. 62 T.C. at 275.

99. See 65 T.C. at 1020-21.

100. The *Glenn* court listed, as the two major factors that influenced its decision, the fact that state law allowed certified public accountants to engage in a tax practice as well as perform all

difficulties and unconvincing arguments in cases, including the "foreigner" cases,¹⁰¹ that should have been decided as minimum-requirements cases. The courts have held, for example, that an intern pharmacist is not engaged in the same trade as a registered pharmacist,¹⁰² that a parochial school teacher and a public school teacher are engaged in different trades,¹⁰³ and that a New York attorney and a California attorney are in different lines of work.¹⁰⁴ Although the *Glenn-Davis* comparison-of-duties test may be useful in some situations,¹⁰⁵ it becomes a less respected tool when used to reach the unsound results described above. The new-trade-or-business test has provoked further controversy because the regulation provides more liberal treatment for teachers than for other taxpayers. The regulation contains a series of examples¹⁰⁶ illustrating the proposition that "all teaching and related duties shall be considered to involve the same general type of work."¹⁰⁷ At least two of these examples clearly violate the *Glenn-Davis* test.¹⁰⁸

Application of the new-trade-or-business test is further complicated because the regulation speaks of education that will *lead to* qualifying the taxpayer in a new trade or business. This is the important new feature of the 1967 regulation. Any education that leads to qualification in a new trade or business is automatically nondeductible; the taxpayer is conclusively presumed to have undertaken the education for the purpose of qualifying for the new trade.¹⁰⁹ The new test thereby

functionary public accountants were allowed to perform, and that certified public accountants were generally considered to possess a higher degree of professional competence than uncertified public accountants. 62 T.C. at 275-76.

The notion that higher competence indicates the attainment of a new trade contrasts with the language in the regulation that the initial test for determining deductibility is whether the education maintains or improves skills. Treas. Reg. § 1.162-5(a)(1) (1967). Although the ability to engage in a tax practice is significant, this fact alone, when compared with the duties that both certified and uncertified public accountants are allowed to perform, should not be sufficient to designate the two groups as being engaged in different trades.

101. See text accompanying notes 83-92 *supra*.

102. *Antzoulatos v. Commissioner*, 34 T.C.M. (CCH) 1426 (1975).

103. *Toner v. Commissioner*, 71 T.C. 772 (1979), *rev'd*, 623 F.2d 315 (3rd Cir. 1980).

104. *Sharon v. Commissioner*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979).

105. See, e.g., *Reisinger v. Commissioner*, 71 T.C. 568 (1979) (licensed practical nurse to physician's assistant); *Hogue v. Commissioner*, 37 T.C.M. (CCH) 126 (1978) (hospital orderly and ward clerk to hospital administrative assistant).

106. Treas. Reg. § 1.162-5(b)(3) (1967).

107. *Id.*

108. See *id.*, examples (c) (classroom teacher to guidance counselor) and (d) (classroom teacher to principal). See also Rev. Rul. 68-580, 1968-2 C.B. 72.

109. See *Games v. Commissioner*, 35 T.C.M. (CCH) 1415, 1418 (1976). The new regulation essentially adopts the Commissioner's interpretation of the old regulation. See Rev. Rul. 60-97, 1960-1 C.B. 69, 73-74. The taxpayer need not actually acquire the degree, certificate, or title in order for a disputed educational expenditure to be rendered nondeductible. In *Glenn v. Commis-*

purports to avoid the dilemma encountered under the 1958 regulation of trying to determine whether an individual intends to remain in his old profession, or to use his education to move on to greener pastures.

This "lead to" element of the new-trade-or-business test, however, has failed in practice to eliminate consideration of the taxpayer's intent because the courts have been unable to apply the test in a reasonable and objective manner. In many cases, of course, it is clear that the education leads to a particular trade or business, as illustrated by law school and by certified public accountant exam review courses. In many other cases, however, education is helpful in the pursuit of a variety of trades. Theoretically, no deduction would be allowed in these latter cases because the education would qualify the taxpayer for *some* new trade regardless of the business he was previously engaged in. The cost of an undergraduate education, therefore, typically would be non-deductible given the great variety of occupations requiring bachelors' degrees of entry-level job candidates.¹¹⁰ The combination of a narrow definition of trade or business under the *Glenn-Davis* test and a broad interpretation of what leads to a new trade seems to jeopardize most potential deductions.¹¹¹

In fact, however, the courts sometimes have allowed deductions even when the education arguably led to qualifying for a new trade or business. In *Cooper v. Commissioner*,¹¹² for example, the court denied an unlicensed accountant a deduction for accounting courses because the courses would lead to qualifying him to sit for the certified public accountant exam. The court allowed a deduction to the same taxpayer, however, for the cost of mathematics, finance, and economics courses which the court found would be useful in advising his clients. The court did not mention that these courses might lead to qualifying the taxpayer as a mathematician, stockbroker, or financial analyst.

sioner, 62 T.C. at 276-77, for example, the court held that the review course led to a new trade even though Glenn failed to pass the certification exam.

