Solving the B-School Tax Riddle: A Proposal To Clarify the Confusion Surrounding Deductions for MBA-Related Educational Expenditures Under § 162 of the Internal Revenue Code

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INTRODUCTION

The deductibility of tuition expenses for coursework toward a Master of Business Administration (MBA) degree has confounded taxpayers and the courts for decades. Specifically, courts have frequently struggled in their efforts to determine whether MBA-related tuition expenses fall within the Internal Revenue Code's express allowance—codified in § 162—of deductions for "ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business."[1] A source of particular confusion is Treasury Regulation § 1.162-5's disallowance of educational expenses which are "part of a program of study being pursued by [the taxpayer] which will lead to qualifying him in a new trade or business."[2]

Recently, in an effort to resolve conflicting court decisions on this issue, at least one commentator has called for a bright-line disallowance of deductions for MBA-related educational expenditures.[3] This Note takes a different stand and argues that a blanket disallowance of deductions for MBA tuition expenses would constitute an overbroad rule that would result in the exclusion of many deductions entirely consistent with the policy motivations underlying § 162 of the Internal Revenue Code.[4] This Note also recommends modifications to Treasury Regulation § 1.162-5 that, if promulgated, would permit deductions

1. 26 U.S.C. § 162(a) (2006).

2. Treas. Reg. § 1.162-5(b)(3)(i) (as amended in 1967).

3. *See* Jill Kutzbach Sanchez, Note, *The Deductibility of MBA Degree Expenses Under Treasury Regulation 1.162-5: Are You One of the Lucky Few Who Qualify?*, 32 J. CORP. L. 659, 675 (2007).

4. As articulated by many commentators, the purpose of § 162 is to permit deductions for the costs of doing business—that is, the costs of engaging in one's trade or profession—but not for costs associated with personal consumption, which are expressly disallowed by § 262 of the Internal Revenue Code. *See, e.g.*, James L. Musselman, *Federal Income Tax Deductibility of Higher Education Expenses: The Good, the Bad, and the Ugly*, 35 CAP. U. L. REV. 923, 924–27 (2007); Hamish P. M. Hume, Note, *The Business of Learning: When and How the Cost of Education Should Be Recognized*, 81 VA. L. REV. 887, 890–97 (1995); *see also* 26 U.S.C. § 262(a) ("Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses."). If Treasury Regulation § 1.162-5 is any guide, the Treasury appears to view education not directly attributable to one's *current* trade or profession—such as education that facilitates the taxpayer's professional "reinvention" or entrée into a new trade—as having a significant, perhaps even dominant, personal consumption component. *See* Treas. Reg. § 1.162-5(b)(1) (as amended in 1967). As this analysis ultimately will demonstrate, however, many MBA educations pass muster even under the Treasury's rather narrow interpretation of §§ 162 and 262.

consistent with the purpose of § 162 while simultaneously disallowing most deductions for educational expenditures that would reasonably lead to qualification "in a new trade or business." In so recommending, this Note examines a key policy consideration missed by those who call for blanket disallowance: The majority of MBA educations do not, despite suggestions to the contrary, reasonably result in virtually automatic qualification in new trades or businesses.

Part I of this Note will provide relevant background, beginning with an overview of § 162 and Treasury Regulation § 1.162-5, continuing with a survey of court cases addressing the question of MBA tuition deductibility over the years, and concluding with a discussion of recent commentary on the issue. Part II will make the case for MBA tuition deductibility in most cases, in large part by refuting the argument that the MBA degree results in virtually automatic qualification in new trades and businesses. Finally, Part III will outline three proposed amendments to § 1.162-5 that, if implemented, would more cleanly separate legitimate MBA-related deductions from those likely to offend the policy motivations behind § 162.

Ultimately, the goal of this Note is threefold: first, to demonstrate that most MBA educations do not offend the Treasury Department's professed policy against deductions for educational expenses that lead to the qualification of a taxpayer in a new trade or business; second, to dispel the argument—one adopted not only by at least one recent commentator, but also quite possibly by the enforcement arm of the IRS itself—that blanket disallowance is appropriate in cases involving tax deductions for MBA-related expenditures; and third, to outline possible changes to Treasury Regulation § 1.162-5 that would serve to more closely align MBA-related deductions with Treasury Department policy.

I. BACKGROUND: SORTING THROUGH THE MBA TAX RIDDLE

Although § 162 of the Internal Revenue Code and its accompanying regulations permit deductions for educational expenditures under certain circumstances, courts have long struggled in their efforts to apply the applicable legal standards in cases involving MBA-related deductions. Although some coherent principles can be synthesized through a careful review of what might at first blush appear to be conflicting court rulings, a few recent commentators have asserted that MBA-related expenditures rarely—if ever—satisfy the legal requirements for deductibility. In fact, at least one commentator has argued that the Treasury should enact a blanket disallowance of all deductions for MBA-related educational expenditures.[5]

A. SECTION 162 AND TREASURY REGULATION § 1.162-5

Section 162 of the Internal Revenue Code permits deductions for "all the

5. *See* Sanchez, *supra* note 3, at 675.

ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."[6] As a matter of policy, § 162 codifies the long-recognized principle that, generally speaking, ordinary business expenses constitute the costs of generating income—as opposed to consumption or personal expenditures—and therefore are not properly includable in a taxpayer's taxable "bottom line."[7] As express examples of expenses normally deductible as "ordinary and necessary" business expenditures, § 162 offers the following: "salaries or other compensation for personal services,"[8] "traveling expenses . . . while away from home in the pursuit of a trade or business,"[9] and "rentals or other payments required to be made as a condition to the continued use or possession . . . of property."[10]

Although § 162 itself makes no express mention of educational expenses, § 1.162-5 of the Treasury Regulations[11] outlines the circumstances under which expenses for education may be deductible as "ordinary and necessary" business expenditures under § 162. Pursuant to § 1.162-5, educational expenses are deductible under § 162[12] if all three of the following conditions are satisfied: (1) the education "[m]aintains or improves skills required" by the taxpayer in his employment, trade, or business,[13] *or* meets express requirements imposed by the taxpayer's employer or by applicable law as a condition to the retention of the taxpayer's established employment, status, or rate of compensation;[14] (2) the education is *not* required in order to meet the minimum educational requirements for qualification in the taxpayer's employment, trade, or business;[15] *and* (3) the education is *not* part of a program of study that will lead to qualifying the taxpayer in a new trade or business, irrespective of whether the taxpayer actually intends to enter the trade or business for which the program of study

6. 26 U.S.C. § 162(a).

7. *See, e.g.*, Henderson v. Comm'r, 46 T.C.M. (CCH) 566 (1983) (noting the distinction between deductible costs of doing business and "personal, living, or family expense[s]").

8. 26 U.S.C. § 162(a)(1).

9. *Id.* § 162(a)(2).

10. *Id.* § 162(a)(3).

11. Pursuant to § 7805 of the Internal Revenue Code, the Secretary of the Treasury has the authority to "prescribe all needful rules and regulations for the enforcement of" the Code, except where such authority is expressly given to others. *Id.* § 7805(a). Such rules and regulations promulgated by the Secretary are codified in the Treasury Regulations.

12. A minor caveat worth mentioning here is that educational expenses deducted under § 162 constitute "miscellaneous itemized deductions" within the meaning of the Internal Revenue Code and are therefore deductible only to the extent that they exceed [two] percent of the taxpayer's adjusted gross income—even if all other statutory and regulatory requirements are satisfied. *See id.* § 67(a) ("In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds two percent of adjusted gross income."). For instance, a taxpayer with an adjusted gross income of $100,000, $20,000 in permissible educational expenses, and no other miscellaneous deductions would only be allowed to deduct $18,000 of his educational expenses, as that is the amount by which the aggregate of his miscellaneous itemized deductions ($20,000) exceeds two percent of his adjusted gross income ($2,000).

13. Treas. Reg. § 1.162-5(a)(1) (as amended in 1967).

14. *Id.* § 1.162-5(a)(2).

15. *See id.* § 1.162-5(b)(2)(i).

qualifies him.[16] Where a taxpayer's educational expenditures fail to satisfy any one of these three requirements, the costs constitute personal expenditures[17] and therefore are not deductible as "ordinary and necessary" business expenditures under § 162.[18]

In addition to outlining the general rules governing the deductibility of educational expenses under § 162, § 1.162-5 provides several examples of expenditures that satisfy the regulation's requirements as well as examples of those that do not. For instance, the regulation specifically states that an aspiring attorney may *not* deduct the costs associated with law school and bar preparation courses because such courses "constitute education required to meet the minimum educational requirements for qualification in [the student's] trade or business"[19] and are part of a course of study that "qualifies him for a new trade or business."[20] On the other hand, the regulation notes that a general practitioner of medicine who takes a two-week course reviewing "new developments in several specialized fields of medicine" *may* deduct the costs associated with the course because the course "maintains or improves skills required by him in his trade or business and does not qualify him for a new trade or business."[21]

Conspicuously absent from § 1.162-5's many examples is any mention of educational expenses incurred in pursuit of an MBA. One possible explanation for this omission is the fact that an MBA degree—unlike a law degree, a medical degree, or a degree in education—is not an express requirement for licensure in any particular profession, nor are the courses that comprise the degree "refresher" or "update" courses of the sort that one might typically place in a "continuing education" category. In other words, MBA courses fall into a

16. *See id*. § 1.162-5(b)(3).

