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THE DEDUCTIBILITY OF EDUCATION EXPENSES:
OCCUPATIONAL HAZARD?

by

Kathleen M. Weiden* and Helen F. Tomasko**

INTRODUCTION

In his book, *The Wealth of Nations*, Adam Smith identifies four canons of taxation, by which to evaluate a tax system.¹ These canons are: equality, convenience, economy and certainty. Equality means that a taxpayer is treated fairly and equitably by the payment of taxes in proportion to his or her income level. Convenience represents simplicity in administration of the tax system, which impacts compliance. Economy refers to the collection of tax revenue in the most cost efficient manner possible. Certainty means the ability of taxpayers to predict the effect of the tax structure on their affairs.

Beyond paying taxes in proportion to one's income, equality should also imply that taxpayers in similar situations should receive the same treatment under the tax laws. This paper addresses the issue of equality *in practice* by examining the record of judicial and administrative decisions, with respect to the deductibility of education expenses under §162 of the Internal Revenue Code ("I.R.C."), across various occupations.

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This examination is motivated by the United State Tax Court ("Tax Court") analysis and holding in an August, 2004 case, *Will M. McEuen III, et ux. v. Commissioner*² on the deductibility of education expenses under I.R.C. §162. In disallowing the taxpayer's expenditures for a Masters of Business Administration degree ("MBA"), the court concluded that the taxpayer's educational expenditures were incurred to meet the minimum educational requirements for the position of an associate in an investment banking firm, and therefore, were investments in personal capital, and were non-deductible. In reaching this conclusion, the court held that the three year position of analyst (the position from which one could be promoted to associate) was a "subordinate temporary position", and therefore analysts were not yet engaged in the trade or business of investment banking, despite being employed by an investment banking firm. In addition, the court held that the change in the taxpayer's potential scope of duties, as a result of additional education, qualified her for a new trade or business, which also made the education costs nondeductible.

The Tax Court's conclusion that the position of analyst was a "subordinate temporary position" to the "permanent career position" of associate raises the following questions. Across occupations, when are more specialized and/or responsible positions considered a different trade or business than positions less specialized and/or responsible? Is there a basis for taxpayers to argue that the holdings and/or decisions in this area have resulted in less than equitable treatment across the various occupations under the tax law?

This paper examines the record of judicial and administrative decisions on the deductibility of education expenses under § 162, for tax years after 1967, when the regulations for I.R.C. § 162 were last amended. The paper considers only decisions where the taxpayer is employed in a trade or business, in a general sense, prior to incurring

education costs. Decisions involving a taxpayer obtaining a bachelor's degree, the teaching profession or foreign nationals are not considered.

This paper first discusses I.R.C. §162 and the relevant regulations. Prior judicial and administrative decisions across a variety of occupations are then summarized, followed by an analysis of the decisions as they have been applied across occupations. The conclusion discusses the implications of, and questions raised by, this study. It appears that more questions are raised than answered.

AUTHORITY FOR THE DEDUCTIBILITY OF EDUCATION EXPENSES

The authority for the deduction of education expenses is established in I.R.C. §162(a), which allows for the deduction of "ordinary and necessary trade or business expenses paid or incurred during the tax year in carrying on a trade or business." Although I.R.C. §162(a) provides several examples of expenses that qualify for deductibility, it does not provide an exhaustive list of qualifying expenses. The Regulations under I.R.C. §162 are more specific, however, and address a variety of expenses, including travel, repairs and rentals. Reg. §1.162-5 addresses expenses for education.

For purposes of this article, the first three paragraphs of Reg. §1.162-5 are relevant. Reg. §1.162-5(a) identifies the general types of educational expenditures that are deductible, Reg. §1.162-5(b) identifies the general types of educational expenditures that are not deductible, and Reg. §1.162-5(c) elaborates on the characteristics of deductible educational expenditures.

Reg. §1.162-5(a) indicates that expenditures made by an individual for education are deductible, as ordinary and necessary business expenses, ". . . if the education (1)

maintains or improves skills required by the individual in his employment or other trade or business, or (2) meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation." Under Reg. §1.162-5(c)(1), refresher courses, courses dealing with current developments, and academic and/or vocational courses are deemed to be education that maintains or improve skills required in an individual's employment or other trade or business. Under Reg. §1.162-5(c)(2), education meets the express requirements of the individual's employer or the applicable law or regulation, imposed as a condition of employment retention, status or rate of compensation, when there is a bona fide business purpose for the employer to impose such requirements.

Reg. §1.162-5(b)(1) indicates that when educational expenditures constitute an investment in the taxpayer's personal capital, such expenditures are not deductible. Under Reg. §1.162-5(b)(2)(i), a taxpayer's expenditures, for an education that meets the minimum educational requirements for qualification in his/her employment or other trade or business, are investments in the taxpayer's personal capital, and are therefore, nondeductible. The employer's requirements, applicable law and regulations, as well as standards of the profession, trade or business involved are all factors in determining the minimum education required to qualify for a position or other trade or business. In addition, the fact that a taxpayer is rendering services in a particular employment status suggests that the taxpayer has already met the minimum education requirements. Under Reg. §1.162-5(b)(3), educational expenditures that qualify the taxpayer for a new trade or business are also considered investments in the taxpayer's personal capital, and are therefore, nondeductible.

This regulation further indicates that a change of duties will not constitute a new trade or business if the new duties involve the same general type of work performed in the taxpayer's current position.