110. See *Anahehn Paper Mill Supplies, Inc. v. Commissioner*, 37 T.C.M. (CCH) 403, 406 (1978) ("Receipt of an undergraduate degree qualified [an employee] for any number of occupations that were substantially different from his employment"). Deductions for the cost of undergraduate degrees thus appear to be unobtainable under the 1967 regulation. See, e.g., *Thorbahn v. Commissioner*, 38 T.C.M. (CCH) 342 (1979); *Cangelosi v. Commissioner*, 36 T.C.M. (CCH) 1070 (1977); *Garwood v. Commissioner*, 62 T.C. 699 (1974). *Glasgow v. Commissioner*, 486 F.2d 1045 (10th Cir. 1973), the one case allowing a deduction for an undergraduate degree, was decided under the 1958 regulation.

111. See, e.g., *Josephs v. Commissioner*, 39 T.C.M. (CCH) 138, 139 (1979) (engineering courses qualified engineering technician to take exam to become certified professional engineer, held to be a new trade).

112. 38 T.C.M. (CCH) 955 (1979).

In *Randick v. Commissioner*¹¹³ the court indicated in dictum that it might allow an attorney to deduct the cost of several accounting courses.¹¹⁴ Nowhere did the court mention that these courses could lead to qualifying the taxpayer as an accountant. In *Kosmal v. Commissioner*¹¹⁵ a Los Angeles Deputy District Attorney took Spanish lessons to help him interview Spanish-speaking witnesses and crime victims. The court allowed a deduction for the cost of the lessons, without addressing whether the education may have led to qualifying the taxpayer for a new career as an interpreter.

The holdings in those cases, however, conflict with others in which deductions have been denied on similar facts. For example, *Cooper*, in which the court permitted an accountant's deduction for mathematics and finance courses, contrasts with *Cangelosi v. Commissioner*,¹¹⁶ in which the court denied a computer programmer a deduction for courses leading to a bachelor's degree in mathematics. The court acknowledged that the courses improved his skills as a computer programmer, but found that the education qualified the taxpayer for a new, but unnam'd, trade.¹¹⁷ The dictum in *Randick* intimating that the court might allow an attorney a deduction for the cost of accounting courses contrasts with *Cooper's* denial of a deduction to an accountant for the cost of accounting courses. Finally, *Kosmal*, in which an attorney was allowed to deduct the cost of Spanish lessons, contrasts with *Garwood v. Commissioner*,¹¹⁸ in which the court denied a deduction to a substitute teacher for the expenses of earning a French degree. One basis for the decision was that the education qualified Garwood for the new trade of interpreter.¹¹⁹

The major distinction between cases allowing deductions and cases denying them on the basis of leading to a new trade, when the existence of the new trade is not obvious, is the court's perception of how the taxpayer is likely to use the education. The *Randick* court acknowledged that had it known more facts, it would have been influenced by *Randick's* motives in taking the accounting courses.¹²⁰

113. 35 T.C.M. (CCH) 195 (1976).

114. *Id.* at 198-99. The court did not reach the question because the taxpayer failed to carry his factual burden. *Id.*

115. 39 T.C.M. (CCH) 651 (1979), *appeal docketed*, No. 5637-78 (9th Cir. May 6, 1980).

116. 36 T.C.M. (CCH) 1070 (1977).

117. *Id.*

118. 62 T.C. 699 (1974).

119. *Id.* at 703.

120. 35 T.C.M. (CCH) at 199. *See also* Thorbahn v. Commissioner, 38 T.C.M. (CCH) 342 (1979), denying a deduction for a psychology degree. The court noted that although the taxpayer's primary purpose in pursuing the degree was irrelevant under the 1967 regulation, his intent to

In short, the assumption that an attorney taking Spanish lessons does not generally intend to become an interpreter does influence the court's decision whether the education leads to qualifying the taxpayer for a new trade or business. The court might be more suspicious of an interpreter, working for the Los Angeles District Attorney's office, who took a few law courses to help him interview crime victims and witnesses, even though the situation seems essentially the same as *Kosmal*.

This covert resurrection of the investigation of the taxpayer's purpose, with the resulting inconsistencies, is perhaps the most disturbing problem that has arisen under the 1967 regulation, given the regulation's goal of making objective the determination of the deductibility of educational expenses.¹²¹ In order to place some boundary on what leads to a new trade, the courts have continued to examine the taxpayer's likely purpose. This fact, and other difficulties with the regulation, suggest that alternative ways of dealing with the deductibility of educational expenses should be considered.