17. Though not dictated by statute, the Treasury has long taken the position that virtually all expenditures for education are personal expenditures and are therefore not eligible for deduction or amortization under § 162 or any other provision of the Internal Revenue Code, even where such expenditures—for instance, the costs associated with obtaining a bachelor's degree in engineering, a necessary prerequisite for a career in the engineering field—have a clear connection to one's trade or business. *See, e.g.*, David S. Davenport, *Education and Human Capital: Pursuing an Ideal Income Tax and a Sensible Tax Policy*, 42 CASE W. RES. L. REV. 793, 805–10 (1992). The exceptions to that general rule, including those promulgated in Treasury Regulation § 1.162-5, which appear to be aimed at isolating those educational expenditures that do not have a significant "personal consumption" component, are quite narrow indeed. Scholars disagree as to why the Treasury has assumed such a restrictive view of the deductibility of educational expenditures over time. Some attribute the government's position to concerns regarding "the practical problems of judicial and administrative line drawing between those education expenditures for which cost recovery arguably should be allowed and those that might be viewed as costs of personal consumption." *Id.* at 797. Others argue that the restrictive position is justified on the grounds that the benefits of deductions for educational expenditures might accrue in large part to those who least need them, such as those in the more affluent segments of society. *Id.* at 797–98. Nevertheless, many observers bristle at "the notion that the joys of obtaining a [professional education] are considered to be akin to the personal consumption involved in renting their apartments, consuming pizza, or watching the Red Sox chase a pennant." *Id.* at 811–12.

18. *See* Treas. Reg. § 1.162-5(b)(1) (as amended in 1967).

19. *Id.* § 1.162-5(b)(2)(iii), Example (3).

20. *Id.* § 1.162-5(b)(3)(ii), Example (1).

21. *Id.* § 1.162-5(b)(3)(ii), Example (3).

peculiar middle ground between courses that *clearly* lead to qualification in a new trade or business and those that *merely* improve or maintain skills that the taxpayer already has acquired; for this reason, they do not lend themselves to bright-line distinctions and clear examples under the rules articulated in § 1.162-5. Another possible explanation for the absence of any mention of the MBA in § 1.162-5 is that when the regulation was drafted in 1967 the degree was far less ubiquitous than it is today, perhaps making it an unattractive (or non-obvious) candidate for mention in the regulation's many examples.[22]

In any event, all possible explanations aside, it remains plain that neither § 162 nor § 1.162-5 offers clear guidance with respect to the deductibility of educational expenses incurred in pursuit of an MBA.[23] This explains, at least in part, why the courts have long struggled with cases involving disputes over MBA-related deductions.

B. TAX COURT TREATMENT OF MBA-RELATED TUITION EXPENSES

As noted in section I.A, the courts often have struggled when confronted with the question of whether MBA-related educational expenditures are deductible as "ordinary and necessary" business expenditures under § 162. Although the question of whether a particular MBA curriculum improved or maintained skills used by the taxpayer in his established profession has rarely been contested—provided, of course, that the taxpayer was in fact firmly established in a trade or profession prior to pursuing an MBA[24]—much ink has been spilled in disputes[25] over the following: (1) whether the taxpayer remained engaged in a trade or profession while pursuing his MBA and (2) whether the taxpayer's MBA coursework qualified him in a new trade or profession. Results have not

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22. *See* Jeffrey Pfeffer & Christina T. Fong, *The End of Business Schools? Less Success than Meets the Eye*, 1 ACAD. MGMT. LEARNING & EDUC. 78, 78 (2002), *available at* http://www.aomonline.org/Publications/Articles/BSchools.asp ("For instance, in 1955–56, graduate business education was virtually nonexistent, with only 3,200 MBA degrees awarded in the U.S. By 1997–98, this number had grown to over 102,000." (internal quotation marks omitted)).

23. The regulatory history of Treasury Regulation § 1.162-5 similarly provides no guidance regarding the deductibility of MBA-related educational expenses. For instance, the Treasury Decision published when the regulation was amended in 1967 provides little more than the regulation's amended text. *See* T.D. 6918, 1967-1 C.B. 36. In addition, a visit to the Freedom of Information Reading Room at the Internal Revenue Service headquarters in Washington, D.C. unearthed no Technical Memorandum or other internal agency document providing insight into the Treasury Department's opinions regarding the deductibility of MBA educations.

24. *Cf.* Link v. Comm'r, 90 T.C. 460, 461–62, 464–65 (1988) (finding that a recent college graduate who left his job as a market research analyst to pursue an MBA a mere three months after graduating from college had not engaged in "considerable, continuous, and regular activity" sufficient to establish him in a trade or business prior to pursuing a graduate education).

25. *See, e.g.*, Allemeier v. Comm'r, 90 T.C.M. (CCH) 197 (2005); Schneider v. Comm'r, 47 T.C.M. (CCH) 675 (1983). Although the IRS disallows deductions for MBA-related educational expenditures with some frequency, the precise standards that it applies in determining whether a given business school student's educational expenditures should be disallowed remain somewhat unclear. The Internal Revenue Manual makes no mention of MBA-related educational expenditures and generally includes very little discussion of Treasury Regulation § 1.162-5.

always been consistent—at least when viewed in terms of the broad question of whether MBA-related expenditures are deductible under § 162—because outcomes frequently have turned on the factual peculiarities of cases, often after detailed analysis of the taxpayer's behavior both before and after pursuit of the MBA degree. Nevertheless, a careful review of court opinions addressing MBA deductibility reveals several common principles that may serve as the foundation for amendments to Treasury Regulation § 1.162-5.

1. Victory for the IRS: Cases Decided in Favor of the Commissioner

In many cases, courts have ruled in favor of the Commissioner and against the taxpayer. For instance, in *Schneider v. Commissioner*, the United States Tax Court ruled against a former Army officer with considerable management and leadership experience who left military service to pursue a full-time MBA at the Harvard Business School and a full-time Master of Public Administration (MPA) degree at Harvard's Kennedy School of Government.[26] Following completion of both programs, the taxpayer began a career as a business strategy consultant.[27] He deducted costs associated with his MBA education on his 1977 and 1978 tax returns, which the Commissioner disallowed.

In ruling against the taxpayer, the *Schneider* court determined that he was not "carrying on" a trade or business during his time at Harvard and that his education clearly qualified him for a new trade or business.[28] Specifically, the court found that the taxpayer's absence from work was not temporary and definite, and therefore, it could not reasonably be argued that he was "carrying on" a trade or business while enrolled at Harvard.[29] Moreover, although the taxpayer had accumulated considerable leadership experience during his tenure as an Army officer, the court found that his military skills were insufficiently related to his MBA courses and his post-MBA career to support the assertion that he was engaged in the trade or business of being a "manager" before, during, and after his time at Harvard; this, the court argued, inevitably led to the conclusion that the taxpayer's MBA degree qualified him in a new trade or profession—that of a business strategy consultant—which in turn rendered his educational expenses non-deductible under § 1.162-5.[30]

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26. Schneider v. Comm'r, 47 T.C.M. (CCH) 675, 676–77, 680 (1983).
27. *Id.* at 677.
28. *Id.* at 678.
29. *Id.* The court asserted that

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

Id. at 680 n.6 (quoting Sherman v. Comm'r, 36 T.C.M. (CCH) 1191 (1977)).

30. *Id*. at 678–79. The court stated that "petitioner's work as an Army officer is a different trade or business from the consulting business for which his course of study at Harvard prepared him." *Id.* at 679.

Similarly, in *McEuen v. Commissioner*, the United States Tax Court held that a graduate of Northwestern University's Kellogg School of Management could not deduct the costs of her MBA education because the degree program led to qualifying her in a new trade or business.[31] The *McEuen* taxpayer enrolled at Kellogg as a full-time student after spending four years as a financial analyst at two different investment banking firms.[32] After completing her MBA, she entered a management development program at a home furnishings manufacturer. Upon completion of the management development program, she became an associate brand manager for the same manufacturer. On her 1998 income tax return, the taxpayer claimed a deduction of $20,317 for "required education."

