

# Deducting Employee MBA Expenses

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The deductibility of the cost of a Master of Business Administration (MBA) degree under Sec. 162(a) as a trade or business expense for an employee is a complex subject, with several factors to consider. The costs of an MBA are generally deductible if the degree maintains or improves skills required by the individual's employment or trade or business or meets the express requirements of the individual's employer or the requirements of applicable law.<sup>1</sup>

If the MBA will qualify the employee for a new trade or business or is required to meet the minimum education requirements for qualification in the individual's employment or other trade or business, its costs are generally not deductible.<sup>2</sup> However, the determination is fact intensive and depends in part on what the taxpayer did before, during, and after pursuing the degree.

## Is an Established Trade or Business Being Carried on While the MBA Expenses Are Incurred?

For an employee to take a deduction under Sec. 162(a), a trade or business must have previously been established.

In *Primuth*,<sup>3</sup> the tax court established that performing services as an employee is a trade or business for Sec. 162(a) purposes. To be in the business of being an employee for purposes of deducting educational expenses, an individual needs to have started his or her employment before pursuing a degree. The amount of time necessary to establish a trade or business as an employee is subjective, and no set standard has been established.

In *Sherman*,<sup>4</sup> the Tax Court held that a business manager with two years' experience as a manager in the Army before he attended Harvard to earn his MBA had established he was carrying on a trade or business; however, in *Wassenaar*,<sup>5</sup> the Tax Court held that a student who had a clerkship in the summer before he graduated from law school and was also pursuing a Master of Law in Taxation had not established a trade or business before pursuing the advanced law degree. As these cases suggest, MBA students must analyze their employment history to determine if they have established a trade or business.

It is clear that individuals are carrying on a trade or business of being an employee if they continue their employ-

ment while completing an MBA program. However, are individuals carrying on a trade or business if they end their employment, pursue their MBA, and resume employment after completing their MBA studies?

In *Furner*,<sup>6</sup> the Seventh Circuit held that a high school teacher's graduate school expenses were deductible, even though she took a year off from teaching to pursue her studies full time and was not on a leave of absence (her school did not grant leaves of absence). In response to *Furner*, the IRS issued Rev. Rul. 68-591,<sup>7</sup> which states: "Ordinarily, a suspension for a period of a year or less, after which the taxpayer resumes the same employment or trade or business, will be considered temporary."

While the "one year or less" rule established in Rev. Rul. 68-591 provides a safe harbor, in *Sherman*,<sup>8</sup> the Tax Court noted that it was not bound by the standard in Rev. Rul. 68-591 that a one-year limit applied because it considered the IRS ruling to be no more than the opinion of one litigant in the case: "There is no magic in a one year limit on 'temporary,' . . . and we believe a facts and circumstances test is the appropriate test for de-

1 Regs. Sec. 1.162-5(a).

2 Regs. Sec. 1.162-5(b).

3 *Primuth*, 54 T.C. 374 (1970).

4 *Sherman*, T.C. Memo 1977-301.

5 *Wassenaar*, 72 T.C. 1195 (1979).

6 *Furner*, 393 F.2d 292 (7th Cir. 1968).

7 Rev. Rul. 68-591, 1968-2 C.B. 73.

8 *Sherman*, T.C. Memo 1977-301.

termining whether a hiatus is temporary rather than indefinite." In *Sherman*, the court concluded that the taxpayer's "two-year suspension of active participation in his business was temporary and definite." The course plan and expected duration of the MBA curriculum should be evaluated in determining if an individual is still engaged in an active trade or business. The longer the hiatus from employment, the more likely that the IRS or a court will determine that the individual has abandoned the former trade or business.

### Regs. Sec. 1.162-5

Assuming that an individual is engaged in an active trade or business, Regs. Sec. 1.162-5 provides the criteria to determine if educational expenses can be deducted as ordinary and necessary under Sec. 162(a). Under Regs. Sec. 1.162-5, the cost of obtaining an MBA is deductible if it meets the following three criteria:

1. The education is not required to meet the minimum education requirements for qualification in his or her employment or other trade or business;
2. The education is not part of a program of study that will lead to qualifying for a new trade or business; and
3. The education must either:
  - a. Maintain or improve the skills required by the individual's employment or trade or business; or
  - b. Meet the express requirements of the individual's employer or the requirements of applicable law, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation.

### Minimum Educational Requirements

Regs. Sec. 1.162-5(b)(2)(i) states that "[t]he minimum education necessary to qualify for a position or other trade or business must be determined from a consideration of such factors as the requirements of the employer, the applicable law and regulations, and the standards of the

profession, trade, or business involved." As examples 2 and 3 of Regs. Sec. 1.162-5(b)(2)(iii) illustrate, the minimum education requirements are generally the required degree for the position.

In *Allemeier*,<sup>9</sup> the Tax Court found that, even if an MBA would help an employee advance faster in his or her career, this was "not tantamount to a requirement that [an employee] obtain the MBA." A thorough review of an individual's current or potential employer's and/or industry's educational requirements should be undertaken to determine if obtaining an MBA would allow an individual to meet the minimum educational requirements.