III. ALTERNATIVE TREATMENTS OF EDUCATIONAL EXPENSES¹²²

A. Overview.

The 1967 version of section 1.162-5,¹²³ by abandoning the primary-purpose test, was intended to decrease the amount and complexity of litigation concerning business deductions for educational expenses. Many thought it provided more liberal treatment of these expenditures than the 1958 regulation had offered.¹²⁴ The 1967 regulation has failed, however, to live up to expectations. Educational expenses continue to comprise one of the most litigated areas in taxation.¹²⁵ Although the primary-purpose test is no longer officially part of the regulation, the taxpayer's intent is still relevant in determining whether he is carrying on a trade or business,¹²⁶ and has infiltrated

pursue a management position with the degree tended to "highlight" that the education qualified him for a new trade. *Id.* at 345.

121. See note 57 *supra* and text accompanying notes 53-59 *supra*.

122. The discussion will focus on alternatives that provide a more accurate measurement of net income, rather than on means of supporting and encouraging education or of providing relief to taxpayers with children in college. For discussion of the latter topic, see McNulty; Zinman, *Educational Expense: Deduction, Capital Expenditure or Credit*, 27 TAX EXECUTIVE 17 (1974); Wolfman, *The Cost of Education and the Federal Income Tax*, 42 F.R.D. 535 (1966) (presented to the 3d Circuit Judicial Conference, Sept. 9, 1966).

123. Treas. Reg. § 1.162-5 (1967).

124. See authorities cited in notes 60-61 *supra*.

125. Samuels & Samuels, *supra* note 6. The number of reported cases dealing with § 1.162-5 has not decreased appreciably under the 1967 version. In fact, the largest number of cases reported in a single year occurred in 1978.

126. See note 57 *supra*.

the determination of such issues as whether minimum requirements have been satisfied¹²⁷ and whether education is leading to a new trade.¹²⁸ Furthermore, the new regulation continues to present confusing and sometimes illogical results. One revenue ruling, for example, states that deductions are permissible for unaccredited correspondence courses in law, but not for courses taken at an accredited law school.¹²⁹ This subsidizes the very education that the Service regards as of a lesser quality. The narrow definition of trade or business,¹³⁰ and the denial of deductions under the new-trade-or-business test to individuals who clearly intend to remain in their old trade,¹³¹ have belied the predictions of increased liberality. The fact that some groups, particularly teachers, receive more favorable treatment than others has led to confusion in the cases and attacks on the perceived arbitrariness of the regulation.¹³²

B. *Elimination of the New-Trade-or-Business Test.*

Most of the problems encountered under the 1967 regulation arise from the new-trade-or-business test. The definition of what constitutes a new trade, and the "leads to" element of the test, are especially troublesome¹³³ and make the current section 1.162-5 less beneficial to the taxpayer than its predecessor. Moreover, the denial of a deduction for expenses of non-minimum-requirement education that is helpful to a taxpayer's current business—denied because that education also happens to lead to a different trade—is conceptually undesirable, especially when the taxpayer does not intend to enter the new trade or when the education is required by the current employer.¹³⁴

Eliminating the new-trade-or-business test would result in more equitable treatment of educational expenses without opening the flood-

127. See note 89 *supra* and accompanying text.

128. See text accompanying notes 112-20 *supra*.

129. Rev. Rul. 76-62, 1976-1 C.B. 12. The distinction is that unaccredited courses do not lead to qualifying the individual to take the bar exam.

130. See notes 96 and 100 *supra* and text accompanying notes 95-108 *supra*.

131. See, e.g., *Anderson v. United States*, 75-2 U.S. Tax Cas. ¶ 9578 (N.D. Cal. 1975); *Reed v. Commissioner*, 37 T.C.M. (CCH) 1508 (1978); *O'Donnell v. Commissioner*, 62 T.C. 781 (1974), *aff'd*, 519 F.2d 1406 (7th Cir. 1975). This classification includes those individuals required by their employer to undertake the education for which the deduction is denied. See *Ardavany v. Commissioner*, 38 T.C.M. (CCH) 569 (1979); *Roussel v. Commissioner*, 38 T.C.M. (CCH) 565 (1979).

132. See, e.g., *Melnik v. United States*, 521 F.2d 1065 (9th Cir. 1975), *cert. denied*, 425 U.S. 911 (1976); *Gaines v. Commissioner*, 35 T.C.M. (CCH) 1415 (1976); *O'Donnell v. Commissioner*, 62 T.C. 781 (1974), *aff'd*, 519 F.2d 1406 (7th Cir. 1975); *Weiszmann v. Commissioner*, 52 T.C. 1106, 1111-12 (1969). See also R. GOODE 82.

133. See text accompanying notes 93-121 *supra*.

134. See *Roussel v. Commissioner*, 38 T.C.M. (CCH) 565 (1979).

gates to a great number of unjustified deductions. An examination of cases denying deductions under the new-trade-or-business test reveals that if the test were eliminated, most deductions would still be denied because of the application of the remaining requirements of the regulation. But in cases in which eliminating the new-trade-or-business test would change the result, the change would be appropriate.