In ruling against the taxpayer and in favor of the Commissioner, the *McEuen* court found that the taxpayer's acceptance into her post-graduate employer's management development program—a program that recruited actively at top business schools—and her ultimate assumption of a brand manager position unrelated to her pre-MBA career made it plain that her MBA education "led to qualifying her to perform significantly different tasks and activities than she performed before the education."[33] This, the court said, served as evidence that her education had qualified her for a new trade or business and thus rendered her educational expenses non-deductible under § 162.[34]

2. Victory for the MBA: Cases Decided in Favor of the Taxpayer

In numerous other cases, however, courts have ruled in favor of taxpayers seeking to deduct MBA-related expenses. For instance, in *Blair v. Commissioner*, the Tax Court ruled in favor of a personnel representative employed by Sherwin-Williams who completed a two-year part-time MBA program at Baldwin-Wallace College.[35] While her studies were in progress, but prior to their completion, the taxpayer received a promotion to personnel manager. She deducted costs associated with her MBA education on her 1975 and 1976 tax returns.[36]

In ruling in the personnel manager's favor, the *Blair* court concluded that, although she received a promotion while her MBA courses were in progress, her elevation from personnel representative to personnel manager constituted a

31. McEuen v. Comm'r, T.C. Summ. Op. 2004-107.

32. *Id.*

33. *Id.*

34. *Id.* Note that *Schneider* and *McEuen* represent only two of several cases in which courts have ruled against taxpayers seeking to deduct MBA-related expenses. *See, e.g.*, Foster v. Comm'r, T.C. Summ. Op. 2008-22 (holding that an engineer and project manager who pursued a full-time MBA at the Harvard Business School could not deduct the costs of her education because she did not possess the skills required in her post-MBA marketing job prior to matriculating at business school); McIlvoy v. Comm'r, 38 T.C.M. (CCH) 987 (1979) (holding that an engineer with few, if any, business-related responsibilities could not deduct the costs of his MBA education because his MBA courses taught him entirely new skills and therefore did not improve or maintain existing skills within the meaning of Treasury Regulation § 1.162-5).

35. Blair v. Comm'r, 41 T.C.M. (CCH) 289, 290 (1980).

36. *Id.* at 289, 291.

change of duties as opposed to a transition into a new trade or business.[37] In addition, the court noted that, with the exception of a single course for which the taxpayer did not claim a deduction, all of her MBA courses improved or maintained skills that she had already acquired in her job at Sherwin-Williams.[38]

Much more recently, in *Allemeier v. Commissioner*, the Tax Court ruled in favor of a salesman and marketing manager for a dental appliance manufacturer who completed a part-time MBA program at Pepperdine University.[39] Throughout the duration of his MBA studies, the taxpayer worked for his employer on a full-time basis. He also continued to work for the same employer in the same general capacity after completing the degree. Moreover, prior to completing his MBA, he already had assumed significant managerial, marketing, and business strategy duties.[40] On his 2001 income tax return, the taxpayer deducted $17,500 of tuition expenses associated with his MBA education, which the Commissioner subsequently disallowed.[41]

The *Allemeier* court rejected the Commissioner's arguments that the taxpayer pursued an MBA in order to meet the minimum education requirements of his employer and that his MBA degree qualified him for a new trade or business.[42] In so holding, the court concluded that nothing in the record supported the Commissioner's contention that the taxpayer's employment or promotions were contingent upon his completion of an MBA program.[43] The court also asserted that because the taxpayer's duties did not change markedly during or after the completion of his MBA studies, and because his MBA did not qualify him for a professional certification or license, the record strongly suggested that the taxpayer's MBA education did not qualify him for a new trade or business.[44] Specifically, the court declined "to find as an objective matter that the MBA qualified petitioner in a 'new' trade or business, where petitioner had substantial work experience directly related to his MBA coursework. The MBA qualified petitioner to perform the same general duties he performed before enrolling in the MBA program."[45]

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37. *Id.* at 291–92.
38. *Id.* at 292.
39. Allemeier v. Comm'r, 90 T.C.M. (CCH) 197, 197–98 (2005).
40. *Id.* at 198, 200.
41. *Id.* at 198.
42. *Id.* at 199, 201.
43. *Id.* at 199.
44. *Id.* at 199–200.
45. *Id.* at 201 (citation omitted). Courts have similarly found for the taxpayer on several other occasions. *See, e.g.*, Beatty v. Comm'r, 40 T.C.M. (CCH) 438 (1980) (holding that an engineer who pursued a Master of Science in Administration (MSA) degree on a part-time basis could deduct the costs of his education because he had already assumed significant management responsibilities before entering graduate school, suggesting that the degree merely maintained or improved skills he had already acquired); Sherman v. Comm'r, 36 T.C.M. (CCH) 1191 (1977) (holding that a business planning manager who left work to pursue a full-time MBA and subsequently assumed a planning and research position with another employer could deduct the costs of his MBA education because a

3. Making Some Sense of the Confusion: Synthesis of Imbedded Rules

Despite the apparent lack of consistency among court decisions ruling on the deductibility of MBA-related expenses, a review of the cases exposes a more coherent series of underlying guiding principles. Specifically, an attentive analysis reveals at least three imbedded rules applied consistently across the various MBA-related cases. First, absent some compelling distinguishing factor, the Tax Court's MBA-related decisions demonstrate that a student who pursues an MBA on a part-time basis while continuing to work in his established profession is presumed to remain engaged in a trade or profession during his studies, whereas an MBA student who exits the workforce for an extended period of time to pursue graduate study full-time is presumed to be not so engaged.[46] Second, the decisions reveal that where an MBA student remains engaged in his pre-MBA profession after completion of his degree, it is presumed that his degree has not qualified him for a new trade or profession, whereas a student who transitions into a new trade or profession shortly after completing his studies is practically *per se* considered to have become qualified for a new trade or profession as a result of his MBA degree.[47] Finally, the decisions teach that the MBA-related expenses of a student who did not acquire substantial business- or management-related skills prior to pursuing an MBA are *per se* non-deductible under § 162.[48]

These three guiding principles, which will be unpacked further in Part III, will serve as the foundation of this Note's proposal to update Treasury Regulation § 1.162-5. The goal, ultimately, is to guide courts and taxpayers more coherently in their efforts to determine when educational expenses—and MBA expenses in particular—are, or are not, deductible under § 162.

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taxpayer who temporarily ceases employment for a definite period of time in order to pursue full-time study may still be "carrying on" a trade or business while in school).

46. *See* Foster v. Comm'r, T.C. Summ. Op. 2008-22 (disallowing a deduction for full-time MBA study); Allemeier v. Comm'r, 90 T.C.M. (CCH) 197 (2005) (permitting a deduction for part-time MBA study); McEuen v. Comm'r, T.C. Summ. Op. 2004-107 (disallowing a deduction for full-time MBA study); Link v. Comm'r, 90 T.C. 460 (1988) (same); Schneider v. Comm'r, 47 T.C.M. (CCH) 675 (1983) (same); *Beatty*, 40 T.C.M. (CCH) at 438 (permitting a deduction for part-time MBA study); Blair v. Comm'r, 41 T.C.M. (CCH) 289 (1980) (same). *But see Sherman*, 36 T.C.M. (CCH) at 1191 (*permitting* a deduction for *full-time* MBA study).

47. *See Foster*, T.C. Summ. Op. 2008-22 (disallowing a deduction where the student's pre- and post-MBA professions differed); *Allemeier*, 90 T.C.M. (CCH) at 197 (permitting a deduction where the student's pre- and post-MBA professions were the same); *McEuen*, T.C. Summ. Op. 2004-107 (disallowing a deduction where the student's pre- and post-MBA professions differed); *Schneider*, 47 T.C.M. (CCH) at 675 (same); *Beatty*, 40 T.C.M. (CCH) at 438 (permitting a deduction where the student's pre- and post-MBA professions were the same); *Blair*, 41 T.C.M. (CCH) at 289 (same); *Sherman*, 36 T.C.M. (CCH) at 1191 (same).

48. *See Allemeier*, 90 T.C.M. (CCH) at 197 (permitting a deduction where the student had obtained substantial business- or management-related skills before pursuing an MBA); *Beatty*, 40 T.C.M. (CCH) at 438 (same); *Blair*, 41 T.C.M. (CCH) at 289 (same); McIlvoy v. Comm'r, 38 T.C.M. (CCH) 987 (1979) (disallowing a deduction where the student had obtained few, if any, business-related skills before pursuing an MBA).

