GERMAN-TRAINED LAWYER COULD NOT DEDUCT U.S. EDUCATIONAL EXPENSES

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Under Internal Revenue Code ("Code") §162(a), taxpayers generally may deduct all the ordinary and necessary expenses paid or incurred during the tax year in carrying on a trade or business. Treasury Regulations address the deductibility of educational expenses and the circumstances under which educational expenses are deductible, including if the education "maintains or improves skills required by the individual in his employment or other trade or business."[1]

However, not all eduction expenses paid or incurred by a working individual are deductible. Educational expenses are considered to be nondeductible personal expenditures[2] if they are incurred (i) in order to meet the minimum educational requirements for qualification in the individual's employment or other trade or business, or (ii) for education that is part of a program of study being pursued by the individual which will lead to qualification in a new trade or business.[3] Where either fact exists, it does not matter that the education may also assist in maintaining or improving skills.

In the recent case of *O'Connor v. Commr.*,[4] the taxpayer was a U.S. citizen who had studied law in Germany. In 2007, he completed the minimum requirements to become a member of the legal profession in Germany and obtained a German law license. During that year, he was living in the U.S., and at some point during the year, he took a job as a project manager of a residential building project in Utah.

In 2009, while still living in Utah, he began studying law at a law school in California. During the tax years involved in the case – 2010 and 2011 – he was not an employee of any company, and his tax return for each of those tax years did not include a Schedule C (Profit or Loss from Business), for any business operated by him.

In 2012, he received his juris doctor degree from the California law school, and in 2014 he passed the New York State bar examination. Sometime in 2014, he was also involved in investigating a *qui tam* legal action (*i.e.*, a whistleblower action). He filed a *qui tam* complaint in September 2014.

The taxpayer was married during the tax years in question and jointly filed U.S. Federal income tax returns with his wife for those years. On their tax returns for 2010 and 2011, they deducted the expenses of his juris doctor studies. The Internal Revenue Service (the "I.R.S.") disallowed the educational expenses under Treas.

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1 Treas. Reg. §1.162-5(a)(1).

2 Treas. Reg. §1.162-5(b)(1).

3 Treas. Reg. §§ 1.162-5(b)(2),(3).

4 An unpublished order of the 10th Circuit Court of Appeals (Docket No. 15-9006, June 28, 2016), published unofficially at 117 AFTR 2d 201,. affirming T.C. Memo. 2015-155.

Reg. §1.162-5 on the grounds that expenses were not incurred to maintain or improve skills required in his employment, he had been absent from work for more than a year, and the expenses were incurred while he was not employed or actively engaged in a trade or business.

In his case before the U.S. Tax Court (the "Tax Court"), the taxpayer asserted that because he had fulfilled the requirements to practice law in Germany, he had already met the minimum requirements of the trade of a legal professional. In fact, in light of his German qualifications, he could have been licensed in New York, even without a juris doctor degree. Further, he was active in "any" trade or business, as Code §162 requires, because he worked as a project manager and was involved in the *qui tam* action.

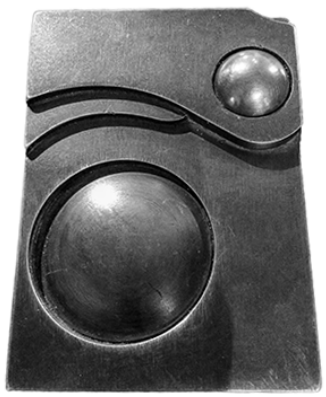
The I.R.S. asserted that he was not employed or engaged in a trade or business while attending law school (*i.e.*, during 2009 to 2012), and alternatively, that the expenses were incurred to meet the minimum educational requirements to qualify for a new trade or business.

The Tax Court determined that the disallowance should be sustained because (i) notwithstanding his German law license, he was not established in the legal profession in the U.S., and therefore his law school expenses were incurred in connection with entering into a new trade or business; and (ii) even if he were involved in project management and investigating a *qui tam* legal action in 2010 and 2011, he had not shown any connection between those activities and his U.S. legal education.

The taxpayer appealed the case to the appellate court, arguing that the Tax Court failed to consider his German law degree and improperly required a nexus between the educational expenses and his business activities.

The Court of Appeals for the Tenth Circuit disagreed and sustained the Tax Court's judgment. The court noted that a person who is admitted to practice law in one jurisdiction, but then incurs expenses to become qualified to practice in another jurisdiction, is considered to be entering a new trade or business.[5]

The taxpayer tried to argue that he was active in creating a new business model based upon his acquired knowledge of German law and German construction standards. However, the court dismissed the "new business-model" argument because it was based on facts not presented to the Tax Court.



Finally, the court stated that taxpayer's argument that the Tax Court improperly required him to show nexus between the educational expenses and his business activities made little sense. The primary requirement for deductibility under Code §162 is that the particular expense be an ordinary and necessary expense, which bears a proximate cause and a direct relationship to the taxpayer's trade or business. The taxpayer failed to meet the requirement.

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[5] *Vetrick v. Commr.*, 628 F.2d 885, 886-87 (5th Cir. 1980); *Sharon v. Commr.*, 591 F.2d 1273, 1275 (9th Cir. 1978) (*per curiam*); see also *Levine v. Commr.*, 54 T.C.M. (CCH) 209 (1987); *Walker v. Commr.*, 54 T.C.M. (CCH) 169 (1987); and *Horodysky v. Commr.*, 54 T.C. 490, 492-93 (1970).