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Tax Court Reverses Course on Deduction for MBA Costs

by

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ABSTRACT

Obtaining an MBA degree is an expensive and time-consuming process. The cost is ameliorated, however, if a tax deduction can be taken. Although many in the business community believe they are entitled to deduct the costs of obtaining an MBA, the fact of the matter is that a deduction is not a certainty. There have been numerous litigated cases concerning whether a deduction for the cost of an MBA should be allowed. The cases reveal, however, that it all depends on the particular facts and circumstances. This paper reviews the case law concerning the deductibility of the costs of obtaining an MBA: first some older cases, then some more recent cases, and finally the most recent case decided in 2005. Based upon two cases decided by the Tax Court in 2002 and 2004, in which the taxpayers lost, tax practitioners were concerned that a tax deduction for the cost of an MBA was virtually foreclosed for everyone. But in the case decided in 2005, it appears that the Tax Court softened its position. Accordingly, it seems that there is still the possibility of deducting the cost of an MBA. But again, it's not automatic and will depend on the facts.

I. INTRODUCTION

Anyone considering obtaining a Master of Business Administration degree (MBA) is no doubt acutely aware that the cost of the degree is expensive, and, if past is prologue, will continue to increase. Presently, the annual cost of an MBA in top-tier schools is approaching $40,000, with an average cost of about $34,000.[1] For those pursuing the degree full time, an additional cost to consider is lost earnings. The average salary of a pre-MBA student, it may be noted, is $67,000.[2] One estimate, considering only tuition and lost salary, states that the overall cost of an MBA often tops $175,000.[3] Additionally, for a full-time student, cash is needed for everyday expenses, such as, housing, food and utilities, which will have to be paid through borrowing or savings. Moreover, full-time students forego opportunities for advancement and the gaining of experience they could have by working and going to school part time. Obviously, those striving for an MBA anticipate that it will more than compensate for the cost and lost opportunities. Whether the anticipation is likely to become the reality has been questioned. For instance, a professor teaching in a top-tier business school, to the apparent dismay of his colleagues, has posited that MBA holders seemed no more successful than persistent business leaders without the degree.[4]

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In 2002, the latest year for which statistics are available, there were over 120,000 MBA degrees granted in the U.S. It is the second most popular graduate degree after a degree in education.[5] Recently, however, there has been a significant decline in applications for admission to MBA programs, including applications to the top-tier schools. There is speculation that the reasons for the decline are the high cost of obtaining the degree and some uncertainty as to its value.[6]

For many, if not most, people, the financing of an MBA is met through loans, which are often piled onto amounts borrowed for an undergraduate degree.[7] Moreover, the cost of borrowing will be increasing since the Deficit Reduction Act of 2006 will lop $12.7 billion off the student loan program, which will result in an increase in the interest paid on student loans.[8]

If the cost of the MBA can be taken as a tax deduction, however, the cost is to some extent subsidized by the government, the exact benefit correlated with one's tax bracket. As a result of some Tax Court decisions in 2002 and 2004, however, there was considerable concern among tax professionals that a deduction for the costs of an MBA was virtually foreclosed.[9] But in a significant decision in 2005, the Tax Court reversed course and found in favor of the taxpayer. Accordingly, there now appears to be a greater possibility that a tax deduction for the cost of an MBA will be allowed. Nonetheless, the

cases illustrate the difficulty of generalizing in this area. Ineluctably, the result in each case will turn on the specific facts and circumstances.

II. BACKGROUND

While the Internal Revenue Code (IRC) nowhere deals directly with education expenditures, IRC §162(a) provides for the deduction of the ordinary and necessary expenses paid or incurred in carrying on a trade or business. The requirements that must be met in order to deduct educational expenses as a business expense are detailed in an IRS regulation.[10] In pertinent part, the regulation states that a deduction will be allowed 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 his employment, status or compensation, but only if such requirements were imposed for a bona fide business purpose of the employer.

With respect to expenditures to obtain an MBA, the first hurdle to vault is whether the education maintains or improves skills that are required on the job or, alternatively, whether the education is to meet express requirements of an employer. A careful reading of these provisions reveals that a determination under either of the alternatives depends on the particular facts and circumstances.

With respect to alternative (1), it is evident that an MBA should maintain or improve business skills. But whether there is any nexus between what is learned in an MBA program and what is *required* in a particular employee's job is another matter.

Alternative (2) refers to employer requirements. But note that the employer requirements must be *express.* Obviously, there is a difference between a mere suggestion by an employer and a clear-cut demand, with a host of possibilities in between. Perhaps nothing less than a written policy or written demand would meet the language of the regulations that there be an express requirement. Moreover, it would have to be demonstrated that the employer had a bona fide business purpose for imposing the requirement.