C. THE FLAWED CASE FOR BLANKET DISALLOWANCE: OVERVIEW OF RECENT COMMENTARY

Although the deductibility of educational expenses incurred in pursuit of an MBA is hardly a topic of substantial scholarly discourse, a few recent commentators have explored the issue and have concluded, largely without factual substantiation, that the MBA degree almost always—if not always—qualifies a student in a new trade or business and is therefore nearly always violative of Treasury Regulation § 1.162-5.[49] One commentator has even gone so far as to call for a bright-line disallowance of deductions for MBA-related educational expenditures on the grounds that "[w]hen a taxpayer obtains an MBA degree, he or she is qualified to enter many new trades and businesses."[50] Although these analyses include many legitimate critiques of the courts' MBA-related decisions,[51] they ultimately fail—at least in significant part—because they neglect to examine whether their assertions regarding virtually automatic qualification in a new trade or business have any basis in fact.

In a 2007 article in *The Journal of Corporation Law*, Jill Kutzbach Sanchez argues that the difficulties inherent in applying Treasury Regulation § 1.162-5 to MBA-related educational expenses, combined with confusing and conflicting court decisions on the issue, have led to disparate treatment of taxpayers, tax avoidance schemes, and unnecessary administrative costs in the form of numerous disputes between taxpayers and the IRS.[52] To alleviate such problems, she ultimately calls for the blanket disallowance of deductions for expenses incurred in pursuit of an MBA.[53] While some, though certainly not all,[54] of Sanchez's many critiques have merit, a critical weakness of her analysis is her failure to substantiate her oft-stated—and heavily relied upon—assumption that the MBA degree essentially results in automatic qualification in new trades or professions.[55] Absent factual support for her claim that MBA expenditures

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49. *See* Sanchez, *supra* note 3, at 676 (asserting, without factual support, that an MBA automatically qualifies a taxpayer to "enter many new trades and businesses"); Robert A. Stolworthy, Jr., Note, *No M.B.A. Left Behind: Professional Education as a Business Expense in* Allemeier v. Commissioner, 59 TAX LAW. 927, 928 (2006) (asserting that "graduate education leading to a degree only rarely passes the new trade or business test").

50. Sanchez, *supra* note 3, at 676.

51. For instance, the Sanchez and Stolworthy notes both criticize the courts' tendency to apply what is widely held to be an objective test—whether a given course of study qualified the taxpayer for a new trade or profession—in a manner that focuses on the taxpayer's subjective intent. *See id.* at 666; Stolworthy, *supra* note 49, at 927, 934–35.

52. *See* Sanchez, *supra* note 3, at 669.

53. *Id.* at 675 ("The courts and the IRS should not allow taxpayers to deduct educational expenses incurred to obtain an MBA degree under any circumstances.").

54. Sanchez's concerns regarding tax avoidance schemes, for instance, are purely theoretical. While she argues that the current regulations make it possible for employers and employees to conspire to escape taxation of MBA-related expenditures, she cites to no case or other authority showing that employers and employees have in fact implemented such schemes. *See id.* at 675.

55. As the sole support for her argument that the MBA degree results in virtually automatic qualification in new trades or professions, Sanchez cites to a web site that provides advertising services for business schools. *See id.* at 671 & nn.120–21 (citing All Business Schools, Finance Career Resource

almost always will fail § 1.162-5's prohibition against education leading to qualification in a new profession, Sanchez's call for across-the-board disallowance of MBA-related deductions appears at best premature, and perhaps unnecessarily overbroad.

Similarly, in a 2006 article published in *The Tax Lawyer*, Robert Stolworthy, Jr. argues—again without much substantiation—that graduate education leading to a degree, including courses taken in pursuit of an MBA, "only rarely passes the new trade or business test."[56] While Stolworthy's conclusions are considerably less bold than those of Sanchez—he does not call for blanket disallowance, and instead focuses his analysis on criticizing the manner in which the courts have applied § 1.162-5's existing tests[57]—he, too, relies at least in part on an implicit and largely unsupported assumption that an MBA nearly always qualifies a taxpayer in new trades or professions. Like Sanchez, he leaves a critical factual consideration virtually unexamined.

Thus, although commentators who have recently examined the question of MBA deductibility have offered some helpful insights, their analyses—particularly to the extent that they lean heavily in favor of non-deductibility—suffer from a failure to carefully examine the underlying assumption that an MBA education nearly always constitutes a career-transforming undertaking. This Note attempts to remedy that error by examining the legitimacy of the proposition that the MBA degree gives rise to qualification in new trades and professions virtually as a matter of course.[58]

Guide, http://www.allbusinessschools.com/faqs/finance.php (last visited Mar. 19, 2009)). Moreover, the web site she references hardly asserts that an MBA results in automatic qualification in certain trades or professions; rather, it merely discusses the types of career opportunities that may be available to graduates of MBA programs. *See id.*

56. *See* Stolworthy, *supra* note 49, at 928. To be fair, Stolworthy's argument that graduate education leading to a degree only rarely passes the new trade or business test is based largely upon a legal analysis of cases in which courts ruled against the taxpayer—as opposed to a direct assertion that the MBA degree grants, as a matter of fact, virtually automatic entry into new trades or businesses. *See id.* at 932–33. Peculiarly, Stolworthy devotes little analysis to the several cases—other than *Allemeier*—in which courts have ruled in favor of taxpayers who deducted MBA-related expenses.

57. *See id.* at 933–35 (analyzing the *Allemeier* court's use of subjective factors in the application of an objective test).

58. It is important to note here that the call for blanket disallowance is not a purely academic exercise, nor is it the far-reaching idea of a single commentator. In fact, despite its flaws, it would appear that the blanket approach may very well be the current official policy of the Services and Enforcement arm of the IRS itself. As evidenced by the IRS's tendency to disallow MBA-related deductions even in cases where the taxpayer's arguments for deductibility are compelling, *see* Allemeier v. Comm'r, 90 T.C.M. (CCH) 197 (2005), it would appear that, in recent years, the agency's enforcement arm has adopted a strict policy of rejecting such deductions in most, if not all, circumstances. This development has not gone unnoticed by tax practitioners and the popular business press. *See, e.g.*, Albert B. Crenshaw, *A Little Learning Is a Dangerous Thing To Deduct*, WASH. POST, Aug. 22, 2004, at F4 (noting that the IRS has begun to take a "hard line" on deductions for MBA-related educational expenditures); Jane J. Kim, *M.B.A. Students May Lose Tax Break*, WALL ST. J., Aug. 17, 2004, at D2 (noting that the IRS has increasingly begun to challenge taxpayers' ability to deduct MBA-related educational expenses and quoting a practitioner who asserted that "you'd have to be pretty bold to take a deduction at this point").

II. A CRITICAL TAX POLICY CONSIDERATION: NOT ALL MBAS ARE CREATED EQUAL

Two important considerations counsel against the conclusion that the MBA degree nearly always results in qualification in new trades or professions. First, unlike many other professional degrees, the MBA does not lead to certification or licensure in any particular trade or profession nor does it satisfy the minimum educational requirements of any non-regulated profession or industry. Second, despite its reputation as a career-transforming degree, the most lucrative benefits of an MBA education typically accrue only to the graduates of a small number of elite schools. Given these considerations, it is plain that, for many taxpayers, MBA-related expenses remain squarely within the boundaries of the tax policy motivations behind § 162.

A. CERTIFICATION, LICENSURE, AND MINIMUM QUALIFICATION: CRITICAL DIFFERENCES BETWEEN THE MBA AND OTHER PROFESSIONAL DEGREES

Unlike a law degree, a medical degree, a nursing degree, or a master's degree in social work, an MBA does not render one eligible for certification or licensure in any particular trade or business. Moreover, following recent developments in industries that traditionally required an MBA for advancement, the degree is no longer required for entry into, or progression through, any particular non-regulated trade, business, or profession. Although certainly not dispositive of the question explored here, these findings counsel against the conclusion that an MBA automatically qualifies a graduate in new trades or professions.

That the MBA degree does not qualify one for official licensure or certification in any particular trade or business is a virtually uncontested fact.[59] Indeed, even those who maintain that the MBA results in automatic qualification in new trades or professions concede the point. For instance, in her article calling for blanket disallowance of deductions for MBA-related educational expenditures, Jill Kutzbach Sanchez recognizes that "the law does not require individuals to obtain a license or certificate to engage in the profession of an MBA as it does for the medical, legal, and accounting professions."[60] In addition, the courts have similarly recognized the distinction between the MBA and degrees that lead to licensure or certification. In ruling in favor of the taxpayer in *Allemeier*, for example, the Tax Court relied in part on its finding that "[p]etitioner's MBA was not a course of study leading him to qualify for a professional certification or license."[61]

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59. *See, e.g.*, Kim, *supra* note 58 (quoting a tax journal editor who noted that "there is no legal impediment to getting a job without an M.B.A. as there would be for careers that have licensing requirements").