Many of the new-trade-or-business cases that contain the most questionable definitions of what constitutes a new trade, including the foreigner cases¹³⁵ and other apprenticeship cases,¹³⁶ would be more appropriately decided under the minimum-requirements test.¹³⁷ Some of the other cases holding that the taxpayer is qualifying for a new trade or business could be decided instead on the ground that the taxpayer is not yet established in his trade.¹³⁸ Finally, a large number of cases denying deductions under the new-trade-or-business test could reach the same result by holding that the education fails to bear a direct and proximate relationship to the taxpayer's business duties.¹³⁹ This would be the outcome, for instance, in many of the cases in which a taxpayer not professionally involved in the law seeks a deduction for the cost of attending law school.¹⁴⁰

Eliminating the new-trade-or-business test would allow deductions in cases in which the education is related to the taxpayer's trade but also leads to qualification in what courts now might consider a new trade. In fact, many cases decided under this test involve questionable holdings regarding whether the position the education led to was actually in a separate trade.¹⁴¹

135. See, e.g., *Sharon v. Commissioner*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979); *Toner v. Commissioner*, 71 T.C. 772 (1979), *rev'd*, 623 F.2d 315 (3rd Cir. 1980); Rev. Rul. 75-412, 1975-2 C.B. 62. See text accompanying notes 83-92 *supra*.

136. See, e.g., *Johnston v. Commissioner*, 37 T.C.M. (CCH) 1112 (1978); *McDermott v. Commissioner*, 36 T.C.M. (CCH) 144 (1977); *Antzoulatos v. Commissioner*, 34 T.C.M. (CCH) 1426 (1975); *Garwood v. Commissioner*, 62 T.C. 699 (1974). See text accompanying notes 70-82 *supra*.

137. See text accompanying notes 100-08 *supra*.

138. See note 57 *supra*. Cf. *Wassenaar v. Commissioner*, 72 T.C. 1195 (1979) (decided on both grounds).

139. See, e.g., *Fleischer v. Commissioner*, 403 F.2d 403 (2d Cir. 1968) (entertainer obtained psychology degree); *Ramella v. Commissioner*, 38 T.C.M. (CCH) 747 (1979) (printer took real estate courses); *Hogue v. Commissioner*, 37 T.C.M. (CCH) 126 (1978) (ward clerk obtained degree in hospital administration); cf. *Anaheim Paper Mill Supplies, Inc. v. Commissioner*, 37 T.C.M. (CCH) 403 (1978) (decided on both grounds).

140. See, e.g., *Bouchard v. Commissioner*, 36 T.C.M. (CCH) 1098 (1977) (math professor); *Dimsmore v. Commissioner*, 36 T.C.M. (CCH) 1008 (1977) (computer assistant project manager); *Bodley v. Commissioner*, 56 T.C. 1357 (1971) (vocational school teacher); Rev. Rul. 72-450, 1972-2 C.B. 89 (artillery officer).

141. See, e.g., *Josephs v. Commissioner*, 39 T.C.M. (CCH) 138 (1979) (engineer and certified professional engineer); *Cangelosi v. Commissioner*, 36 T.C.M. (CCH) 1070 (1977) (computer

The results in a number of law school cases would also be altered when the taxpayer's current trade was somehow law-related. Again, an examination of the facts of such cases reveals that the change would be justified, because the education is required by the employer¹⁴² or because the taxpayer continues to engage in the old trade. In *O'Donnell v. Commissioner*,¹⁴³ for example, the court denied a deduction for the cost of a legal education to an accountant employed in the tax department of a major accounting firm. His employer encouraged the accountants in the department to obtain law degrees, and a substantial majority of the taxpayer's co-workers had done so. Examples of other cases in which deductions for legal education previously denied would be allowed if the new-trade-or-business test were eliminated involve a history professor,¹⁴⁴ a medical expert in medical malpractice litigation,¹⁴⁵ and a judge.¹⁴⁶ In all but one of these cases the taxpayer used his new knowledge in his previous employment, rather than embarking on a new career in law.¹⁴⁷

Of course, a taxpayer sometimes undertakes a course of study in order to change from one related business to another. Given the education's nexus to the initial business, however, deductibility should not be denied. The primary-purpose test and the new-trade-or-business test both fail to provide reasoned and manageable approaches to such situations. Eliminating the new-trade-or-business test would abandon the search for a means of disqualifying deductions for education that aids a taxpayer in both current and future employment. Rather, it would recognize that once an individual meets the minimum requirements of the profession in which he is engaged, he is entitled to a deduction for any subsequent education that aids him in that profession, whether or not it also enables him eventually to change to another related business.¹⁴⁸

Taxpayers whose deductions have been the subject of litigation¹⁴⁹

programmer and unspecified new trade resulting from acquisition of math degree); *Glenn v. Commissioner*, 62 T.C. 270 (1974) (accountant and certified public accountant).

142. See *Ardavany v. Commissioner*, 38 T.C.M. (CCH) 569 (1979).

143. 62 T.C. 781 (1974). See also *Taubinan v. Commissioner*, 60 T.C. 814 (1973).

144. *Reed v. Commissioner*, 37 T.C.M. (CCH) 1508 (1978).