As may be apparent, the foregoing ambiguous language is fodder for controversy often resulting in litigation. However, what makes a determination of deductibility even more uncertain and contentious is that the regulations go on to say that *even if* you qualify under either of alternatives (1) or (2), the expenditures will be considered personal, and non-deductible,[11] if either:

(a) Made for education that is required of the individual in order to meet the minimum educational requirements for qualification in his/her employment or other trade or business, or

(b) Made for education that is part of a program of study being pursued by the individual that will lead to qualification in a new trade or business.

In the case of an employee, however, a change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment.

In summary, the first hurdle that must be vaulted is to qualify under either general rule (1) or (2). But even if that hurdle is cleared, it is necessary to vault the second hurdle by demonstrating that neither (a) nor (b) is applicable. Based on a number of court decisions, it seems that the second hurdle is the one that taxpayers frequently trip over.

It appears well settled that education leading to a license or certification qualifies a person for a new trade or business. For example, in one case, a deduction for education expenses was denied to a public accountant seeking to become a certified public accountant.[12] In another case, an education deduction was denied to an intern pharmacist studying to become a registered pharmacist.[13] There have been considerable litigated cases concerning whether a course of study qualifies a person for a new trade of business.[14] This paper, however, will be reviewing only cases on the deductibility of MBA costs, first some earlier cases, then some more current ones, and finally the most recent case decided in 2005.

III. EARLIER CASES ON MBA DEDUCTION

In *Sherman*,[15] a 1977 Tax Court decision, the taxpayer had been a military officer. About a year after his discharge from active duty, he obtained employment in a civilian capacity with the Army and Air Force Exchange Service (AAFES) as Chief, Plans and Programs Office. Much of his duties were of a managerial type. Approximately two years later, he was accepted into the MBA program at Harvard and applied for a leave of absence from the AAFES. This was denied since his employment contract was shortly due to expire. Upon expiration of his contract with AAFES, the taxpayer entered the Harvard MBA program as a full-time student, but was not employed while there. While in the MBA program, however, he applied for re-employment with the Army. His application was denied due to a cutback in management personnel in AAFES. Upon graduation, the taxpayer obtained employment with a corporation as Director of Planning and Research. For the tax year at issue, he deducted the amount he expended for tuition and books. The Internal Revenue Service (IRS) denied the deduction on the grounds that at the time the taxpayer incurred the education expenses, he was not carrying on a trade or business.

Citing prior relevant cases, the Court noted that a taxpayer who *temporarily* ceases active participation in a trade or business during a transition period between leaving one position and obtaining another may be carrying on a trade or business during the hiatus, and that a formal leave of absence is not essential to carry on a trade or business while attending school.[16] The Tax Court specifically rejected the IRS assertion that the taxpayer's unemployment was indefinite because it was longer than the IRS guideline of a year or less. The two years it took to finish the MBA was found not to be indefinite, and there was no "magic" in the IRS's arbitrary one-year rule. The Court observed that the length of a hiatus as temporary or indefinite depends on the particular facts and circumstances.

Importantly, the Court found that the taxpayer was established in the trade or business of being a manager before he went to Harvard and continued in that trade or business after he completed the MBA. The degree did not equip him for a different career, but rather to be a better manager than he had been, although not with the same employer.

Accordingly, the deduction for tuition and books was allowed. Consequently, the fact that a taxpayer is enrolled in an MBA program full time, while unemployed during the course of study, is not necessarily in and of itself grounds for denying the deduction.

In *McIlvoy*,[17] a 1979 Tax Court decision, the taxpayer had a bachelor's degree and a graduate degree in geophysical engineering. For several years thereafter, he held a number of jobs that were essentially of a technical nature. After the termination of his last employment, the taxpayer began to pursue an MBA degree as a full-time student. After graduation, he was hired as an engineer/geologist by a different firm. The IRS determined that he was not allowed to deduct his education expenses.

The Court agreed with the IRS. It found that the MBA courses did not maintain or improve skills used by the taxpayer in his trade as a professional engineer. The major finding was that the taxpayer was a technician, not a manager. The Court found no relationship between the MBA courses and his technical duties or the skills he possessed as an engineer; it found that the MBA courses taught him new skills. As further pointed out hereafter, cases have held that education that teaches significantly new skills qualifies a person for a new trade or business.

This case demonstrates that one must be in a managerial position in the first place in order to have a shot at deducting MBA costs. Furthermore, the course work must be related to what one's job entails.