60. Sanchez, *supra* note 3, at 670; *see also* Robert Willens, *Deducting an MBA Candidate's Education Expenses*, 121 TAX NOTES 415, 415 (2008) ("[I]t seems intuitive . . . that the MBA does not qualify the student to engage in a new trade or business in the manner of a law or medical degree.").

61. Allemeier v. Comm'r, 90 T.C.M. (CCH) 197, 200 (2005); *see also* Beatty v. Comm'r, 40 T.C.M. (CCH) 438 (1980) ("We also take note that petitioner's course of study involved a broad, general

The importance and relevance of this distinction are evident in the illustrative examples outlined in Treasury Regulation § 1.162-5. Subsections (b)(2) and (b)(3) of that regulation—those governing the prohibitions against deductions for expenditures that meet minimum educational requirements and those that lead to qualification in new trades or businesses, respectively—offer a total of seven examples that illustrate the deductibility, or non-deductibility, of educational expenditures under § 162.[62] Tellingly, with one exception,[63] every such example that demonstrates a scenario under which educational expenditures are *not* deductible concerns a taxpayer who attempted to claim a deduction for education leading to official certification or licensure in a regulated profession.[64] If nothing else, this observation suggests that when it promulgated § 1.162-5, the Treasury Department drew a distinction between courses that clearly lead to official certification or licensure in some identifiable profession, and those that, like courses in business administration, might *theoretically* lead to qualification in some new trade or profession *under certain circumstances*. While disallowance of expenses incurred in pursuit of courses in the latter category might still be appropriate in certain cases, it is not unreasonable to interpret § 1.162-5 as suggesting that such courses should not be subject to blanket disallowance, but instead should be evaluated in light of the facts presented in specific cases.

Also worthy of note is the fact that, in addition to not giving rise to official licensure or certification in any particular trade or profession, the MBA is arguably no longer even unofficially required for entry into, or continuing progression through, any particular, business, profession, trade, or industry. Although an MBA was once deemed virtually required for long-term survival in

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overview of the management and administrative operations of business life. There were no specialized programs which would qualify a graduate, as a matter of technical training or as a pre-requisite to professional certification, for any particular trade, profession or business. Thus, petitioner's studies are not akin to those present in other cases which have disallowed deductions on new trade or business grounds. In the context of this case, we do not view the general study of business management and administration as qualifying petitioner for a trade or business that is new and different than that which he was already engaged in.").

62. *See* Treas. Reg. § 1.162-5(b)(2)–(3) (as amended in 1967).

63. *See id.* § 1.162-5(b)(2), Example (2) (demonstrating disallowance of educational expenses incurred by a university instructor in order to satisfy his employer's minimum requirements for permanent employment). In this scenario, however, the question is not whether the education at issue necessarily qualified the instructor in a *new* trade or business, but rather whether the education was necessary to satisfy the minimum educational requirements of his *current* employer. This is not directly relevant to the question posed in this analysis, which is: Irrespective of the requirements of one's particular employer, does the MBA virtually always qualify a taxpayer in *new* trades or professions, and if so, should the Treasury Department implement a blanket disallowance for MBA-related deductions claimed under § 162?

64. *See id.* § 1.162-5(b)(2)(iii), Example (1), Situation (3) (demonstrating disallowance of educational expenses incurred in order to satisfy requirements for state licensure as a secondary school teacher); *id.* § 1.162-5(b)(2)(iii), Example (3) (demonstrating disallowance of educational expenses incurred in pursuit of a law degree); *id.* § 1.162-5(b)(3)(ii), Example (1) (same); *id.* § 1.162-5(b)(3)(ii), Example (2) (same).

certain elite professions—investment banking and management consulting being the most prominent examples—recent developments in those fields have essentially rendered the degree optional.[65] In investment banking, for instance, the most prominent firms traditionally required entry-level analysts to enroll in business school after two or three years of work experience, permitting them to proceed to the more permanent position of associate only after completing MBAs.[66] Now, however, the decision of whether to pursue an MBA is left largely to the employee because top banks routinely promote analysts directly into permanent associate-level positions without requiring a business school detour.[67] The same is true of the management consulting industry, in which the MBA is no longer viewed as a requirement for entry or career progression—even at the most elite firms.[68] Also telling is the fact that among top executives at leading companies, fewer than one-third hold MBAs,[69] which further suggests that the degree is hardly a requirement for entry into any particular industry or for entry into business management generally.

What all of these findings suggest is that in the absence of a demonstration that the MBA is *required* for entry into certain trades, professions, or industries—or at least for advancement therein—those who claim that the MBA

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65. *See* Louise Story, *Bye, Bye B-School*, N.Y. TIMES, Sept. 16, 2007, § 3, at 1 (describing how many elite professional services firms that once deemed the MBA degree a virtual necessity no longer require it).

66. *See id.*; *see also* McEuen v. Comm'r, T.C. Summ. Op. 2004-107 (noting that, during the taxpayer's tenure as a financial analyst at two investment banking firms in the mid-1990s, "an M.B.A. degree was required to obtain a position as an associate with an investment banking firm").

67. *See* Kim, *supra* note 58 (noting that "analysts in investment banks can be directly promoted to higher associate levels" without first obtaining MBAs); Story, *supra* note 65 ("[I]nvestment banks like Goldman Sachs and Credit Suisse have changed their tune on business school. Instead of pushing all their young employees into M.B.A. programs, banks are telling the best ones to stay put."); *see also* Willens, *supra* note 60, at 415 ("In most cases, the MBA candidate will not run afoul of [the] prohibitions regarding the deductibility of education expenses. Most notably, for those candidates who will be working at investment banks, hedge funds, or private equity firms, it seems clear beyond cavil that the MBA degree is not a minimum educational requirement for securing a position at any of those organizations. In fact, every investment bank has, at any one time, scores of employees functioning as associates—the position the MBA candidate will occupy on graduation—who lack the MBA credential."); Merrill Lynch, Build a Career Foundation, http://careers.ml.com/?id=76716_79332_76756_76790_76795_76843_76852 (last visited Mar. 27, 2009) (indicating that, at Merrill Lynch, an MBA is not required for progression from investment banking analyst to associate).

68. *See* Kim, *supra* note 58 (noting that an MBA is not required "to be a general manager or a consultant"); McKinsey & Company, Roles and Career Paths, http://www.mckinsey.com/careers/is_mckinsey_right_for_me/roles_and_career_paths.aspx (last visited Mar. 24, 2009) (indicating that, at McKinsey & Company, an elite management consulting firm, entry-level business analysts may be promoted to associate with or without taking leave to pursue a graduate degree). Although the reasons for the industry's shift away from the MBA requirement are not readily apparent, a possible explanation emerges in a widely-cited internal McKinsey study which found that the firm's consultants with MBAs did not outperform those consultants without the degree. *See* Heather Sokoloff, *Little to Gain from MBA Classes: Prof*, CHI. SUN-TIMES, July 5, 2002, at 31 (citing a McKinsey study which found that, among consultants who had been on the job for one, three, and seven years, employees without an MBA were as successful as those who held the degree).

69. *See* Louis Lavelle, *Is the MBA Overrated?*, BUS. WK., Mar. 20, 2006, at 78 (finding that in 2004, only 146 of the 500 highest paid executives at S&P 100 companies held MBAs).

degree results in virtually automatic qualification in new trades or businesses must hurdle a rather formidable obstacle in order to prove their point. Although it admittedly remains possible that an MBA might qualify certain individual taxpayers for new trades or businesses under certain circumstances—a taxpayer who pursues an MBA without first acquiring any business-related experience comes to mind here[70]—the case for blanket disallowance appears greatly diminished in the absence of a showing that the degree plays a professional gatekeeping role akin to that of a law, medical, or nursing degree.

B. THE CAREER-TRANSFORMING MBA: A REALITY FOR THE ELITE FEW

Although the MBA arguably remains a career-transforming degree for graduates of a small number of elite business schools, for graduates of most programs—many of whom pursue graduate study on a part-time basis while continuing to work—the economic and career advancement benefits of the degree are far more modest. This further suggests that those who argue that the MBA necessarily opens innumerable opportunities to pursue new trades or professions have, at best, not undertaken sufficient study of the facts behind their conclusions.

Admittedly, the MBA degree remains an economically lucrative—and perhaps even career-transforming—credential for students at a small number of elite business schools. At top business schools, such as the Harvard Business School and the University of Chicago Booth School of Business, starting annual compensation for MBA graduates exceeds $100,000 by wide margins.[71] Moreover, MBA students at such schools remain heavily recruited by elite firms that, while not requiring the MBA degree for entry or promotion, maintain substantial recruiting pipelines at top schools.[72] Clearly, the graduates of these elite institutions enjoy opportunities to not only substantially—and relatively quickly[73]—increase their annual compensation by considerable amounts, but

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70. Even this scenario, however, is perhaps far less common than it might appear. Most business schools, particularly the elite institutions most likely to confer career-transforming benefits on their graduates, typically require at least some relevant work experience as a prerequisite for admission. *See, e.g.*, Harvard Business School, Who Are We Looking For?, http://www.hbs.edu/mba/admissions/ (last visited Jan. 30, 2009) (noting that most candidates for admission to the Harvard Business School are optimally prepared after at least two or three years of post-college work experience).