As a final consideration, both Reg. §§1.162-5(c) and 1.162-5(b)(1) contain the same caveat. If the education fulfills the minimum employment requirements for the taxpayer or qualifies the taxpayer for a new trade or business, such expenditures will be treated as investments in personal capital, and therefore, nondeductible. Thus, in order to successfully deduct educational expenditures under I.R.C. § 162, taxpayers must not only demonstrate that the educational expenditures meet the definition of deductible educational expenditures; they must also show that those same expenditures do not constitute investments in personal capital.

DETERMINATION OF THE TRADE OR BUSINESS BOUNDARIES OF CERTAIN OCCUPATIONS

Almost without exception, the decisions in this area begin with the question of whether the occupation-related education costs meet the standards for non-deductibility under Reg. § 1.162-5(b), rather than whether they meet the standards for deductibility under Reg. § 1.162-5(a). A determination that educational expenses are non-deductible renders moot the question of whether the education expenses are deductible. The majority of the decisions have focused on the standards for non-deductibility provided in Reg. §1.162-5(b)(3), rather than those provided in Reg. §1.162-5(b)(2).

Reg. §1.162-5(b)(3) indicates that a change in duties resulting from further education will not constitute a new trade or business if the new duties reflect similar responsibilities prior to the education. The courts and the IRS use a

commonsense approach to determine whether the taxpayer has entered a new trade or business.³ Typically, this means that a comparison is made of the taxpayer's duties before the education versus the taxpayer's duties after the education so as to establish lines of demarcation between trades or businesses. In making this comparison, the courts and/or the IRS have often relied upon the duties described and permitted under state licensure law and/or professional certification standards for the particular occupation ("external determinants of duties"). In those occupations without applicable state licensure law or professional certification standards, the courts and/or the IRS have relied upon the taxpayer's or the employer's own delineation or description of duties for the particular occupation ("internal determinants of duties").

External Determinants of Duties

Occupations with Licensure:

Despite the fact that the taxpayer was already engaged, either completely or to a large extent, in a particular field, the courts generally conclude that moving from unlicensed status to licensed status in the same field is moving from an existing trade or business to a new trade or business for purposes of Reg. §1.162-5(b)(3). This reflects the perception that an unlicensed taxpayer cannot be performing the same general duties as a licensed taxpayer, despite being in the same field.

Thus, unlicensed accountants have been denied deductions for courses required to qualify as a Certified Public Accountant⁴ ("CPA") and for review courses to prepare for the CPA exam⁵. A landscape architect was denied a deduction for education to qualify him to sit for the Registered Landscape Architect exam in Massachusetts⁶. A law librarian was denied the costs of law school⁷, as were patent examiners.⁸

The courts have also generally viewed a taxpayer moving from one license to another as moving from an existing trade or business to a new trade or business. These decisions reflect the notion that changing licenses means changing fields, and it is not reasonable to assert that the general duties can be the same for purposes of Reg. §1.162-5(b)(3) when two different fields are involved.

A CPA engaged in taxation and business planning was denied deductions for costs of law school⁹, a licensed practical nurse was denied deductions for costs of education to become a physician's assistant¹⁰, an attorney was denied deductions for education costs to become a real estate broker¹¹, and a nurse was denied deductions for costs of a degree program in biology, a prerequisite for entrance into medical school.¹²

One decision involves two licenses in the same field. In *Charles A. Robinson*¹³, the taxpayer, a licensed practical nurse ("LPN"), deducted the costs incurred in pursuing a program that would entitle her to sit for the registered nurse ("RN") examination in Minnesota. The taxpayer argued that the education maintained or improved her skills in the trade or business of nursing. The court first reviewed the Minnesota nursing statutes, which licenses both practical nursing and registered nursing. The court concluded that the state's separate licensing of practical and registered nursing was evidence that Minnesota "... envisions a very definite qualitative difference between a RN and a LPN." The court indicated that while the statute identifies some duties as being identical, RNs possessed certain additional powers that LPNs did not, such as delegating nursing functions to other nursing personnel. It should be noted that the court also reviewed the job descriptions of the positions of LPN and RN at the hospital where the taxpayer worked part-time during her education, and concluded that the hospital-employer also viewed an LPN and a RN as two different trades or businesses. This decision

reflects the notion that the two licenses in the same field must be two different trades or business because the state regulations specify two distinct sets of duties.

Occupations with Licensure and Professional Certification:

In Rev. Rul. 74-78¹⁴, the IRS ruled that a dentist engaged in the full time practice of general dentistry, who returned to dental school on a full-time basis to study orthodontics, was entitled to deduct his costs of the orthodontics education. The taxpayer continued his general dentistry practice on a part-time basis during the time he was in dental school, and after the postgraduate education, limited his practice to orthodontics. The IRS concluded that the costs incurred for the studies in orthodontics were incurred to maintain or improve the taxpayer's skills as a dentist, and did not qualify him to enter a new trade or business. In reaching this conclusion, the IRS cited Example (4) of Reg. §1.162-5(b)(3)(ii), which indicates that the costs of a program of study and training for psychoanalysis by a practicing psychiatrist are deductible, as the program maintains or improves skills required in the taxpayer's trade or business. Thus, in Rev. Rul. 74-78, the IRS did not deem the practice of general dentistry as a different trade or business than the practice of orthodonture.