In *Beatty*,[18] a 1980 Tax Court decision, the taxpayer held a bachelor's and master's degree in aeronautical engineering and was employed by McDonnell Douglas Corporation (McDonnell). Initially, the taxpayer worked on highly sophisticated and technical projects. Later, his duties expanded and, among other things, he became responsible for software integration. In this capacity, he had to coordinate the activities of numerous other engineers and had to interact with individuals at various levels within

and without McDonnell; he had to resolve conflicts among various individuals, groups, and subcontracting companies. To enhance his career objectives of engineering operations management, the taxpayer entered into a part-time program leading to a Master's of Science in Administration degree, and ultimately graduated.

The IRS disallowed the taxpayer's education deduction asserting that the education lacked proximity to his trade or business, and that even if the education was sufficiently related to what he was doing, it qualified him for a new trade or business.

The Court disagreed with the IRS. It could not "perceive any discrete line of demarcation between the engineering aspects of his employment and the administrative role he played in the software integration area." The skills that the taxpayer used were found to "transcend any strict and rigid definition of engineering." Accordingly, the Court concluded that the degree he obtained maintained and improved his employment skills.

The Court also found that the degree did not qualify the taxpayer for a new trade or business. In this regard, it said that it was necessary to compare the type of tasks the taxpayer was qualified to perform before and after obtaining the degree. The Court found that the taxpayer's activities before entering the master's program were components of administration and management. The education corresponded at most with a change of duties. The Court pointed out that under IRS regulations, a change of duties does not constitute a new trade or business.[19]

A final point made by the Court was that the courses the taxpayer took were not a prerequisite to professional certification for any particular profession or trade or business.

In *Blair*,[20] a 1980 Tax Court decision, the taxpayer had a bachelor's of arts in English. She was hired as a personnel representative. Subsequently, she began a two-year program of evening instruction leading to an MBA degree. About half way through the program, she was promoted to personnel manager. Her duties became primarily supervisory and she received a substantial pay increase. As a manager, she made hiring decisions and was responsible for her department budget. About a year after her promotion, she graduated.

The IRS disallowed the taxpayer's deduction for the cost of the MBA on the basis that a personnel manager was a new trade of business insofar as the taxpayer was concerned. There was no contention by the IRS that the taxpayer's job had a minimum educational requirement.

The Court disagreed with the IRS position. The Court referred to the IRS's own regulations that provide: "In the case of an employee, a change of duties does not constitute a new trade or business if the new duties involve the same general type of work as is involved in the individual's present employment."[21] It determined this regulation to be relevant since it found that there was a substantial overlap between a personnel representative and a personnel manager. The only significant difference found by the

Court was that the former made only recommendations while the latter made decisions. The fact that the taxpayer acquired a new title did not constitute a new trade or business.[22] As a final point, the Court observed that even if a "personnel manager" in this situation were deemed to be a new trade or business, the educational expenses did not *qualify* the taxpayer to be a personnel manager.

What is particularly noteworthy about *Blair* is that the Court analyzed each course that the taxpayer took in the MBA program to see how it related to the taxpayer's duties on her job. It found a relationship for each course other than a course in Marketing Information Systems for which it disallowed a deduction. Consequently, the IRS, with apparent court sanction, can divide the MBA degree into its component courses and require the taxpayer to show a relationship between each course and specific duties required in the taxpayer's job.

In *Link*,[23] a 1988 Tax Court decision, the taxpayer earned a bachelor's degree in operations research. Following graduation, he obtained employment where his job was to develop market research procedures, a position that did not require an MBA. He remained in this position roughly three months over the summer. He could have continued with this employment but decided to pursue an MBA full time. Upon graduation, he obtained employment with another company as an operations research analyst. This employment likewise did not require an MBA. For the taxable year at issue, the IRS disallowed the taxpayer's deduction for education expenses.

The Court sustained the disallowance. It observed that implicit in I.R.C. §162 and the regulations is that the taxpayer must be established in trade or business in order for any expenses to be deductible. Here, the taxpayer's first employment seemed to be a "hiatus" in his academic endeavors. Since he worked only three months, the Court considered his employment as at best only a summer job.

The Court declined to set a minimum period of time over which one must be employed to be considered engaged in a trade or business, but noted that a very short employment is relevant evidence in making a determination.

In *Schneider*,[24] a 1983 Tax Court decision, the taxpayer graduated with a bachelor of science degree from the United States Military Academy at West Point. He pursued a general engineering curriculum with an elective concentration in national security and public affairs. Upon graduation he served on active duty in the Army for five years as an infantry officer.

While in the Army, the taxpayer held numerous positions among which were: vehicle maintenance officer, platoon leader, company commander, personnel officer, base supply officer, and executive officer in Special Forces. These positions involved supervision of those under his command, including civilians. At the time of his discharge from active duty, the taxpayer had achieved the rank of Captain.