71. *See Schools of Business*, U.S. NEWS & WORLD REP., Apr. 2009, 20–21 (reporting base salaries of $115,665 and $103,219, and total compensation—including bonuses—of $135,630 and $126,818 for 2007 graduates of Harvard and Chicago Booth, respectively).

72. *See, e.g.*, Harvard Business School, Recruiting Partners, http://www.hbs.edu/recruiting/printready/statistics-mba.html (last visited May 15, 2009) (referring to campus recruiting efforts at the Harvard Business School by McKinsey & Company, Merrill Lynch, Bain & Company, Barclays Capital, and numerous other elite firms); McKinsey & Company, M.B.A. Candidates, http://www.mckinsey.com/careers/is_mckinsey_right_for_me/backgrounds_like_yours/mba.aspx (last visited Mar. 4, 2009) (referring, via a long drop-down window, to McKinsey & Company's recruiting efforts at a list of elite business schools, including Harvard, Stanford, Pennsylvania, Columbia, and Chicago).

73. The completion of an MBA program requires no more than two years of full-time study. *See, e.g.*, University of Chicago Booth School of Business, Full-Time MBA Curriculum, http://

also to attract the attention of elite firms that might not otherwise give them more than a passing look. One must concede that such lucrative and perhaps even career-transforming benefits are not within the spirit of § 162(a) to the extent that that statutory provision contemplates deduction of the costs of doing business, but not the costs of self-transformation and wholesale reinvention. It is perhaps these elite business students that stand foremost in the minds of those who advocate blanket disallowance of deductions for MBA-related expenditures.

The reality, however, is that all but a small percentage of the many thousands of MBA students in the United States fall well outside of the elite school context. For most MBA students, many of whom pursue their studies on a part-time basis while continuing to work, the economic and transformational benefits that flow from their degrees are far more modest. Today, more than 900 colleges and universities in the United States award the MBA degree, with the annual total number of MBA degrees awarded exceeding 100,000.[74] Of the degrees awarded, only twenty percent are conferred upon students pursuing full-time study in traditional two-year programs; the vast majority of the remainder go to working professionals in part-time programs.[75] Moreover, for those who pursue their degrees at the 800-plus institutions that fall outside the elite category comprising the top twenty schools, the economic rewards are far less compelling.[76] At DePaul University's Kellstadt School of Business, for instance, the typical 2007 MBA graduate earned a starting base salary of $66,929,[77] a figure nearly $50,000 lower than that of the average 2007 Harvard graduate[78] and nearly $40,000 lower than that of a graduate of the school's cross-town neighbor, the University of Chicago Booth School of Business.[79] At the flagship branch of the University of Missouri, the 2007 starting base salary figure was $56,400.[80] At the University of Kentucky, the figure was $46,991,[81] a number that actually fell *below* the 2007 national average for students earning *undergraduate* degrees in economics, finance, and management information systems.[82] Furthermore, a brief glance at the recruiting schedules of the most

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www.chicagogsb.edu/fulltime/academics/curriculum/index.aspx (last visited Apr. 22, 2009) (indicating that the twenty-one-course, full-time MBA program at the University of Chicago Booth School of Business is completed over a two-year period).

74. *See* Pfeffer & Fong, *supra* note 22, at 78.

75. *See* Kurt Badenhausen & Lesley Kump, *Part-Time Fever*, FORBES, Sept. 5, 2005, at 148.

76. *See* Pfeffer & Fong, *supra* note 22, at 78 (noting that the economic benefits of MBA study accrue "mostly to graduates of the more prestigious programs" and citing a study showing that individuals from less competitive programs "earned amounts that were more similar to people who either did not attend business school at all or who did not graduate").

77. *See Directory*, U.S. NEWS & WORLD REP., *supra* note 71, at 82.

78. *Id.* at 88.

79. *Id.* at 83.

80. *Id.* at 91.

81. *Id.* at 85.

82. *See* Rob Kelley, *Most Lucrative College Degrees*, CNNMONEY.COM, July 11, 2007, http://money.cnn.com/2007/07/11/pf/college/starting_salaries/index.htm (reporting that 2007 graduates earn-

elite professional services firms—those paying six-figure salaries and providing their recruits with entrée into elite professions like investment banking and management consulting—reveals that such firms focus their hiring efforts on a small number of elite institutions, most of which do not offer part-time study.[83] All of this leads one to a composite image of the *typical* MBA student: a modestly-compensated working professional pursuing MBA study on a part-time basis at a non-elite school, motivated by a desire to enhance his business skills and thus improve his career prospects in the long-term—quite simply, a student much like the taxpayers in *Allemeier* and *Blair*.

These observations together dispel the common misconception of the archetypal MBA student as a career-changing, soon-to-be-highly-compensated, future Wall Street "shark" or high-end management consultant.[84] Although MBA students of that ilk do in fact exist—Harvard graduates them at a rate of more than 900 per year[85]—a more accurate conception of the common MBA is one whose ambitions are more modest and arguably more in line with the policy motivations behind § 162. As will be discussed briefly in section II.C, these findings counsel against blanket disallowance of deductions for MBA-related expenses and instead point toward the need for modifications to Treasury Regulation § 1.162-5 that will more cleanly separate those MBAs whose educations conform to § 162 from those whose educations plainly flaunt its purposes.

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ing undergraduate degrees in economics, finance, and management information systems reported average starting salaries of $48,483, $47,239, and $47,648, respectively).

83. *See, e.g.*, McKinsey & Company, M.B.A. Candidates, http://www.mckinsey.com/careers/is_mckinsey_right_for_me/backgrounds_like_yours/mba.aspx (last visited Mar. 4, 2009) (showing that McKinsey & Company's active MBA recruiting plans for the 2008–2009 academic year include only eighteen U.S. business schools, none of which ranks lower than nineteen in *U.S. News & World Report*'s 2009 ranking of the top business schools). For other schools from which McKinsey recruits, the firm permits applications from students via an online recruiting site, but does not actively recruit on campus. *See id.* The *U.S. News* rankings of these "online application-only" schools range from seventeen (Carnegie Mellon) to forty-eight (Babson), with one of the schools (Pittsburgh) not appearing on the magazine's list of the top fifty schools at all. In any event, it remains plain that McKinsey's active MBA recruiting efforts generally do not extend far beyond the twenty or so most elite schools. For a complete list of the *U.S. News* rankings associated with the schools listed on McKinsey's recruiting web site, see *Schools of Business*, *supra* note 71, at 20.

84. One need look no further than the popular press for evidence of this not uncommon misconception of the typical MBA. *See, e.g.*, *Having an MBA Never Hurts*, GRAND RAPIDS PRESS, Oct. 5, 2003, at E1 (contrasting employed, down-to-earth, part-time MBA students with the stereotypical image of "a preoccupied man in a three-piece suit with crisp $50 bills stuffed into his pockets" and images of those pursuing "a golden ticket to the big-time promotions and bonuses associated with the East Coast's most-lauded business schools"); Thomas Kostigen, *Beyond Dollar Signs: MBA Students See Green as the Way to Go*, MARKETWATCH, Aug. 7, 2008, http://www.marketwatch.com/story/mba-students-see-green-as-the-way-to-go?dist=msr_1 (describing the stereotypical MBA as one "looking to make his or her mark on the world through a successful career on Wall Street").

85. *See Schools of Business*, *supra* note 71, at 20 (pegging the Harvard Business School's total full-time enrollment at more than 1800 students).

C. THE OBVIOUS OVERBREADTH OF BLANKET DISALLOWANCE

Given the differences between the MBA and degrees that lead to certification or licensure in new trades or professions, and given that a large percentage of MBA graduates do not reap the transformative benefits that accrue to graduates of the most elite schools, it remains plain that—for at least some graduates—completion of the degree results in the maintenance or improvement of existing skills and little more. For such individuals, pursuit of the degree falls squarely within the four corners of the policy motivations of § 162, which seek to permit deductions for costs associated with continuing in one's current trade or business but not for those that lead to broader career transformation. Accordingly, a blanket disallowance of deductions for MBA-related expenses would result in an overbroad rule that would unnecessarily disqualify many taxpayers whose educations do not violate the letter or spirit of § 162.