In *Iglesias v. Commissioner*¹⁵, the taxpayer, a licensed general physician and second year resident in psychiatry, underwent psychoanalysis. As part of the residency, the taxpayer worked a forty-hour week, one third of which was spent in classes and two thirds of which was spent in various patient care activities in the hospital. In addition, the taxpayer was on call at the hospital for twelve hours per week. The psychoanalysis was not a requirement of the psychiatry residency, nor a requirement to become a board-certified psychiatrist. The Commissioner argued against deductibility of

the psychoanalysis costs on the grounds that the medical specialty of psychiatry is a different trade or business than the trade or business of general medicine. The court declined to rule on this point. Although the court noted that Example (4) of Reg. §1.162-5(b)(3)(ii) addressed a practicing psychiatrist, the court concluded that the taxpayer's services rendered as a psychiatry resident meant he was already engaged in the trade or business of "a licensed physician treating psychiatric patients". Since the taxpayer was already engaged as "a licensed physician treating psychiatric patients", the psychoanalysis maintained or improved his skills, and therefore, the costs associated with the psychoanalysis were deductible.

Occupations with Professional Certification:

In *Ted Radin*¹⁶, the taxpayer, an actuarial analyst, endeavored to pass the Society of Actuaries exam. Passing the initial seven parts of the exam offered by the Society conveys the title of "Enrolled Actuary" ("EA"), and completion of all ten parts of the exam conveys the title of "Fellow of the Society of Actuaries" ("FSA"). In the year under issue (1983), and even now, actuaries are not licensed by the states. The taxpayer deducted the costs of actuarial books and materials as well as actuarial examination fees, on the grounds that these expenses were incurred to maintain his present position and salary. The court pointed out that an EA can prepare and submit certain pension plan documents to the Internal Revenue Service, and that a FSA has additional rights and privileges beyond those of an EA. Based on these factors, the court determined that, under professional standards, the services the taxpayer could provide as an actuarial analyst were different than those he could render as an EA or a FSA. Since the professional standards envisioned different services, the duties

of an actuarial analyst and an EA or a FSA cannot be the same, and education costs to become an enrolled actuary or a FSA are therefore not deductible.

Internal Determinants of Duties

Occupations without Licensure or Professional Certification:

In *Albert C. Ruehmann III*¹⁷, the Commissioner argued against deductibility of the taxpayer's graduate tax studies on the basis that the taxpayer had not yet established himself in a trade or business. The court, however, determined that the taxpayer's four months of practice as an attorney, after graduation from law school but prior to entrance into the master's of tax law program, were sufficient to demonstrate that the taxpayer had established himself in the trade or business of practicing law. Since the court found that the taxpayer had indeed been engaged in a trade or business at the time the education costs were incurred, the next issue was whether the education qualified the taxpayer for a new trade or business. The court was not required to determine whether the practice of general law and the practice of tax law were two different trades or businesses, because the Commissioner had conceded this issue in a reply brief submitted earlier to the court. By arguing that the education costs should be denied because the taxpayer had never engaged in a trade or business (in the Commissioner's opinion, four months was an insufficient time for a taxpayer to establish a trade or business), the Commissioner indicated the regulations would permit the taxpayer's deduction of the costs of obtaining his LL.M. degree if the taxpayer was already engaged in the practice of law prior to the education. The IRS apparently made no distinction between the practice of general law and the practice of tax law. Since the court found that the taxpayer had engaged in the

trade or business of law before entering the graduate tax studies program, the court had no option but to hold that the education expenses were deductible.

In *Stephen G. Sherman*¹⁸, in July 1969, the taxpayer secured a two year managerial-administrative position with the Army and Air Force Exchange Service ("AAFES") Viet Nam Regional Exchange. The taxpayer's responsibilities included formulating and monitoring management, contingency and emergency plans, including the phase-down of exchanges in conjunction with troop redeployment; personnel management; and the review and evaluation of major policy and procedures with respect to inventory control, procurement and distribution. Additionally, he represented the Viet Nam region in discussions regarding planning operations with the Department of Defense, the Department of State and legislative officials. In early May 1971, the taxpayer was accepted into the MBA program at Harvard University, and requested a leave of absence from the AAFES. The request was denied on the grounds that his two-year employment term with the AAFES would expire on July 25, 1971, leaving the taxpayer free to pursue graduate studies. While denying the leave of absence, the AAFES encouraged the taxpayer to apply for employment upon completion of his graduate studies. After the taxpayer's employment contract with the AAFES terminated in July 1971, the taxpayer entered the MBA program, presumably in September 1971, and graduated in June 1973. During the two years the taxpayer was a full time student in the MBA program, he was not under an employment contract with the AAFES or any other employer. In late 1972, while still at Harvard, the taxpayer applied for re-employment at AAFES, but was denied due to reduced staff needs. Upon graduation from Harvard in August 1973, taxpayer became Director of Planning and Research at Radix Corporation. The taxpayer deducted the costs of his MBA education at Harvard

University. The court concluded that the taxpayer's trade or business was business administration and that he had been engaged in the trade or business of business administration both before (with the AAFES) and after (with Radix Corporation) the education. Since the taxpayer was engaged in the same trade or business both before and after the education, the time during which the taxpayer was unemployed and completing his education was treated as time spent in the taxpayer's trade or business, under the hiatus principle. Since the Commissioner only argued that the taxpayer had not established himself in a trade or business before the education, that the taxpayer was not carrying on a trade or business while in graduate school and that the taxpayer's suspension from his trade or business was not temporary or definite, the court assumed that the education costs otherwise met the standards of deductibility stipulated in Reg. §1.162-5 and allowed those costs as a deduction.