Following his discharge, the taxpayer entered a full-time MBA program graduating two years thereafter. While in the program, he did not engage in any employment. After completing the MBA, the taxpayer continued his schooling for another year earning a master's degree in public administration. After completing these degrees, he began working as a business consultant. He deducted the cost of his MBA on his tax returns for the two years that he was in this program.

The IRS disallowed the deductions contending: (1) that as an Army officer, the taxpayer could not be considered engaged in a trade or business of being a manager, (2) that the MBA qualified the taxpayer for a new trade or business, and (3) that the taxpayer's cessation of employment while in the MBA program was indefinite rather than temporary. The taxpayer, of course argued to the contrary. The Tax Court agreed with the IRS contentions.

First, it found that while in the MBA program, the taxpayer was not engaged in any trade or business. He resigned his commission and had no plans to return to active duty. The Court distinguished the taxpayer's situation from those cases where a taxpayer was found to be on a temporary leave of absence from an established trade or business while pursuing the degree.[25] In this case, the Court determined that in no sense of the word was the taxpayer's leave of absence from the military temporary. Rather, it was indefinite since his resumption of employment was to begin at "some future time."

Second, the Court found that the taxpayer's "education was designed to, and did, prepare him for a new trade or business…."[26] It determined that the taxpayer had never been in the business world. Despite the fact that as an Army officer he served in a variety of leadership and administrative positions, the Court stated that he had not shown any substantial relationship between such positions and the course of study he pursued in the MBA program. The taxpayer's comparison of his managerial responsibilities in the Army to those of business executives was deemed insufficient to negate that the MBA studies were not preparing him for a new trade of business.

Essentially, the taxpayer argued that whether someone is a manager should not be determined by whether the person wears a uniform or a business suit. The Court did not specifically disagree, but observed that the business of being a "manager" is too amorphous to come to any definitive conclusions. It noted, as an example, that a chef "manages" a kitchen and a teacher "manages" a classroom.

What the Court deemed most important in analyzing a particular situation is the differences that exist in the *tasks and activities* required in a particular trade or business vis-à-vis another trade or business. In sum, the Court found that the taxpayer's duties as an Army officer constituted a different trade or business than the consulting business for which the MBA prepared him.[27]

IV. RECENT CASES ON MBA DEDUCTION

Two recent cases involving the deductibility of the costs of an MBA, one decided in 2002 and the other in 2004, illustrate the restrictive interpretation of the regulations taken by the IRS, with which the Tax Court in these cases agreed. The cases were decided in the small claims part of the Tax Court, at the taxpayer's election, since the amounts in controversy did not exceed $50,000. Consequently, the decisions could not be appealed and should not be cited as authority.[28] Nevertheless, after the cases were decided, tax practitioners were concerned that the pro-government reasoning in them would be followed in a regular Tax Court controversy.[29]

A. *Lewis V. Commissioner*[30]

1. *Facts*

The taxpayer attended the University of California at Los Angeles (UCLA), graduating in June 1998 with an MBA. Prior to his enrollment in the MBA program, the taxpayer was employed in the telecommunications industry. Since he was increasingly called upon to negotiate contracts with a wide variety of clients, he noted in a written statement submitted into evidence that, "I needed additional accounting, financial and general business administration skills." At trial, the taxpayer testified that the MBA degree qualified him for "a wider variety of positions," although he did not pursue such positions.

2. *Court Opinion*

The Court first reviewed the regulations dealing with the deductibility of education expenses, focusing on the provision that denies a deduction for education that is part of a study program being pursued leading to qualification in a new trade or business. The Court correctly observed that even if the studies are required by an employer, and the taxpayer does not intend to enter a new field of endeavor, or even though the taxpayer's duties are not significantly different after the education from what they had been before, the expenditures are not deductible if the course of study would *qualify* the taxpayer for a new trade or business.[31]

As the Court saw it, there was no doubt that the MBA improved the taxpayer's skills in his employment. But the seminal question, it pointed out, was whether the MBA qualified the taxpayer for a new trade or business. In this regard, the Court referred to what is called the *commonsense approach*.[32] Under this standard, if the education qualifies the individual to perform significantly different tasks and activities than previously, the education qualifies the individual for a new trade or business.[33]

Based on the record, the Court concluded, from what it perceived as a commonsense standpoint, that the MBA would qualify the taxpayer to perform significantly different tasks and activities. Accordingly, even though there was no indication that the taxpayer

was given significantly new tasks and activities after obtaining the MBA, and no indication that he intended or desired to move into another position with significantly different tasks and activities, the point is that the Court believed that the MBA label *qualified* him to do significantly new things and to move on to a significantly new job.