A closer examination of the facts of the *Allemeier* case brings this conclusion into focus. The *Allemeier* taxpayer first joined his employer, a small dental appliance manufacturer, as an entry-level salesperson in 1996.[86] His early duties with the company included making sales calls via telephone, managing small budgets, and working with business partners and customers to educate them on use of the company's products.[87] The company thought very highly of the taxpayer's performance during his early tenure and swiftly promoted him into more demanding roles. By the time he chose to pursue a part-time MBA at Pepperdine University in 1999, the taxpayer had risen to become a top salesperson within the firm. Moreover, his responsibilities had broadened considerably to include the following: designing marketing strategies, organizing informational seminars, traveling extensively to promote the company's products in talks at dentistry conventions, analyzing financial reports, and assessing the effectiveness of marketing campaigns. Moreover, shortly after commencing his MBA studies, but long before he completed his degree, the company promoted the taxpayer to the position of Marketing Manager. At all times during the pursuit of his MBA, the taxpayer remained employed with the company on a full-time basis. Among the courses he took while pursuing his MBA were the following: "accounting for managers, statistics, managerial finance, marketing management, quantitative methods, negotiation and conflict resolution, organizational theory and management, and business strategy." The taxpayer completed his degree in 2001.

If those who call for blanket disallowance of deductions for MBA-related expenditures are correct, the *Allemeier* taxpayer's MBA degree surely must have resulted in his virtually automatic ability to "enter many new trades and businesses."[88] And yet, on close inspection, one struggles to contemplate precisely what those "many new trades and businesses" might be. By virtue of his

86. Allemeier v. Comm'r, 90 T.C.M. (CCH) 197, 198 (2005).
87. *Id.*
88. *See* Sanchez, *supra* note 3, at 676.

pre-MBA business experiences, the *Allemeier* taxpayer had already established himself as a general manager, marketing manager, marketing analyst, business strategist, business development manager, and financial analyst, among other functions. Moreover, his MBA curriculum was fairly narrowly tailored to include only those subject areas in which he had previously developed a certain degree of competence, making it difficult for the Commissioner to argue that he had somehow positioned himself for entry into wholly new professional enterprises.[89] Further still, he, like the vast majority of MBA students, pursued his graduate studies on a part-time basis at a business school of modest stature—in this case, Pepperdine University—and not at the sort of elite institution likely to present him with opportunities to enter exclusive, highly selective industries like Wall Street investment banking or high-end management consulting. Simply put, though it may be possible to conceive of some specific *job* or *position* for which the *Allemeier* taxpayer may have become qualified only after completing his MBA—as would be the case, it must be noted, with virtually any form of education, including those expressly permitted by § 1.162-5[90]—the argument that he somehow became qualified in "many new trades or businesses" simply by virtue of his graduate degree is untenable.

Ultimately, a careful examination of the facts of the *Allemeier* case reveals a taxpayer whose educational expenditures—incurred in an effort to improve existing skills and not to effect a wholesale career reinvention or to facilitate entry into some grand new trade or enterprise—were wholly within the letter and spirit of § 162 and Treasury Regulation § 1.162-5. Given the existence of MBA students like the taxpayer in *Allemeier*, the ultimate effect of a blanket disallowance would be to prohibit deductions for, and perhaps even discourage, education undertaken in order to legitimately improve one's effectiveness as a businessperson or manager. It seems, then, that the more prudent and fair approach to preventing abuse of § 1.162-5 would be to identify changes to the regulation that would make inappropriate deductions less likely. Such is the goal of the third and final Part of this Note.

III. A NEW WAY FORWARD: PROPOSED MODIFICATIONS TO TREASURY REGULATION § 1.162-5

Three relatively simple amendments to Treasury Regulation § 1.162-5 would,

89. At trial, the Commissioner argued that the taxpayer's MBA education had qualified him to enter the "new trade or business of 'advanced marketing and finance management,'" an argument which the Tax Court found unconvincing. *See Allemeier*, 90 T.C.M. (CCH) at 200.

90. The regulation indicates, for instance, that a psychiatrist would be permitted to deduct the costs associated with "a program of study and training at an accredited psychoanalytic institute which will lead to qualifying him to practice psychoanalysis." Treas. Reg. § 1.162-5(b)(3)(ii), Example (4) (as amended in 1967). Clearly, one could conceive of jobs or positions that might require training in psychoanalysis in addition to a degree and licensing in psychiatry. Nevertheless, the regulation indicates that coursework toward qualification in psychoanalysis would be wholly deductible under § 162.

without implementing blanket disallowance of MBA-related expenditures, serve to separate educational expenditures that violate the purpose of § 162 from those that legitimately improve or maintain existing skills while not resulting in qualification in new trades, professions, or businesses. Each of these amendments is informed by one or more of the core concerns gleaned from the MBA cases analyzed in section I.B: general disapproval of extended full-time study, disapproval of career transformation, and disapproval of study in areas in which the taxpayer has not already obtained substantial professional experience. The three recommended amendments, each of which will be outlined in detail below, are as follows: first, a prohibition of deductions for expenses incurred as part of a program of study in which the taxpayer engages in extended full-time study; second, an express requirement that deduction eligibility be determined on a course-by-course basis; and third, implementation of a "twenty-five percent" rule that would disallow deductions for expenses incurred as part of a program of study in which more than twenty-five percent of courses fall in areas in which the taxpayer had not previously obtained substantial professional experience.

A. PROHIBITION OF EXTENDED FULL-TIME STUDY

The first of the three recommended amendments to Treasury Regulation § 1.162-5 would prohibit deductions for expenses incurred as part of a program of study in which the taxpayer engaged, or will engage, in extended full-time study. The text of the amendment might read as follows:

> Any educational expenses incurred in pursuit of an academic program of study in which the taxpayer engaged, or plans to engage, in full-time study—defined as twelve or more academic credit hours in a single semester, or the equivalent—for more than two academic semesters (or the equivalent)[91] are not deductible under § 162(a). This prohibition applies not only to expenses incurred for courses taken while studying full-time, but also to expenses incurred while studying part-time if those expenses were incurred as part of a program of study in which the taxpayer at some time engaged, or will at some time engage, in full-time study for more than two semesters (or the equivalent). This prohibition also applies even where the taxpayer continued to practice—whether as an employee or as the operator of a business—in his established trade or profession while engaged in full-time study.

The purpose of this amendment would be to prohibit students from attempting to characterize a two-year, full-time, career-transforming degree as a temporary, skills-enhancing sabbatical from one's established trade or profession. Consistent with the case law analyzed in section I.B, the amendment would

91. At an institution that follows a quarter system, for example, the equivalent of more than two semesters of twelve or more credit hours would be more than three quarters of eight or more credit hours.

have the effect of more cleanly separating the career-changing Harvard Business School student[92] from the personnel manager[93] or marketing manager[94] intent on pursuing an MBA in order to improve his existing skills. Furthermore, by noting that the full-time study prohibition does not dissolve merely because the taxpayer continued to work while studying on a full-time basis, the amendment would prevent a taxpayer from arguing that, by virtue of an internship or part-time job, he remained engaged in a trade or profession while pursuing a full-time degree.

At the same time, however, by not expressly disallowing deductions for educational expenses incurred as part of a program of study involving two or fewer semesters of full-time study (or the equivalent), the amendment would preserve deductions for, say, a one-year master's degree in education,[95] or perhaps a summer of full-time study undertaken by an elementary school teacher in pursuit of a master's degree in his area of specialty. Given Treasury Regulation § 1.162-5's apparent policy preference for educational deductions by teachers,[96] the drafting of the amendment to preserve such options would appear to be prudent, and perhaps necessary, in order to maintain existing Treasury Department policy.

B. COURSE-BY-COURSE EVALUATION OF DEDUCTION ELIGIBILITY

The second of the three proposed amendments would expressly state that deduction eligibility must be determined on a course-by-course basis. The text of the amendment might read as follows:

> Where a taxpayer has pursued education as part of a multi-course program of study, eligibility for deduction under § 162 must be determined on a course-by-course basis. For instance, where a broad program of study improves or maintains skills used in the taxpayer's established trade or business, but where certain courses in that broader program of study fall in areas in which the taxpayer did not have substantial professional experience prior to commencing his studies, the taxpayer may claim a deduction only for those courses which explore areas in which he had previously demonstrated substantial

92. *See* Foster v. Comm'r, T.C. Summ. Op. 2008-22; Schneider v. Comm'r, 47 T.C.M. (CCH) 675, 679 (1983).

93. *See* Blair v. Comm'r, 41 T.C.M. (CCH) 289, 290 (1980).

94. *See* Allemeier v. Comm'r, 90 T.C.M. (CCH) 197, 198 (2005).