145. *Anderson v. United States*, 75-2 U.S. Tax Cas. ¶ 9578 (N.D. Cal. 1975).

146. *Carter v. Commissioner*, 39 T.C.M. (CCH) 350 (1979).

147. The exception is *Carter*; the judge was defeated for reelection after graduating from law school.

148. See *Commissioner v. Johnson*, 313 F.2d 668, 672 (9th Cir. 1963); *Wolfman*, *supra* note 122, at 546.

149. See *Diaz v. Commissioner*, 70 T.C. 1067 (1978), *aff'd*, 607 F.2d 995 (2d Cir. 1979); *Dinsmore v. Commissioner*, 36 T.C.M. (CCH) 1008 (1977); *Feistman v. Commissioner*, 63 T.C. 129 (1974).

have unsuccessfully proposed two compromises between the current system and elimination of the new-trade-or-business test. Both alternatives would significantly narrow the scope of the "leads to" language. The first method, the "last-step" test, would not consider education as qualifying the taxpayer for a new trade unless and until the taxpayer actually completes all requirements for qualification in the trade. Advocates of this test include individuals who pursue education leading to a new trade but do not pass certification exams for the trade.¹⁵⁰ Another alternative is the degree-nondegree test, which would allow a deduction for educational expenses to students who are not candidates for degrees.¹⁵¹ These two proposals would effectuate the current test's goal of denying deductions to individuals undertaking education in order to change their occupations, but contrary to the current approach, would allow deductions to those who will not actually change trades.

Adoption of either the last-step test or the degree-nondegree test, however, would pose enforcement problems. The outcome of each case would be dictated by the time at which the determination is made. A taxpayer will ordinarily not have entered a new trade at the time a deduction is taken, but he may decide to take the last step toward certification or change from nondegree to degree status at some later date. A recapture provision, in which any deduction taken would be added back into income if the taxpayer completes the last step, would help alleviate this problem, but would operate imperfectly because of the time value of money¹⁵² and simple problems of enforcement.

Both alternatives to outright elimination of the new-trade-or-business test admittedly present problems, but these problems should be evaluated in comparison with the current system. The new-trade-or-business test contains inequities of its own which make it less desirable than the proposed alternatives. The common feature of the new-trade-or-business test and its alternatives is that each operates as an attempt to forecast how the taxpayer will use the education. The essential difference is that the current new-trade-or-business test errs further in this forecast on the strict side of the primary-purpose test than do the alternatives. A still better solution, however, is to recognize that the maintains-or-improves-skills and minimum-requirements tests are sufficient, and to eliminate the new-trade-or-business test entirely.

150. See *Diaz v. Commissioner*, 70 T.C. 1067 (1978), *aff'd*, 607 F.2d 995 (2d Cir. 1979); *Dinsmore v. Commissioner*, 36 T.C.M. (CCH) 1008 (1977).

151. See *Feistman v. Commissioner*, 63 T.C. 129 (1974).

152. Dishonest taxpayers thus could use the last-step test as an interest-free loan for part of the cost of education.

C. *Capitalization and Amortization.*

The last-step test, the degree-nondegree test, and outright elimination of the new-trade-or-business test would all improve the tax treatment of educational expenses. Focusing solely on these alternatives, however, overlooks the broader problem. The major flaw in section 1.162-5 is not its inconsistency, its broad definition of "new trade," or its susceptibility to subjective considerations, but rather its failure to comport with a theoretically sound treatment of educational expenses as capital expenditures. The proper treatment for most educational expenditures, assuming that they satisfy the reasonable-nexus test and are thereby deemed business-related,¹⁵³ is to capitalize the expenditure and amortize the cost over the useful life of the education.

Errors in the definition and treatment of capital educational expenditures distinguish the current regulation from a proper characterization of educational expenses. These errors result in excessively liberal treatment of some expenditures and excessively strict treatment of others. The definitional error lies in the regulation's adoption of the *Coughlin* court's current-business/new-business test¹⁵⁴ to distinguish current from capital expenditures. The proper distinction, however, depends not on whether the expenditure will benefit a new or old trade, or will satisfy the minimum requirements to engage in a business, but rather on the number of years the expenditure will benefit. An amount spent to benefit one period is a current expense and should be deductible as an ordinary and necessary business expense.¹⁵⁵ If the expenditure benefits a number of periods, it is a capital expenditure—which falls outside the scope of section 162 of the Internal Revenue Code.¹⁵⁶ In fact, nearly all educational expenditures will benefit more than a single tax period, and are therefore capital in nature.

153. The approach the regulation takes in attempting to distinguish between personal and business expenditures is the most satisfactory method of making this determination, even though it may not be theoretically correct. By demonstrating either that the education is required by the employer or that it satisfies the reasonable-nexus test, the taxpayer makes a sufficient showing that the expenditure is business-related rather than personal. The alternative to this approach is the 1958 regulation's examination of the taxpayer's primary purpose. The problems with this alternative are well illustrated in Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859, 866-76 (1974).