B. *Mceuen V. Commissioner*[34]

1. *Facts*

The taxpayer, Tracy McEuen, began working at Merrill Lynch (M-L) in 1992 as a "financial analyst." The next step up was "associate," which required an MBA degree. The taxpayer left M-L in 1995 to work for Raymond James Financial, Inc. (James) in its corporate finance department. Her position there was also "financial analyst" and, similar to M-L, she needed an MBA to become an "associate." In the investment banking industry during the relevant time, an MBA generally was required to advance to "associate."

Analysts at James were evaluated using three criteria: (a) mastery of analytics; (b) attention to detail; (c) teamwork and positive attitude; and (d) communication and leadership skills.

Associates at James were evaluated according to performance criteria grouped under five categories: (a) general performance expectations; (b) recruiting and team building; (c) management and supervision of banking analysts; (d) execution of business; and (e) business generation. The management and supervision category stated that associates were responsible for supervising and training analysts, and were responsible for the quality of work they produced.

While working at James, the taxpayer was accepted at the Kellogg School of Management at Northwestern University (Kellogg) to pursue an MBA degree. The taxpayer resigned her position at James in 1996 in order to attend school full time, realizing that it would be impractical to undertake the MBA while working at James due to the long hours required on the job.

The taxpayer majored in marketing, organizational behavior, and finance and received a master's of management degree (equivalent to an MBA) in 1998. Shortly after graduating, the taxpayer was hired by Spring Industries (Spring), a manufacturer of home furnishings, into its "General Management Program" (program). Only persons with an MBA were hired into the program. The program was described as a "proving ground for future top executives" and "prepares associates for careers in marketing, finance or operations management." When the taxpayer completed the program, she became an "associate brand manager." On her joint return with her husband for 1998, the taxpayer took an itemized deduction (Schedule A) in the amount of $20,317 for her MBA costs.[35]

2. *Court Opinion.*

The Court noted the taxpayer's argument that she was employed as an "investment banker" with the M-L and James firms. It further noted her argument that she did not abandon this trade or business by attending Kellogg for two years.[36] She further alleged that the expenses of her master's degree were incurred to maintain and improve her skills. Alternatively, she argued that the education was required as a condition to the retention of an existing employment relationship status, or rate of compensation.

The Court first reviewed the applicable regulations referring to the general rule that educational expenses are deductible if incurred to maintain or improve skills required in one's employment or trade of business. However, the Court then focused in on the disallowance rules. As noted previously, these rules provide that educational expenses incurred to meet minimum educational requirements for qualification for an employment, or that will qualify the taxpayer for a new trade or business, are not deductible.

In advancing her argument, the taxpayer asserted that the duties of an analyst and associate at the M-L and James firms was similar, both falling within the general category of investment banking positions. The Court noted, however, that the fact that an individual is already performing services in an employment situation does not mean that the person has met the minimum educational requirement for qualification in that employment.[37] Such a determination must be made by 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.

Considering all the facts and circumstances, the Court remarked that although there was some overlapping of duties of an analyst and an associate at both M-L and James, the analyst position was a subordinate temporary position lasting for a maximum of three years. At both companies, the associate position was a prerequisite to further advancement. Accordingly, the Court concluded that analysts had not achieved the status of "investment banker" although, in a broader sense, they were in the investment banking business. Consequently, the expenses incurred by the taxpayer in obtaining an MBA were held to be for the purpose of meeting the minimum educational requirements for qualification in her trade or business, as set by her employers and the industry in which she was working.

More significantly, the Court observed that even if not to meet minimum educational requirements, the expenditures nevertheless were not deductible since they qualified the taxpayer for a new trade or business.[38] Moreover, it stated that this rule is applicable although the education is required by an employer or applicable law, the taxpayer does not intend to enter a new field of endeavor, or the taxpayer's duties are not significantly different after the education from before.[39] In this regard, the Court referred to precedent holding that if the education qualifies the taxpayer to perform *significantly new tasks and activities*, the education qualifies the taxpayer for a new trade or business.[40] Accordingly, if the MBA obtained by the taxpayer qualified her to perform

significantly different tasks compared to what she was doing before the MBA, the degree qualified her for a new trade or business.

After obtaining her MBA, the taxpayer did not go back to work for an investment banking firm. Rather, she was hired into a management-training program with Spring, with the potential, though not assured, of moving into upper management. Although the Court agreed that the MBA did not automatically qualify her for a new trade or business, it noted that it could lead to such qualification, and that is all that is necessary under the regulations to bar a deduction.[41]

From the record before it, the Court found that the MBA degree would lead to qualifying the taxpayer to perform significantly different tasks and activities than she performed before obtaining the degree. Accordingly, the Court concluded that the MBA qualified the taxpayer for a new trade or business, which was just icing on the cake since it had also held that the MBA was to meet minimum education requirements as set by her employer and the industry in which she was working.