In *Frank S. Blair*¹⁹, the taxpayer was hired by Sherwin Williams Co. as a personnel representative after earning her undergraduate degree on a full time basis. Prior to attending college, the taxpayer had been a homemaker for fourteen years, but worked part-time and accumulated the equivalent of five and one-half years of bookkeeping and payroll accounting experience. As a personnel representative, the taxpayer made hiring recommendations, suggested personnel policy changes, established salaries for various jobs within the firm and assisted employees with health and other employee benefits. In January 1975, the taxpayer entered a two-year part-time evening MBA program, while continuing to work full time for Sherwin Williams. When the taxpayer was promoted to personnel manager in December 1975, her duties became primarily supervisory. She received a substantial increase in pay and became responsible for hiring decisions and for the department budget. The taxpayer received her MBA in

December 1976. The Commissioner argued that the positions of personnel representative and personnel manager were two different trades or business, and that the MBA qualified the taxpayer for the position of personnel manager. Although the court noted that a personnel representative could only make recommendations while a personnel manager could make decisions, the court also recognized that there was substantial overlap in the taxpayer's responsibilities as personnel representative and personnel manager. The court concluded that neither the acquisition of a new title or the difference with respect to making recommendations versus making decisions were sufficient to constitute different duties for purposes of Reg. §1.162-5(b)(3), and held the educational expenditures deductible.

In *Robert C. Beatty*²⁰, the taxpayer joined McDonnell Douglas in January 1972, after receiving bachelor's and master's degrees in aeronautical engineering. The taxpayer's title was "Engineer/Scientist Specialist" and his initial responsibilities primarily involved the design and testing of technology used to guide, navigate and control aircraft flight. The taxpayer's career objective was to move into engineering operations management, by becoming involved in software integration, which involved the management of the technical aspects of guidance system development, coordination of the integration of the guidance system into the flight computer program, and development of software for testing and evaluation. These activities required him to coordinate the work of numerous other engineers within the firm across area specialties, and to interact with related professionals inside and outside the firm, as well as resolve conflicts between individuals, groups and subcontractors. The taxpayer matriculated in a Master's of Science in Administration program, which was oriented towards management administration. In holding the costs of the education

deductible, the court concluded that the education maintained or improved the taxpayer's skills in his trade or business, despite the fact that the bulk of the taxpayer's duties revolved around engineering responsibilities. The court could not "... perceive any discrete line of demarcation between the engineering aspect of his employment and the administrative role he played in the software integration area; ..." The court concluded that the education did not qualify the taxpayer for a new trade or business, because "... the studies merely reflected a change in his duties at McDonnell." That is, the change in the taxpayer's duties after the education was not sufficiently different than his duties before the education to be treated as a new trade or business for purposes of Reg. §1.162-5(b)(3).

In *Daniel D. Granger*²¹, the taxpayer was employed as a Fifth Key Carrier by a supermarket chain, checking-out customers, maintaining shelves and ordering inventory. The Fifth Key Carrier position, on the lower management level of a retail food establishment, is lower in supervisory and managerial authority and responsibility than Fourth, Third, Second and First Key Carrier, where the store manager is First Key Carrier. The taxpayer worked the night shift at the supermarket. Since no store manager (First Key Carrier) or anyone with more supervisory authority was on duty at night, the taxpayer served as the manager on the night shift. Upon his own initiative, the taxpayer attended a food marketing management program, earning a certificate upon completion. The employer did not require the education, but after obtaining the certificate, the taxpayer was subsequently promoted through the ranks to First Key Carrier. The court upheld the taxpayer's deduction for the costs of the education, finding that the education "... bore a substantial and direct relationship to the skills he needed in his ascension in the field of retail food management." The court concluded that, for purposes of Reg.

§1.162-5(b)(3), the duties of all ranks of Key Carriers were substantially the same. Interestingly, the court also found that the education did not qualify the taxpayer for a new trade or business because the taxpayer, despite holding the title of Fifth Key Carrier, functioned as a First Key Carrier when he worked the night shift.

In *Owen Gilliam III*²², the taxpayer, a level T-5 employee at Honeywell, deducted costs of college level courses in business and computer programming. Although not required, the taxpayer was motivated to take the courses after his supervisor informed him that taking the college level courses would improve his chances for promotion. The taxpayer's principal duties were to program and repair computers. A promotion to T-6 or C-6 status would still require him to perform that work, but also allow him to become involved in management decisions, such as handling reports, scheduling and planning complex programs. The court concluded that the college level courses maintained and improved the taxpayer's skills as a computer programmer, and also found the taxpayer's testimony credible that a promotion to grade 6 would involve basically the same skills and requirements of a grade 5, but with greater responsibilities.

In Private Letter Ruling 9112003, the taxpayer, a practicing attorney for four years, intended to resign from his position as associate attorney and return to school to obtain a master's degree in tax law. During the course of his employment with two law firms over the four-year period, the taxpayer did minimal tax-related legal work. The master's in tax law was expected to take nine months on a full time basis to complete, after which, the taxpayer intended to return to the practice of law. The Commissioner cited *Ruehmann* to conclude that the master's of tax law merely improves the taxpayer's skills in his existing trade or business, rather than qualifies him for a new one. Again, the IRS made no

distinction between the practice of general law and the practice of tax law.