### Qualifying for a New Trade or Business

Under Regs. Sec. 1.162-5(b)(3), qualifying an individual for a new trade or business is the other disqualifying category into which MBA expenses could fall. There are several ways to evaluate if an MBA qualifies an individual for a new trade or business. Both examples 1 and 2 of Regs. Sec. 1.162-5(b)(3)(ii) and the courts have made it clear that, if a program of study or degree qualifies an individual for a new trade or business, the expenses are disallowed whether or not the individual intends to engage in the new trade or business. Regs. Sec. 1.162-5(b)(3)(i) does state that "a change of duties does not constitute a new trade or business if the new duties involve the same general type of work as the present employment."

In *Glenn*,<sup>10</sup> the Tax Court established the "common sense approach" to determining whether a license or degree qualifies an individual for a new trade or business. This approach requires comparing the types of activities that an individual was qualified to perform before acquiring the particular license or degree with those the individual would be qualified to perform afterward. If the activities are significantly different, the expenses for education necessary to obtain the license or degree are nondeductible under

Sec. 162(a). In *Glenn*, the court ruled on whether the costs of a course to obtain a CPA license were deductible as educational expenses; however, the Tax Court has applied the same approach in a number of cases to determine whether the costs of obtaining an MBA are deductible.

In *Beatty*,<sup>11</sup> the Tax Court allowed expenses related to a Master of Science in Administration where the studies provided the taxpayer with a broad general background in management activities that were already components of the taxpayer's work as an aerospace engineer because he supervised other employees. Conversely, in *McIlvoy*,<sup>12</sup> the Tax Court disallowed MBA expenses where the taxpayer's duties were technical before enrolling in the MBA program and managerial afterward.

However, according to the court in *Singleton-Clarke*,<sup>13</sup> "[a]n MBA is a more general course of study that does not lead to a professional license or certification." Therefore, where the taxpayer, who had held prominent nursing positions, obtained an MBA, the degree did not qualify her for a new trade or business and the expenses were deductible. An individual should evaluate the facts and circumstances to determine if he or she can deduct the expenses under the common sense approach.

### Education Requirements

If an individual is able to avoid falling into either of the nondeductible categories, there is still one more hurdle for deducting the cost of an MBA as a business expense under Sec. 162(a). Under the general rule in Regs. Sec. 1.162-5(a), to prove education expenses are deductible business expenses, an individual must meet one of two tests, which are designed to determine if there is a business purpose for incurring the expenses.

### Maintaining or Improving Skills

Under Regs. Sec. 1.162-5(a)(1), the first of the two tests for the deduction

<sup>9</sup> *Allemeier*, T.C. Memo 2005-207.

<sup>10</sup> *Glenn*, 62 T.C. 270 (1974).

<sup>11</sup> *Beatty*, T.C. Memo 1980-196.

<sup>12</sup> *McIlvoy*, T.C. Memo 1979-248.

<sup>13</sup> *Singleton-Clarke*, T.C. Summ. 2009-182.

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## Expenses & Deductions

is that the education must "maintain or improve skills required by the individual in his employment or other trade or business." The facts and circumstances of each situation are taken into account when determining if skills are being maintained or improved. An individual must establish how the education is maintaining or improving his or her skills in a current job based on the tasks and duties that are currently performed.

Because every individual's duties and responsibilities are different, it is possible for the same type of education expense to be allowed as a business expense for one individual and denied for another. In *Smith*,<sup>14</sup> the cost of obtaining an MBA was disallowed because the taxpayer's position as a quality-control foreman required him to have only a basic understanding of business, and the MBA was at "a level and of a nature not proximately related to the skills required of him in his employment." Conversely, in *Allemeier*,<sup>15</sup> the taxpayer so convincingly described the relationship between his skills and the skills required in his position as a marketing manager and a project consultant that the IRS stipulated that the MBA improved his skills.

### Express Requirements of the Employer

Under the alternative test in Regs. Sec. 1.162-5(a)(2), education expenses are deductible if the education "[m]eets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation." While this test is similar to the test for nondeductible expenses, it differs in that it is satisfied after an individual has met the minimum educational requirements and subsequently is required to complete additional education to keep the same job or pay. Thus, if the minimum educational requirement for an individual's current job is a bachelor's degree, and the employer then requires the individual to attend continuing pro-

fessional education courses to keep the same job, the cost of continuing education would satisfy this test.

### Conclusion

Because the analysis under Regs. Sec. 1.162-5 is very fact-intensive, an individual who wishes to deduct the cost of obtaining an MBA as a business expense should thoroughly analyze the current job, focusing on the education and skill requirements, and the courses being taken to determine whether the criteria under the regulation are satisfied.

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### EditorNotes

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<sup>14</sup> *Smith*, T.C. Memo. 1981-149.

<sup>15</sup> *Allemeier*, T.C. Memo 2005-207.