V. THE LATEST WORD

It is clear from the foregoing cases that the IRS has been challenging a deduction for the cost of an MBA degree for many years with mixed success. Of particular concern to tax practitioners as a result of the *McEuen* decision, however, was the Tax Court's reasoning that even if the education does not automatically qualify one for a new trade or business, the cost is nevertheless not deductible if the education will *lead* to such qualification. Once again, the Court equated the ability to perform significantly different tasks and activities with a new trade or business.

Arguably, an MBA will lead to qualifying any taxpayer to perform significantly new tasks and activities. Following this line of reasoning to its logical conclusion, very few persons, if any, would be able to deduct the cost of an MBA, and this is what had tax practitioners particularly concerned.

As a result of a new decision by the Tax Court, however, taxpayers pursuing an MBA degree should have at least some assurance that a deduction for its cost has not been completely foreclosed.

Allemeier V. Commissioner[42]

1. *Facts*

In *Allemeier*, a 2005 Tax Court decision, the taxpayer was a successful and valued salesperson. About three years into his employment, he decided to pursue a part-time MBA. His employer had told him that an MBA would enhance his business skills and speed his advancement in the company. However, his employer did not require him to get an MBA and had a strict policy of not reimbursing employees for education costs.

Shortly after he enrolled in the MBA program, the taxpayer was promoted to several new managerial positions. Consequently, his duties significantly expanded. He became responsible for analyzing financial reports, designing sales plans, and evaluating marketing campaigns. He performed these functions while in the MBA program from which he ultimately graduated.

The IRS disallowed the deduction taken for his tuition and other related expenses, raising two arguments. First, the IRS contended that the MBA was necessary for the taxpayer to get his promotion, and therefore the education was to meet minimum education requirements of his employer. Secondly, it argued that, in any event, the MBA qualified the taxpayer for a new trade or business regardless of his intent to enter a new trade or business, and regardless of whether his duties changed significantly after he obtained the MBA. However, the Tax Court disagreed and allowed the deduction.

2. *Court Opinion*

The Court found factually that the taxpayer's promotion was not contingent on obtaining an MBA. His employer may have encouraged him to get an MBA and may have told him that he might advance faster, but this did not constitute a requirement that he get the MBA. Apparently, the Court felt that his promotion at the same time he entered the MBA program was coincidental.

Citing numerous cases, the Court observed that whether education qualifies a taxpayer for a new trade or business depends on comparing the tasks the taxpayer was qualified to perform before and after getting the MBA.[43] The IRS, of course, argued that when the taxpayer began the MBA program, he advanced to managerial, marketing, and financial duties, all of which were different than what he had been doing prior to beginning the MBA program. The taxpayer on the other hand argued that the MBA merely capitalized on duties that he already had been doing, giving him a better understanding. From the record, however, the Court found that the taxpayer performed the same tasks before and after obtaining the MBA, although on a more complex level afterwards.

The Court, referring to the commonsense approach, observed that acquiring new titles or abilities does not necessarily constitute entry into a new trade or business.[44] In this case, it found that the taxpayer performed the same activities after entering the MBA program as he had been doing previously. The MBA simply improved preexisting skills.[45]

VI. CONCLUSION

As noted, *Lewis* and *McEuen* were decided in the small claims part of the Tax Court. As a regular Tax Court decision, *Allemeier* is therefore more authoritative.[46] One can read the *Lewis* case as denying any deduction for an MBA on the grounds that from a commonsense approach an MBA will always qualify a taxpayer to perform significantly new tasks and activities. In *McEuen*, the Court was even more restrictive, emphasizing that if education will *lead* to qualifying the taxpayer to performing significantly different

tasks and activities, although not automatically, the education qualifies the taxpayer for a new trade or business.[47]

Anyone spending the time and incurring the expense of pursuing an MBA no doubt believes, or at least hopes, that the degree will qualify him or her to perform significantly new tasks and activities, or at least that it will lead in that direction. Although it may be hard to quantify, it would seem from a commonsense approach that most people with an MBA actually do move on to performing significantly new tasks. Retrospectively, it can thus be argued that the MBA led in that direction.

In *Allemeier*, however, The Tax Court did not focus on the whether the MBA qualified the taxpayer to perform significantly new tasks or would lead in that direction, but rather emphasized the relationship between what tasks the taxpayer was performing pre and post the MBA. In this regard, the Court apparently found an insufficient distinction between what he was doing before and after entering the MBA program. Fortunately for the taxpayer, the Court neither prophesized about what the MBA might lead to in the future, nor considered what other tasks the degree qualified him for.