In *Will M. McEuen III, et ux. v. Commissioner*²³, the taxpayer received an undergraduate degree in economics and mathematics in 1992, and began working for Merrill Lynch ("Merrill") later that year. The taxpayer's position there was that of financial analyst. In the financial analyst program, one could remain for a maximum of three years but an MBA was required to advance to the position of associate. At the end of that time with Merrill, the taxpayer had not yet acquired an MBA, so she left Merrill and accepted an analyst position with Raymond James Financial, Inc. ("James"). The analyst program there was of two to three year duration and again, an MBA was required to become an associate. The record indicates that analysts and associates were not always assigned to all of the same securities work. At times, analysts worked directly with a vice president or a managing director, without an associate. The record also indicates that the duties of analyst and associate were, in fact, similar. The court noted that in the investment banking industry at that time (1995 and 1996), an MBA degree was required for the associate position. While at James, the taxpayer resigned her position to enroll in a graduate business program. Upon graduation from the graduate business program, the taxpayer was accepted into the "General Management Program" of a home furnishings manufacturer and became an "associate brand manager".

In claiming deductibility of her educational expenditures, the taxpayer argued that she was in the investment banking business and the expenses were incurred to maintain or improve her skills in the trade or business of investment banking. Alternatively, she argued that the expenditures were required to maintain her existing employment relationship, status or rate of compensation.

McEuen represents somewhat of a departure from the other cases reviewed in this paper, in that the court addressed the standards for non-deductibility in both Reg. §1.162-5(b)(2) and §1.162-5(b)(3). In holding for the Commissioner, the court classified the analyst position as a “subordinate temporary position”, while classifying the associate position as a “permanent career position”, from which one could advance further through the firm. The court cited corporate literature in which James identified itself as consisting of “twenty-three investment bankers and eight financial analysts.” The court inferred from this that James itself did not view analysts as investment bankers. Based on the classification of the analyst position as temporary and James’ description of the professional staff, the court concluded that although the taxpayer was performing investment banking services, she had not yet met the minimum educational qualification as an investment banker, and the expenditures for the MBA were incurred to meet those requirements.

In addition, the court noted that even if the analyst and associate positions were not two different trades or businesses, under Reg. §1.162-5(b)(3), the deduction for the education costs would be denied on the basis that the MBA would enable the taxpayer to perform significantly different duties and activities after the education. The change in the taxpayer’s potential scope of duties provided by the education was sufficient to constitute a new trade or business.

EQUITABLE TREATMENT?

To reach a conclusion on whether the decisions in this area result in equitable treatment for the various occupations under the tax law, three questions must be answered:

- (1) Do the decisions based on external determinants of duties result in equitable treatment for various

occupations, when considering only decisions based on external determinants of duties?

- (2) Do the decisions based on internal determinants of duties result in equitable treatment for various occupations, when considering only decisions based on internal determinants of duties?
- (3) Do the decisions result in equitable treatment across occupations when considering decisions based on both external and internal determinants of duties?

First, do decisions based on external determinants of duties result in equitable treatment across various occupations, when considering only decisions based on external determinants of duties? For the most part, taxpayers appear to be equitably treated in decisions involving external determinants of duties, but an argument could be made that dentists and doctors have received preferential treatment relative to other occupations in terms of the tax deductibility of their occupation-related education costs.

Under Rev. Rul. 74-78, once a taxpayer qualifies and practices as a general practice dentist, the costs of an education to obtain a specialty beyond general dentistry are deductible, as they are deemed to maintain or improve the taxpayer’s trade or business as a dentist. In other words, under Rev. Rul. 74-78, for purposes of Reg. §1.162-5(b)(3), the duties of a general practice dentist are the same as the duties of an orthodontist. Rev. Rul. 74-78 does not address the role of dental board certification of orthodonture, nor state licensure of dental specialties.

The American Dental Association recognizes and regulates nine dental board specialties, and stipulates the advanced education and experience requirements.²⁴ Example (3) of Reg. §1.162-5(b)(3)(ii) indicates that a two-week course reviewing new developments in several medical specialty

fields are deductible by a general practitioner of medicine, since the course maintains or improves skills required in the taxpayer's trade or business. Reg. §1.162-5(c)(1) indicates that refresher courses or courses dealing with current developments are deductible, as long as they are not the minimum requirements to enter the trade or business or to qualify the taxpayer for a new trade or business. Taxpayers generally view Example (3) of Reg. §1.162-5(b)(3)(ii) and Reg. §1.162-5(c)(1) as the authority for the deductibility of continuing professional education courses [e.g., continuing professional education ("CPE"), continuing medical education ("CME"), continuing legal education ("CLE"), etc.]. While continuing education is typically taken by professionals to maintain their license or professional certification, dental or medical specialty education is typically undertaken to obtain a new license or professional certification. It is clear that significant education and experience is required to obtain a dental board certification. Given the significant education and experience requirements for dental board specialty certification, it does not seem equitable to argue that the education required for board certification for dentists is the equivalent of the two-week continuing education course for other occupations contemplated by Reg. Sec. 1.162-5(b)(3).