154. See text accompanying note 32 *supra*.

155. I.R.C. § 162(a).

156. "A capital expenditure is not deductible as an 'ordinary' business expense. It is well-settled that money paid out for the acquirement of something of permanent use or value in one's business is a capital investment and not deductible from income as an 'ordinary' business expense." *Acer Realty Co. v. Commissioner*, 132 F.2d 512, 514 (8th Cir. 1942). See I.R.C. § 263; Zinman, *supra* note 122, at 24.

The error in treatment of educational expenses is the failure to allow the taxpayer at any time to deduct those expenditures deemed capital. Normally capital expenditures are viewed as giving rise to assets, tangible or intangible, that will be useful to the taxpayer for some amount of time in excess of one year. The proper tax treatment for such expenditures, when business-related, is to depreciate or amortize them over the useful life of the asset.¹⁵⁷ Under the current regulation, however, educational expenditures that are classified as capital are not treated in the same manner as expenditures for other capital assets. Rather than allowing depreciation of the expenditure over the useful life of the education, the Service permits no deduction at all.¹⁵⁸ Professor Richard Goode analogizes the current treatment of educational expenditures to a system in which deductions are allowed for the maintenance, repair, and replacement of physical capital already in use, but not for the cost of establishing new companies or products or of enlarging an existing business.¹⁵⁹ Over the years, a number of scholars have advocated capitalization and amortization of educational expenditures as the proper method of handling these expenses.¹⁶⁰ This proposal is consistent with proper accounting theory and with the handling of other capital expenditures. A theoretically defensible system would operate as follows:

(1) All educational expenditures that bear a direct and proximate relationship to the taxpayer's trade or business would be capitalized.

(2) The capitalized expenditure would be amortized over a period extending from the date of the expenditure (or entry into the business, whichever is later) until a specified presumed retirement age, such as sixty-five.

(3) The annual deduction would be limited by the amount of income from the trade (or new trade which also satisfies the reasonable-nexus test in step (1)). The outstanding basis would be reduced by the full amount of the deduction as determined from the original basis and useful life, even if this amount exceeds the income from the trade.

(4) The cost of education received by the taxpayer as a gift would be capitalized in the same manner as education paid for by the tax-

157. See I.R.C. §§ 167, 178, 189. The fundamental accounting principle of matching underlies this treatment: net income is properly measured by deducting from gross income expenditures incurred in producing that income. As a capital expenditure assists in producing income in a number of periods, the cost of the expenditure should be divided among each of the periods benefited in order to reflect net income correctly.

158. See Treas. Reg. § 1.162-5(b) (1967).

159. R. GOODE 82-83.

160. See, e.g., R. GOODE 83; Halperin, *supra* note 153, at 903; McNulty 26; Wolfman, *supra* note 122, at 547.

payer. Educational costs not incurred, due to receipt of a scholarship, would not be capitalized.

(5) A loss would be allowed in the year of the taxpayer's death in the amount of any remaining unamortized educational expense.

The capitalization scheme proposed above addresses a number of subsidiary issues, such as what types of educational expenses should be capitalized, what useful life should be used, and how the capitalized expenditure should be treated upon the taxpayer's death.

1. *The Types of Educational Expenses That Should Be Capitalized and Amortized.* The reasonable-nexus test, used by the current regulation to distinguish between business-related and personal educational expenditures,¹⁶¹ is also a satisfactory means of identifying educational costs that should be capitalized. The test would allow capitalization of professional and vocational educational expenditures, and deny capitalization of the cost of elementary and high school education.¹⁶² The cost of a college undergraduate education, however, presents a more difficult case. A general liberal arts education would fail the reasonable-nexus test in most instances,¹⁶³ but a degree in a vocational field such as business, engineering, or nursing is arguably business-related. Permitting a vocational major to amortize the entire cost of his education although the liberal arts major receives no such deduction would undoubtedly strike many people as inequitable, however, because some part of the former's education is undoubtedly personal and some part of the latter's education is probably business-related. This perceived inequity might lead to congressional intervention granting or denying amortization for all college expenditures despite the theoretical flaws of such an approach. A more limited method would allow amortization only of those costs associated with individual courses, or courses from particular departments, that satisfy the reasonable-nexus test. This method would not be simple to administer,¹⁶⁴ but it would be prefera-

161. See note 153 *supra* and accompanying text.

162. See *Kroll v. Commissioner*, 49 T.C. 557 (1968), which involved the cost of a child actor's attendance at a private school. That pre-college education is general in nature and available free of charge also argues against its capitalization. Allowing the capitalization and amortization of such education would act primarily as a mild incentive to attend private schools. R. GOODE 86.

163. A general education undoubtedly makes any individual better at his profession, but unless particular skills related to the taxpayer's business are maintained or improved, the personal element of the education predominates. *Carroll v. Commissioner*, 51 T.C. 213, 218 (1968), *aff'd*, 418 F.2d 91 (7th Cir. 1969). The taxpayer should, of course, be given the opportunity to rebut the presumption that a liberal arts education is personal. Consider, for example, a foreign language major who becomes an interpreter or a fine arts major who takes a job restoring artwork.