95. Typically, a master's degree in education can be completed in two semesters of full-time study. *See, e.g.*, Harvard Graduate School of Education, Academic Programs, http://www.gse.harvard.edu/academics/index.html (last visited Mar. 24, 2009) (noting that it takes one year to complete a master of education degree, or Ed.M., at the Harvard Graduate School of Education).

96. *See* Treas. Reg. § 1.162-5(b)(3)(i) (as amended in 1967) (asserting that "all teaching and related duties shall be considered to involve the same general type of work," and that a classroom teacher's transfer to another subject area, transfer from an elementary school to a secondary school, transfer into a guidance counselor role, or elevation to principal will not constitute a transition into a new trade or business within the meaning of § 1.162-5).

> competence, as only those courses can be said to have maintained or improved the taxpayer's existing skills.[97]

Though perhaps already implicit in the existing incarnation of § 1.162-5, this amendment would explicitly prevent a taxpayer from broadly characterizing an educational program as one that improves or maintains his existing skills and then proceeding to declare deductions for *all* courses in that program—including those that provided instruction in areas entirely new to the taxpayer. Moreover, by expressly disallowing deductions for all courses covering areas in which the taxpayer had no prior exposure, the amendment would place prospective students on notice that, in order for an MBA education—or any type of education—to be deductible, course selection must be tailored to subject areas in which the student has already established some substantial degree of competence.[98]

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97. Admittedly, terms such as "substantial professional experience" and "substantial competence" could themselves serve as the subject of considerable litigation and therefore may need to be more clearly defined in any adopted amendment(s) to Treasury Regulation § 1.162-5. One might, for instance, define "substantial professional experience" more precisely as follows: "extensive professional practice, engaged in as a significant component of one's core job responsibilities, for a period of six months or longer." While it would be virtually impossible to rid Treasury Regulation § 1.162-5 of all subjectivity, the amendments proposed here would, as noted, have the benefit of placing taxpayers on notice that one cannot simply put forward one's general competence as a "businessperson" or "manager" as an excuse to sweep an entire degree program—much of which confers entirely new skills—under the umbrella of a general improvement of one's preexisting "business skills." An approach much like this one seems to have worked well in *Blair v. Commissioner*, where, as noted in section I.B.2, *supra*, the court found that all of the courses at issue in that case, *with the exception of a single course for which the taxpayer did not claim a deduction*, improved or maintained skills that the taxpayer had already acquired in her job. *See* Blair v. Comm'r, 41 T.C.M. (CCH) 289, 292 (1980). In *Blair*, then, it would seem that the taxpayer and the court were both able to separate those courses that improved the taxpayer's existing skills from one that plainly did not, a fact that offers some promise for the approach outlined here. Although there will undoubtedly be close cases under any regulatory scheme, the amendments proposed in this Note would mark a vast improvement over the existing incarnation of Treasury Regulation § 1.162-5, which leaves considerable room for the sort of broad deductibility the courts have generally found unacceptable.

98. Another possible criticism of this proposed amendment is that it would give rise to considerable compliance and enforcement complexities. How, one might ask, would an IRS auditor determine a taxpayer's eligibility for educational expenditure deductions on a course-by-course basis without engaging in extensive and time-consuming review of the taxpayer's academic record and employment history, not to mention detailed review of the intricacies of the course offerings at the taxpayer's educational institution? Admittedly, the implementation of this amendment would present enforcement challenges. One possible way to alleviate such complexities would be to require any taxpayer wishing to take a § 162 deduction for educational expenditures to complete a form on which he would be required to (1) list each course for which he intended to take a deduction; (2) provide the specific cost associated with each individual course; and (3) provide a brief description of (a) the specific existing skills which each course maintained or improved, and/or (b) the extent to which his employer required a given course as a condition to the retention of his established employment, status, or rate of compensation. Although the use of such a form would not eliminate all compliance and enforcement challenges, it would alleviate such complexities in two ways. First, it would force the taxpayer to assert, under penalty of perjury, that each and every course for which he was taking a deduction complied with the requirements of Treasury Regulation § 1.162-5, which would in turn place the taxpayer on notice that he could not escape enforcement or penalties merely by asserting that his broader program of study

C. IMPLEMENTATION OF A "TWENTY-FIVE PERCENT" RULE

Finally, the third of the three proposed amendments would implement a "twenty-five percent" rule that would disallow deductions for expenses incurred as part of a program of study in which more than twenty-five percent of courses fall in areas in which the taxpayer had not previously obtained substantial professional experience. The text of this final amendment might read as follows:

> Where a taxpayer has pursued education as part of a multi-course program of study, and where more than twenty-five percent of the courses pursued as part of that program fall in areas in which the taxpayer had not previously obtained substantial professional experience, the taxpayer may not claim a deduction for expenses associated with *any* of the courses in the program of study—even those which provided instruction in areas in which the taxpayer had previously obtained substantial professional experience.

This amendment would establish a presumption that any academic course of study in which more than a quarter of the courses selected did not maintain existing skills will almost certainly have the effect of qualifying the taxpayer in new trades or professions. While allowing for the fact that any course of study—even one generally compliant with § 162—may mandate a handful of required courses that do not map to a taxpayer's existing skill set, this amendment would make it difficult for a taxpayer to shoe-horn a truly transformational degree program into Treasury Regulation § 1.162-5's mandate that education improve or maintain existing skills and not qualify the taxpayer in a new trade or business. Moreover, like the previous amendment, this proposal would place taxpayers on notice that narrow-tailoring of course selection would be critical to obtaining deductibility of educational expenditures.

* * *

If implemented, the three amendments outlined here would not only have the effect of more cleanly separating legitimate deductions from those likely to violate the policy motivations behind § 162, but would also serve to provide taxpayers and courts with critical guidance in what has, over the course of the past forty years, emerged as a rather confusing area of the tax law. Given that Treasury Regulation § 1.162-5 has remained unchanged since 1967, it would

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served to maintain or improve his existing skills in some general sense. In other words, the form would provide a strong disincentive to engage in bad faith efforts to skirt § 1.162-5's requirements. Second, the form would provide an auditor with a tool for identifying possible compliance problems because it might expose specific instances—such as a chemical engineer's attempt to claim a deduction for a marketing course—in which a taxpayer's claim for a deduction appeared to exceed the boundaries of § 1.162-5. While the use of such a form would add some complexity to the compliance process, the new procedure required would arguably be no more cumbersome than others commonly used by the IRS. For instance, IRS Form 8283, which requires detailed documentation of non-cash charitable contributions, demands at least as much of the taxpayer as the form proposed here—particularly where the value of any of the taxpayer's non-cash donations exceeds $500. *See* Internal Revenue Service Form 8283, Noncash Charitable Contributions (rev. Dec. 2006).

seem that it is now more than ripe for revisions of the sort proposed here.

CONCLUSION

Although the line of Tax Court cases considering the deductibility of MBA-related tuition expenses may at first appear to be a confusing and winding maze of inconsistency, more careful inspection reveals that—in most cases—the courts probably got it right. For the most part, MBA students at elite schools who attempted to take enormous tax deductions for career-transforming educational experiences were turned away,[99] whereas those toiling away in an effort to improve their established business skills while continuing to work full-time were permitted to take their deductions.[100] In short, at the end of the day it appears as if the courts generally muddled through the cluttered, outdated mess that is Treasury Regulation § 1.162-5 and came out with the right answers.

This is not to say, however, that all is well. As recent commentators have noted, the standards outlined in § 1.162-5 are difficult for courts to apply, and even more difficult for the lay taxpayer to comprehend. Perhaps that is one reason why at least one commentator has thrown her hands up and called for blanket disallowance of MBA-related expenditures.[101] If it is difficult on reasonable inspection to determine when, if ever, MBA-related educational expenditures should be deductible, then why not simply disallow the deduction of such expenditures altogether?

As this Note has shown, the implementation of such a drastic approach would be both unnecessary and unfair. For one, it is plain that—stereotypes aside—not all MBA educations offend the purposes of § 162. In addition, as demonstrated in Part III, the Treasury Department need only make a handful of straightforward and long overdue changes to § 1.162-5 to make the parameters governing deductibility of educational expenditures more comprehensible for taxpayers, tax attorneys, and courts alike. Accordingly, it would seem that the solution to the problem is entirely attainable. What remains to be seen, however, is whether the Treasury Department will attempt to make that attainment a reality.

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99. *See, e.g.*, Foster v. Comm'r, T.C. Summ. Op. 2008-22; McEuen v. Comm'r, T.C. Summ. Op. 2004-107; Schneider v. Comm'r, 47 T.C.M. (CCH) 675, 680 (1983).

100. *See, e.g.*, Allemeier v. Comm'r, 90 T.C.M. (CCH) 197, 201 (2005); Blair v. Comm'r, 41 T.C.M. (CCH) 289, 292 (1980).

101. *See* Sanchez, *supra* note 3, at 676.