The more expansive view of duties for dentists established by Rev. Rul. 74-78 (particularly when the revenue ruling notes that the general practice dentist confined her practice to orthodontics after the education) is to be contrasted with the narrow view of duties in decisions involving accountants and landscape architects. The trade or business of an unlicensed accountant is considered different from a CPA, because an unlicensed accountant can serve only a portion of clients requiring accounting and tax services.²⁵ The trade or business of an unregistered landscape architect is considered a different from a registered landscape architect, because an

unregistered landscape architect can service only a portion of clients requiring landscape architecture services.²⁶ Dental patients typically visit their general practice dentist annually or semi-annually, but seek out dental specialists only when the need arises. For example, dental patients typically seek the services of an orthodontist only once. If differences in the types of clients a taxpayer can serve before the education versus after the education is indicative of a change in duties for unlicensed accountants and unregistered landscape architects, is it equitable to maintain that a general practice dentist is serving the same patients as an orthodontist?²⁷

If external determinants of duties are relied upon to decide whether the taxpayer's duties before and after the education involve the same general type of work, are there differences in the weight placed on the external determinants of duties applicable to the particular occupation? What is the role of state licensure and professional certification in deciding if the taxpayer's duties before and after the education are of the same general type? Some occupations have licensure only, while others have licensure and professional certification, and still others have the latter only.

Orthodontists and general practice dentists are in the same field (dentistry) and RNs and LPNs are in the same field (nursing). Orthodontists require additional education beyond that to become a general practice dentist. RNs require additional education beyond that of a LPN. Professional recognition for general practice dentists is conferred by state license, and for orthodontists, by dental board specialty certification. Professional recognition for both LPNs and RNs is conferred by state license. Yet, under Rev. Rul 74-78, the duties of an orthodontist (board certification) are the same as the duties of a general practice dentist (license), while, pursuant to *Robinson*, the duties of a LPN (license) are not the same as the duties of a RN (license). If nurses cannot deduct

the education costs to move from a LPN to a RN license, is it equitable to allow dentists to deduct the costs of moving from a DDS/DMD license to a board specialty certification?

In *Iglesias*, the Commissioner argued that the trade or business of psychiatry is different from that of general medicine, and therefore, the taxpayer's costs of psychoanalytic training should not be deductible. Interestingly, this argument is the opposite of the Commissioner's earlier argument in Rev. Rul. 74-78, that a specialty field is the same trade or business as a general field. The *Iglesias* court declined to decide whether the trade or business of psychiatry is different from general medicine. Although the court noted that board certification did not require the doctor to undergo psychoanalysis, and that it was not part of the hospital program in which the taxpayer was a resident, the court did not address whether completion of the residency in psychiatry was required before the physician (i.e., a medical doctor or "M.D.") could hold himself out as a board certified psychiatrist and seek employment as such.

The Occupational Outlook Handbook of the Bureau of Labor Statistics of the U.S. Department of Labor indicates that M.D.s seeking board certification in a specialty must complete a residence in the specialty and pass a final examination for certification by the American Board of Medical Specialists. A resident is always under the supervision of, and is responsible to, a supervising physician educator of the same specialty in the hospital. The latter must certify that the resident has satisfactorily completed the residency program as part of the board certification process.

Although the taxpayer in *Iglesias* was a licensed general physician by the second year of his residency, it was unclear whether he practiced as a general physician before beginning his psychiatry residency. This is an interesting omission because the simple holding of a license does not necessarily

mean that the taxpayer practices in that occupation. The deductions permitted under I.R.C. §162 are allowed only when they incurred in conjunction with the carrying on of a trade or business. The *Iglesias* court found that the taxpayer's psychiatric patient services during the residency period were sufficient to consider the taxpayer already engaged in the trade or business of "a licensed physician treating psychiatric patients". In other words, the court preferred to characterize *Iglesias*' services required as part of his residency as the equivalent of carrying on a trade or business, rather than as the practical experience prerequisite to enter it. While the taxpayer of Rev. Rul. 74-78 had practiced general dentistry before commencing the orthodonture education, it appears that taxpayer in *Iglesias* did not practice general medicine before his psychiatry residency program. If he had, the court would have been able to rely upon Rev. Rul. 74-78, and would not have needed to characterize the practical experience component of the residency program as the carrying on of a trade or business. If *Iglesias* was already engaged in the trade or business of a licensed physician treating psychiatric patients, and therefore his costs of psychoanalysis were deductible, then, following Rev. Rul. 74-78, would not the education costs of his psychiatric residency, if any, also be deductible? This point was never brought up by the court or the taxpayer.

Taxpayers in occupations other than medicine have generally not been permitted to treat the practical experience prerequisite for licensure or professional certification as the equivalent of carrying on a trade or business. Consider the following: (1) a medical resident must have completed medical school in order to enter a specialty residency program, and an unlicensed accountant must have completed, generally, an undergraduate degree in accounting to obtain a position in a public accounting firm; (2) a resident must accumulate the required number of specialty hours (both in the classroom and

the hospital) of the residency program, and an unlicensed accountant must accumulate, generally, twenty-four months of attestation practical experience; (3) the resident must complete the residency under the supervision of physician-educators, and an unlicensed accountant must complete the practical experience requirement under the supervision of CPAs; (4) the resident must pass an examination at the end of the residency to become board certified, and an unlicensed accountant must pass an examination to become state certified; (5) both the resident and the unlicensed accountant are paid for the services they render. Despite these similarities, *Iglesias* indicates that a psychiatric resident is already considered engaged in the trade or business of a licensed physician treating psychiatric patients, while *Cooper* and other earlier decisions indicate that an unlicensed accountant is not considered already engaged in the trade or business of public accounting, while performing the services of a licensed accountant under the supervision of a CPA. Given that public accounting work experience prior to licensure is not considered the carrying on of the trade or business of a CPA, is it equitable to treat the practical experience acquired during a medical specialty residency as the carrying on of a trade or business, particularly when the taxpayer has not carried on any trade or business before the residency?