164. See Halperin, *supra* note 153, at 904.

ble to a blanket grant or denial of amortization of undergraduate education.

2. *The Period Over Which the Education Should Be Amortized.* A common explanation for the failure to grant capital educational expenditures the same treatment accorded other capital expenditures is that unlike a factory, building, or machine, the useful life of an education is relatively indeterminable.¹⁶⁵ There is merit to this argument, but the point is weakened by the Code's present allowance of amortization of other expenditures whose useful life is indeterminable, such as the organizational expenditures of a business and research and experimental expenditures.¹⁶⁶ The relevant question is not whether the useful life of the expenditure can be determined with certainty, but rather what period of time will best approximate the useful life.

Three methods have been suggested for measuring the useful life of a capital expenditure in education: the normal retirement age in the industry in which the taxpayer is employed,¹⁶⁷ the expected lifetime of the taxpayer,¹⁶⁸ and a standard assumed retirement age such as sixty-five.¹⁶⁹ Of the three methods, the selection of a single assumed retirement age provides the best compromise between accuracy and simplicity. The other methods would involve the use of actuarial tables or computed retirement ages for separate industries with cumbersome calculations by the Service or the taxpayer. A single retirement age of sixty-five would avoid this burden and, because most individuals will retire at about that age, still result in a reasonably accurate base.

165. Wolfman, *supra* note 21, at 1093; Comment, *The Deductibility of Educational Expenses: Administrative Construction of Statute*, 17 BUFFALO L. REV. 182, 210 (1967).

166. I.R.C. §§ 174, 248. One recent case rejected an argument for the amortization of the cost of a bar review course, but allowed amortization of the bar exam fee. *Sharon v. Commissioner*, 66 T.C. 515, 527-31 (1976), *aff'd*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979).

167. Wolfman, *supra* note 122, at 547.

168. The taxpayer in *Sharon v. Commissioner*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979), advocated this method. The method is used to account for fees paid by physicians to acquire hospital privileges. *Walters v. Commissioner*, 383 F.2d 922, 924 (6th Cir. 1967); *Heigerick v. Commissioner*, 45 T.C. 475, 478-79 (1966); *Howard v. Commissioner*, 39 T.C. 833, 838-39 (1963).

169. The taxpayer in *Denman v. Commissioner*, 48 T.C. 439, 441 (1967), unsuccessfully urged this approach. Some have suggested that a shorter time period, such as twenty years, be used for purposes of simplicity. See R. GOODE 87; McNulty 32. Even shorter periods could be applied if the education was used in certain favored employments, such as government service. Zinman, *supra* note 122, at 25. While an accelerated write-off may have merit as a means of encouraging people to invest in education or enter certain trades, its use for such purposes is beyond the scope of this Comment, which focuses on the proper measurement of net income.

3. *The Income Against Which the Expenditure Should Be Amortized.* Although the amortization of educational expenses arguably should be deductible against all taxable income, as are most other business expenses,¹⁷⁰ most proposals rightly suggest that the deduction only be allowed to offset earned income or income from the business activity which the education maintains.¹⁷¹ Limiting the deduction to income from activities the education benefits would be consistent with a determination under the reasonable-nexus test that the education was obtained for business rather than for personal purposes. If the education appeared to be business-related, but was not actually used in the relevant business, limiting the deduction to income from business activity benefited by the education would operate to deny the deduction. For example, although law school ordinarily would be presumed to be business-related, a deduction limited to income from the activity the education supports would serve objectively to separate those who attend law school for its value as a liberal arts education from those who enter into legal practice.¹⁷²

A related issue is the question of what amount should be subtracted from the basis in the educational asset when the amount of income from the business against which amortized expenses can be deducted would limit the deduction to an amount lower than could otherwise be taken. This situation arises when a taxpayer suspends employment for a period of time or changes to an unrelated job. The taxpayer could either be allowed to subtract from the basis only the amount actually deducted, thereby preserving the rest for deduction at a later date, or be required to subtract the maximum amount that would have been deducted had there been sufficient income from the relevant trade. The latter method, which treats the amount not deducted as "unused" education, the benefit of which is lost forever, is preferable. The first method provides a somewhat greater benefit to the taxpayer, and is more accurate in the sense that the education is not unused, but rather is used at a later time. In the usual case, however, when the absence from work is short and the career is long enough that

170. McNulty 31.

171. See R. GOODE 86; McNulty 30-31; Zinman, *supra* note 122, at 25.

172. This approach appropriately resembles the treatment accorded hobby income. Expenditures incurred for both education and alleged hobbies may be made for either personal or business reasons, or for a combination of the two. In the case of hobbies, the difficulty of determining a taxpayer's motivation prompted Congress to enact section 183, which allows deductions derived from an activity to the extent of income from the activity, even if the activity is not engaged in for profit. The inquiry into the taxpayer's intent is thereby avoided.