Accordingly, as a result of the *Allemeie*r decision, it seems that a deduction for an MBA has not been virtually foreclosed, as was feared after the *McEuen* decision. Hopefully, the Tax Court henceforth will follow what appears to be a more liberal rule by adhering to evaluating what a person is doing before and after the MBA, and not speculating about whether the degree might lead to qualification for a new trade or business in the future (i.e., performing new tasks and activities). Of course, as previously pointed out, if the education qualifies a person for a license or certification, the law is clear that no deduction is allowed.

From the standpoint of tax policy, one can contend that the IRS position on deducting the cost of an MBA is overly restrictive. In today's highly competitive global economic environment, it generally has been recognized that an important factor in the long-term economic success of a country is the educational level of its population. Recognizing this, many developing countries (e.g., India and China) are turning out record numbers of college graduates. In this country, education is clearly a highly valued commodity as evidenced by the numerous provisions in the IRC favoring education.[48] Accordingly, denying a deduction for the cost of an MBA for someone working in the business community seemingly contradicts the overall policy of using the tax laws to foster education. Fortunately, *Allemier* seems to sanction a more flexible approach. In any event, it is clear that the result for any taxpayer attempting to deduct the costs of an MBA will depend on the specific facts and circumstances.

ENDNOTES

[1] Jennifer Merritt, "MBA Applicants Are MIA," *Business Week*, April 18, 2005, 28.
[2] Id.
[3] Jennifer Merritt, "What's an MBA Really Worth?" *Business Week*, September 22, 2003, 90.
[4] Id. Statement by Stanford University Graduate School of Business Professor Jeffrey Pfeffer.
[5] According to the National Center of Education Statistics.
[6] *Supra*, Note 1. Also, see Louis Lavelle, "Is the MBA Overrated?" *Business Week*, March 20, 2006, 78.
[7] *See* Susan Berfield, "Thirty and Broke," *Business Week,* November 14, 2005, 76.
[8] "Paying for Education," *The Economist,* February 18, 2006, 71 (Staff).
[9] For example, see statement by Robert Willens (Lehman Brothers) on Tax Prof Blog.
[10] Treas. Reg. § 1.162-5 (as amended in 1967).
[11] As set forth in I.R.C. § 262, no deduction is allowed for personal, living, and family expenses.
[12] Glen v. Commissioner, 62 T.C. 270 (1974).
[13] T.C. Memo. 1975-327.
[14] As further examples: No deduction for attending law school (Weiszmann, 52 T.C. 1106 (1969) (patent trainee), Bodley v. Commissioner, 56 T.C. 1357 (1971) (school teacher), Taubman v. Commissioner, 60 T.C. 814 (1973) and Weiler 54 T.C. 398 (1970) (IRS agents), and Galligan T.C. Memo. 200-150 (law librarian)). No deduction for licensed practical nurse studying to become a registered nurse (Robinson v. Commissioner, 78 T.C. 350 (1982), nor for licensed practical nurse studying to become a physician's assistant (Reisinger v. Commissioner, 71 T.C. 568 (1979)). No deduction for graduate teaching assistant studying for graduate degree (Jungreis v. Commissioner, 55 T.C. 581 (1970)). No deduction for bookkeeper studying for an accounting degree (Browne v. Commissioner, 73 T.C. 723 (1980)). No deduction for clinical social worker pursuing Ph.D in social work to obtain faculty position (Davis v. Commissioner, 65 T.C. 1014 (1976)). No deduction for paraprofessional studying to get a teacher's license (Diaz v. Commissioner, 70 T.C. 1067 (1978)). On the other hand, the regulations treat teachers at all levels the same (Treas. Reg. § 1.162-5(b)(2)(ii) and (iii)). Thus, a person holding an undergraduate degree in education and sociology, and who was a discussion leader in a "Family Education Program," was allowed to deduct the cost of pursuing a master's in educational psychology and guidance (Schwerm v. Commissioner, T.C. Memo 1986-16).
[15] T.C. Memo. 1977-301.
[16] See Haft v. Commissioner, 40 T.C. 2 (1963), Furner v. Commissioner, 393 F.2d 292 (1968), *rev'g*. 47 T.C. 165 (1966) and Ford v. Commissioner, 56 T.C. 1300 (1971), *aff'd. per curiam* 487 F,2d 1025 (9th Cir. 1973).
[17] T.C. Memo. 1979-248.
[18] T.C. Memo. 1980-196.
[19] Treas. Reg. §1.162-5(b)(3)(i) (as amended in 1967). See also Rev. Rul.60-97, 1960-1 CB 69, 73.
[20] T.C. Memo. 1980-488.