Second, do decisions based on internal determinants of duties result in equitable treatment across various occupations, when considering only decisions based on internal determinants of duties? While, for the most part, taxpayers in decisions involving internal determinants of duties appear to be equitably treated across occupations, this review suggests, however, that an argument could be made that certain occupations have received preferential treatment relative to other occupations in terms of the tax deductibility of their occupation-related education costs.

What constitutes a "sufficient" amount of time for a taxpayer to become established in a trade or business seems to depend upon the taxpayer's occupation. Although neither I.R.C. §162 nor the regulations there under identify the amount of time spent in a particular employee or self employed position as a determinant of whether a taxpayer has established himself in a trade or business, the courts and the IRS do consider this factor. In *Ruehmann*, the court concluded that the taxpayer's four months of practice as an attorney during the summer between graduation from law school and entrance into a graduate tax program, were sufficient to show that the taxpayer had established himself in a trade or business prior to incurring the education costs in question. In contrast, in *McEuen*, the court concluded that, because the taxpayer's two employers had "up or out" policies (i.e., the employee must complete a MBA within three years of hire, or leave), the taxpayer's approximately five years of experience as an analyst could not be counted as time spent in the trade or business of investment banking before incurring the costs of an education required for promotion. If the four months between graduation from law school and graduate tax law school is a sufficient amount of time to establish the taxpayer in a trade or business, is it equitable to say that an analyst's five years of experience with two investment banking firms had not established her in a trade or business?

Although neither I.R.C. §162 nor the related regulations specify how to handle employment arrangements with fixed terms, the issue of fixed employment terms also seems to depend upon the taxpayer's occupation. In *Sherman*, the Tax Court concluded that the taxpayer's two year fixed term of employment with the AAFES was sufficient to show that the taxpayer had established himself in the trade or business of business administration, even though the taxpayer was unemployed from the expiration of his employment contract

until he commenced graduate business school. The taxpayer took a position in private industry upon graduation, but whether the taxpayer's new position as Director of Planning and Research required a MBA or not was never addressed. In contrast, in *McEuen*, the court concluded that, because the taxpayer's term of employment at each of two employer firms was limited to three years unless the taxpayer earned a MBA degree, the taxpayer's combined five years of experience as an analyst did not establish her in the trade or business of investment banking before incurring the education costs. If a two-year term employment with the AAFES is sufficient to establish the taxpayer in the trade or business or business administration, is it equitable to say that five years as an analyst with two investment banking firms was a temporary position?

Third, do decisions result in equitable treatment across occupations when considering decisions based on both external and internal determinants of duties? In *Iglesias* and *McEuen*, both taxpayers had positions with three year "up or out" terms. *McEuen*'s position as analyst required her to successfully complete a MBA program by the end of the three-year term in order to continue and be promoted to associate. *Iglesias*' position as psychiatric resident required him to successfully complete the residency program by the end of the three year term, the total years of residency required for board certification as a psychiatrist.²⁸ Residents who fail to complete either the prerequisite training or the exams cannot become board certified. Both taxpayers sought positions that require a combination of practical and educational experiences. The position of associate implicitly requires acceptable performance in the practical on-the-job training at the firm, and explicitly requires educational training. The position of board certified psychiatrist implicitly requires acceptable performance in the practical on-the-job training at the hospital,

and explicitly requires educational training. Both taxpayers were compensated for the time spent in acquiring the necessary prerequisite practical experience.

The *McEuen* court, however, relying upon Reg. §1.162-5(b)(2), held that, although *McEuen* was performing investment banking services, she had not yet met the minimum education requirements for qualification in that trade or business. In contrast, the *Iglesias* court held that the taxpayer's time spent working in the hospital as a psychiatric resident was time spent in the trade or business of a "licensed physician treating psychiatric patients". The *Iglesias* court made no mention of Reg. §1.162-5(b)(2) and seemed to ignore the fact that, although the taxpayer was rendering psychiatric services to patients, he had not yet met the minimum requirements to qualify as a board certified psychiatrist.

CONCLUSION

Employment-related education costs can be significant for many taxpayers, and deductibility of those costs can ease the financial burden. Taxpayers must be able to demonstrate that those educational costs not only meet the standards for deductibility, but also do not run afoul of the standards for non-deductibility. However, in relying upon the record of IRS and court decisions, taxpayers may find that the record contains inconsistencies and inequities.

This paper has reviewed the record of IRS and court decisions with respect to the deductibility of employment-related education costs under I.R.C. §162. In making a comparison of the taxpayer's duties before and after the education (as a means of determining whether the taxpayer has remained in the same trade or business or has qualified to enter a new trade or business), the courts rely, when possible, upon external determinants of the taxpayer's duties, such as state

licensure and/or professional certifications, or upon internal determinants of the taxpayer's duties, such as the taxpayer's or employer's own delineation or description of duties. The analysis of the treatment accorded taxpayers across various occupations suggests that taxpayers in certain occupations have received preferential treatment with respect to the deductibility of their education costs relative to taxpayers in other occupations.