An alternative to limiting the education deduction to income from the appropriate business is to use earned income as the limit. This method provides slightly less protection than the method used for hobbies, but is simpler to administer.

the lost deduction is minimal, the simplicity of the second method countervails. Its superiority becomes even more apparent when the proper treatment of the basis remaining at the taxpayer's death is considered.¹⁷³

4. *Should Deductions Be Allowed Taxpayers Who Did Not Pay for the Education They Received?* Under current tax laws, an individual who receives an asset as a gift is entitled to a depreciation deduction against the basis of the asset as determined after the transfer¹⁷⁴ even though the asset cost the taxpayer nothing. The question thus arises whether to allow amortization for education received by the taxpayer but not paid for by him.¹⁷⁵ This situation occurs when the taxpayer's parents pay for his education, when the taxpayer receives a scholarship, and when the taxpayer attends a service academy at no cost. Amortization is theoretically justifiable when the education is paid for by the student's family but not when it is paid for by scholarship or when there is no tuition. Education paid for by the family is like a gift; scholarship-paid or cost-free education, however, is more in the nature of a reduction in the selling price of the asset. The situation is analogous to one in which the purchaser of a capital asset makes a good buy. His basis is determined by the price he actually pays, not by the prevailing market price that he was able to reduce. The student attending school on a scholarship essentially purchases his education on sale and should not be allowed to amortize the education using a basis applicable to the normal purchaser.

5. *Treatment of Unamortized Educational Costs Upon the Taxpayer's Death.*¹⁷⁶ When a physical asset used in a business is destroyed or becomes obsolete before it has been fully depreciated, the asset is written off and a loss recognized.¹⁷⁷ If education is viewed as a capital asset, similar treatment is appropriate upon the death of a taxpayer who has failed to amortize all of his educational costs before dying.¹⁷⁸ The remainder of the unamortized expense could be written off in the taxpayer's last taxable year, with appropriate carryback of any result-

173. See text accompanying notes 177-80 *infra*.

174. See I.R.C. §§ 167, 1014.

175. For a case presenting this problem, but decided on traditional grounds, see *Denman v. Commissioner*, 48 T.C. 439 (1967).

176. This discussion assumes that the issue is resolved when the taxpayer dies, rather than when he retires. Unlike retirement, death forecloses the possibility that the taxpayer will reenter the labor force at a later date. *Cf.* R. GOODE 87 (reference to later reentry of married women into work force).

177. I.R.C. § 165.

178. R. GOODE 87; McNulty 32.

ing net operating loss.¹⁷⁹

It is important to observe that whether to allow recognition of a loss at the taxpayer's death in the amount of the basis of unamortized expense is related to the question whether to subtract from that basis, throughout the taxpayer's life, amounts not deducted because of limited income against which amortized expenses could be deducted.¹⁸⁰ If unused deductions were carried forward during the taxpayer's life, individuals who incurred a particular educational expense for personal use would probably carry a significant balance of unamortized educational expense at their deaths. Granting a write-off of the unamortized expense under these circumstances would allow a business deduction for a personal expense. To some extent, this would diminish the effectiveness of limiting the deduction to earned income or income from the activity as a means of separating business from personal educational expenses in the first place.

Under the preferred system, in which deductions not taken are subtracted from the basis and lost, the recognition of a casualty loss upon death would include personal educational expenses to a significantly lesser degree. The most equitable approach, then, is to allow the recognition of a casualty loss of unamortized educational expenses upon the death of the taxpayer in conjunction with reducing the basis of the educational cost by the full annual amortizable amount, whether or not such amount is fully deductible.

IV. CONCLUSION

Despite major attempts in 1958 and 1967 to clarify the tax treatment of educational expenses, the area remains one of the most litigated and confused in the Internal Revenue Code. Eliminating the new-trade-or-business test, the prime contributor to the controversy surrounding educational expenses, offers a practical solution to the problems. The test sweeps too broadly in disqualifying otherwise deductible expenditures¹⁸¹ and has been marked by inconsistent application.¹⁸² Eliminating the test would go far in providing a more equitable treatment of the expenses of education.

Although the proposed elimination of the new-trade-or-business test is a practical solution to the problems associated with the tax treatment of educational expenditures, it is only a partial response. By fail-

179. See I.R.C. § 172.

180. See text accompanying notes 170-73 *supra*.

181. See notes 93-111, 141 *supra* and accompanying text.

182. See note 108 *supra* and text accompanying notes 107-08 *supra*.

ing to provide for the amortization of capital educational expenditures, it still falls short of a proper theoretical treatment. Amortization, advocated by scholars for a number of years, would treat both government and taxpayer fairly by denying to each the windfalls now available from improper definition and treatment of capital expenditures. Adopting a system in which business-related educational costs are capitalized and amortized over the useful life of the education would treat educational expenses in a manner that is theoretically sound and consistent with the tax treatment of other business assets.

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