[21] Treas. Reg. § 1.162-5(b)(3) (as amended in 1967).
[22] See Granger v. Commissioner, T.C. Memo. 1980-196, where there was deemed to be no change in trade or business where someone progressed from personnel assistant to assistant personnel director and finally to personnel director.
[23] Link v. Commissioner, 90 T.C. 460.
[24] T.C. Memo. 1983-753.
[25] See Furner v. Commissioner, 393 F.2d 352 (7th Cir. 1968), *rev'g*. 47 T.C. 165 (1966).
[26] Referring to Treas. Reg. § 1.165-5(b)(3).
[27] The Court distinguished this case from the *Sherman* case (*supra* note 4) where the taxpayer, after leaving the Army, was employed in a civilian management position for two years before entering the MBA program. Thus, in that case, the taxpayer had established himself in a trade or business of business administration before entering the MBA program.
[28] I.R.C. §7463.
[29] It may be noted that in the Small Claims part, the cases are decided based upon the preponderance of the evidence regardless of the allocation of the burden of proof otherwise.
[30] 2002 TNT 89-12 (2002).
[31] Citing Robinson v. Commissioner, 78 T.C 550, 556-557 (1982); Bodley v. Commissioner, 56 T.C. 1357, 1360 (1971); and Schwerm v. Commissioner, T.C. Memo. 1986-16.
[32] Citing Reisinger v. Commissioner, 71 T.C. 568, 574 (1979).
[33] Citing Browne v. Commissioner, 73 T.C. 723, 726 (1980) (citing Diaz v. Commissioner, 70 T.C. 1067, 1074 (1978), *aff'd.* without published opinion 607 F.2d 995 (2nd Cir. 1979)); and Glenn v. Commissioner, 62 T.C. 270, 275 (1974).
[34] 2004 TNT 150-9 (2004).
[35] The $20,317 was after the 2% of adjusted gross income reduction under I.R.C. §67.
[36] The Court did not find it necessary to address the contention of the IRS that the taxpayer was not engaged in a trade or business in 1998. However, the fact that someone is not currently working does not mean the person is not in a trade or business. For example, a leave of absence to attend school does not necessarily mean the person is not in a trade or business if the person was in the trade or business before the leave and went back to work in the same field after the leave. See, for example, Furner v. Commissioner, 393 F.2d 292 (7th Cir. 1968), *rev'g*. 47 T.C. 165 (1966). The IRS has ruled that an absence of one or more years from a job terminates the carrying on of a trade or business. Rev. Rul. 68-591, 1968-1 C.B. 73. This ruling apparently was in response to the *Furner* case where the leave of absence was for one year. Of course, the courts are not bound by the interpretation of the IRS, which is a bright line test to the exclusion of the facts and circumstances.
[37] Citing Treas. Reg. §1.162-5(b)(2)(i) (as amended in 1967).
[38] Citing Treas. Reg. §1.162-5(b)(3) (as amended in 1967).
[39] Citing Treas. Reg. §1.162-5(b)(1) (as amended in 1967).

[40] Glen v. Commissioner, 62 T.C. 270, 275 (1974); Wiesmann v. Commissioner, 52 T.C. 1106, 1110 (1969), *aff'd per curiam* 443 F.2d 29 (9th Cir. 1971).
[41] Treas. Reg. § 1.162-5(b)(3)(i) (as amended in 1967).
[42] T.C. Memo. 2005-207.
[43] See Glenn v. Commissioner, 62 T.C. 270 (1974) (other citations omitted).
[44] See Reisinger v. Commissioner, 71 T.C. 568 (1979) (other citations omitted).
[45] See Blair v. Commissioner, T.C. Memo. 1980-488 and Beatty v. Commissioner, T.C. Memo. 1980-196.
[46] Actually, *Allemeier* is a Memorandum decision, which supposedly has somewhat less authority than a Regular Tax Court decision. Regular decisions are supposed to involve novel issues not previously resolved by the Court. However, the distinction is not always observed and some decisions that are Memorandum arguably should have been Regular and vice versa. In any event, both are Tax Court decisions and thus both have value as precedents.
[47] See Treas. Reg. § 1.162-5 (b)(3) for "will lead to" language.
[48] In broad overview, there are: (1) Two savings plans for future education costs: Coverdale Education IRAs[48] and Section 529 plans[48] administered by the states; (2) Two tax credits: Hope Scholarship Credit and Lifetime Learning Credit;[48] (3) Various deductions: Tuition and Fees deduction[48], Educator Expense Deduction,[48] Student Loan Interest deduction,[48] and possibly a deduction for education to maintain or improve job skills, or that is required by an individual's employer;[48] and (4) Two benefits that are excluded from gross income: Scholarships are tax free[48] and, within limits, so is Educational Assistance by an employer.[48]