

10/21/04

To: Paul Preppie 2004 Tax File

From: Annette Nellen

Re: Tax treatment of Paul's 2004 educational expenses

Facts

Paul Preppie is an accountant for the Very Big (VB) Corporation. When Paul went to work for VG, he did not have a college degree. VB required that Paul earn a BS in accounting, so he enrolled in a local private university's night school and obtained the degree. VB does not reimburse employees for attending school. Paul's tuition and other costs were \$5,500 for 2004.

Issue

May Paul obtain any tax benefit for his educational expenditures?

Law

1. Reg. §1.162-5 – Expenses for education

Reg. §1.162-5 allows an individual a deduction for educational expenses where the education:

1. Maintains or improves skills required by the individual in his employment, or
2. Meets the express requirements of the employer in order for the employee to keep his job.

However, this regulation also provides two situations where educational expenses are not deductible:

1. the education is required to meet the minimum educational requirements for qualification for employment
2. the education will qualify the taxpayer for a new trade or business.

Example 2 at Reg. §1.162-5(b)(3)(ii) notes that if an employer requires an employee to obtain a degree, the expenditures are not deductible because they qualify the employee for a new trade or business.

§67 – unreimbursed employee business expenses, such as work-related education, is a miscellaneous itemized deduction subject to the 2% of AGI floor.

Browne v. Comm’r., 73 TC 723 (1980) – taxpayer worked various jobs as a bookkeeper and tax return preparer while attending school to obtain a degree in accounting. Such degree would enable her to take the CPA exam. The court held that taxpayer’s educational expenses were not deductible under Reg. §1.162-5 because they helped her to meet the minimum requirements to be an accountant and prepared her for a new job (CPA). It did not matter that taxpayer said she was going to school to improve her skills in her current work because the courses and degree would prepare her for a new job. The court noted that employers generally view a bachelor’s degree as the minimum requirement for an accountant position.

2. §222 – Qualified tuition and related expenses

This provision allows taxpayers an above-the-line deduction for qualified tuition and related expenses (as defined in §25A). For 2004, the maximum deduction under §222 is \$4,000 if the taxpayer’s AGI does not exceed \$65,000 (\$130,000 if MFJ). The deduction is limited to \$2,000 if the taxpayer’s AGI is greater than \$65,000 and does not exceed \$80,000 (\$160,000 if MFJ). If the taxpayer’s AGI exceeds these limits, no deduction is allowed.

Qualified tuition and related expenses are tuition and fees required for enrollment at an eligible educational institution.

This provision expires after 2005. A taxpayer may not claim the §222 benefit if a deduction or credit is claimed under any other provision for the expenditures.

3. §25A ...

...

Analysis

While Paul’s education may improve his skills in his current job, it also helps prepare him for a new job and it seems to meet the minimum requirements of his job since his employer requires the education. Thus, Paul may not claim a deduction under §1.162-5.

Depending upon Paul's AGI, he may be able to claim an above-the-line deduction under §222 for the expenditures.

§25A ...

Conclusion

Paul may not deduct his educational expenses under §1.162-5. If his AGI does not exceed \$80,000 (\$160,000 if MFJ), he may claim up to \$4,000 of his qualified tuition and costs as an above-the-line deduction in 2004.

Next Steps

Determine Paul's likely AGI for 2004. Talk to him about the nature of his expenditures to see if they qualify and remind him of the need to document his expenditures.