A number of questions remain. What is the role of external determinants of duties when more than one applies to a particular occupation? This is an important issue for occupations such as dentist and doctors, which involve a state license and either board certification or a second license. What is, or should be, the weight accorded each of the external determinants? What happens when a state institutes licensing of a dental or medical specialty that previously was only board certified? Does it alter the deductibility of education related costs? What about situations where the character of the practice before the education differs from the character of the practice after the education? Is the practice of general dentistry the same as a practice focused exclusively on orthodontics (i.e., Rev. Rul. 74-78)? Is the practice of general law the same as a practice focused exclusively on tax law (i.e. PLR 9112003)? Is obtaining orthodontic training the same thing as undergoing psychoanalysis? Example (4) of Reg. §1.162-5(b)(3)(ii) indicates that the costs of a program of study and training for psychoanalysis by a practicing psychiatrist are deductible, as the program maintains or improves skills required in the taxpayer's trade or business. Rev. Rul. 74-78 and *Iglesias*, among other decisions, cite Example (4) of Reg. Sec. 1.162-5(b)(3)(ii) in concluding that the taxpayer's education costs were deductible as they are deemed to be incurred to maintain or improve the taxpayer's trade or business skills. Psychoanalysis is a therapy employed by psychiatrists,

psychologists and social workers as part of psychological counseling to identify the unconscious factors that affect behavior and emotions. Conversely, state law prohibits anyone who is not part of the field of dentistry from practicing orthodonture

The regulations under Sec. 162 were last amended in 1967, when the United States economy was more an industrial economy than the service economy it is today. It is likely since 1967, the increased role of services-type occupations in the economy has been accompanied by a growth in the number of members of professional organizations and boards, as well as a significant increase in the number of occupations, specialties and sub-specialties licensed by states and/or certified by professional organizations or boards. It may be time for Congress to review Section 162 as it applies to employment-related education costs.

ENDNOTES

¹ Smith, Adam. *The Wealth of Nations*. New York: Alfred A. Knopf, Inc., 1991.

² TC Summary Opinion 2004-107 (2004)

³ *Ronald F. Weismann*, 52 T.C. 1106 (1969); *William D. Glenn*, 62 T.C. 270 (1974); *Davis v. Commissioner*, 65 T.C. 1014 (1976)

⁴ e.g., *Howard Sherman Cooper*, TC Memo 1979-241 (1979)

⁵ e.g., Rev. Rul. 69-292, 1969-1 CB 84; *William D. Glenn*, 62 TC 270 (1974); *David Cooper*, TC Memo 1978-117 (1978); *Velma Archie*, TC Memo 1978-425 (1978); etc.

⁶ *Ted Dierker*, TC Memo 1994-422 (1994)

⁷ *Stephen Galligan*, TC Memo 2002-150 (2002)

⁸ e.g., *Rombach v. US*, 27 AFTR2d 71-918 (1971); *John K. Lunsford et al.*, TC Memo 1973-17 (1973)

⁹ e.g., *Danielson v. Quinn*, 45 AFTR 2d 80-1555 (1980); *David Roeberg*, TC Memo 1970-236 (1970); *Patrick L. O'Donnell*, 62 TC 781 (1974); *Michael Joseph Goldberg*, TC Memo 1984-617 (1984)

¹⁰ *Mathew Reisinger*, 71 TC 568 (1979)

¹¹ *David A. Goldstein*, TC Memo 1987-47 (1987)

¹² *John M. Gannon*, TC Memo 1977-283 (1977)

¹³ 78 TC 550 (1982)

¹⁴ 1974-1 C.B. 44

¹⁵ 76 TC 1060 (1981)

¹⁶ TC Memo 1987-348 (1987)

¹⁷ TC Memo 1971-157 (1971)

¹⁸ TC Memo 1977-301 (1977)

¹⁹ TC Memo 1980-488 (1980)

²⁰ TC Memo 1980-196 (1980)

²¹ TC Memo 1980-60 (1980)

²² TC Memo 1986-90 (1986)

²³ *supra* note 2

²⁴ According to the "Report of the American Dental Association ("ADA")-Recognized Dental Specialty Certifying Boards" (April 2004), there are nine ADA board recognized dental specialties: dental public health, endodontics, oral and maxillofacial pathology, oral and maxillofacial

radiology, oral and maxillofacial surgery, orthodontics, pediatric dentistry, periodontology and prosthodontics.²⁴ The report indicates that the years of advanced education required in addition to the DDS or the DMD degree for these specialties ranges from two to four years, and that the total years of specialty experience plus advanced education required in addition to the DDS or the DMD degree ranges from two to five years. Orthodontics is reported to require two to three years advanced education beyond the DDS or the DMD, and a total of four years of advanced education and specialty experience beyond the DDS or the DMD for board certification. See American Dental Association at <http://www.ada.org/prof/ed/specialties/natcert.asp>. The Occupational Outlook Handbook of the Bureau of Labor Statistics of the U.S. Department of Labor (April 2005 version) also indicates that approximately seventeen states license dental specialties (see United States bureau of Labor Statistics at <http://stats.bls.gov/oco/>).

²⁵ e.g., *Howard Sherman Cooper*, TC Memo 1979-241 (1979); Rev. Rul. 69-292, 1969-1 CB 84; etc.

²⁶ TC Memo 1994-422 (1994)

²⁷ Other contractual parties to taxpayers' dental care would also likely argue that general dental services are different from orthodontic services. Insurance companies providing reimbursement of dental costs likely do not classify general dentistry and orthodontics as one in the same service, and in fact, most insurance policies that offer dental coverage almost always have differential reimbursement terms for general dental and orthodontic care. General dental services typically have annual reimbursement limits while orthodontic services typically have lifetime reimbursement limits.

²⁸ American Board of Physician Specialties at http://www.abpsga.org/certification/boc_comparison.html - "Certification Requirements: A Comparison between ABPS, ABMS & AOABOS"