

## Educational Expenses – Deductible?

- > Are educational expenses for trading deductible before the establishment of a trade or business?
  - > Are educational expenses deductible as an ordinary and necessary expense of trading?
  - > Are travel and meal expenses deductible in conjunction with educational expenses?
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Expenses incurred prior to the conduct and establishment of a trade or business are commonly referred to as "start-up" expenses.

Start-up expenses generally include expenses paid or incurred in connection with:

1. investigating the creation or acquisition of an active trade or business;
2. creating an active trade or business; or
3. any other activity engaged in for profit or for the production of income in anticipation of such activity becoming an active trade or business – Sec 195(c)(1)(A)

However, such expenses are treated as start-up expenses only if they would be deductible if paid or incurred in connection with the operation of an existing, active trade or business.

IRS looks to Sec 162 to determine when start-up costs are deductible based upon when an active trade or business begins but the courts have disagreed on various definitions.

A taxpayer is deemed to have made the election to deduct start-up expenses for the tax year in which the active trade or business begins by deducting them on the first tax return. Regs Sec 1.195-1(b)

There are limits to the amount of start-up expenses a taxpayer may deduct for purposes of this discussion – there are higher limits for greater start-up costs. Essentially, for our purposes, these limits fall into four buckets:

1. Expenses up to \$5,000 may be deducted in the year incurred in full,
2. Expenses over \$5,000 but less than \$50,000 may be deducted \$5,000 in the first year and then the remaining costs over 180 months.
3. Expenses of over \$50,000 reduce the \$5,000 limit dollar-for-dollar, and
4. Elect to capitalize all start-up costs

Educational expenses are deductible as an ordinary and necessary expense when incurred in the taxpayer's trade or business and are:

- required to enable the taxpayer to maintain their present status, or
- to maintain or improve skills needed in their current work – Regs Sec 1.162-5(b)(3)

Educational expenses are not deductible to the extent they allow the taxpayer to meet minimum educational requirements – Regs Sec 1.162-5(b)(2)

Educational expenses that will qualify the taxpayer for a new trade or business are not deductible.

In *Holden v Commissioner* (2015), a doctor attempted to deduct as continuing education his flight lessons so that he could reach his distant patients in rural areas. However, Tax Court denied the deduction because he failed to demonstrate how flying lessons improved or maintained his skills as a doctor.

In many cases a reader can determine how to deduct a particular expense from what the Court says as to why it is not deductible, as in this instant case. Here, the Court states that the education expenses did not improve or maintain the skills for which the taxpayer engages in a trade or business. So if those expenses had improved or maintained his skills as a physician, they would have been deductible.

Thus, one could conclude that as long as the education **improves or maintains skills necessary with one's trade or business** as a Trader in Securities or a Mark to Market Trader.

**Conclusion:** If the taxpayer has established a valid and active trade or business before incurring educational expenses that exceed the \$5,000 start-up threshold, those expenses could be deductible if they maintain or improve skills needed for the current trade or business.

Therefore, the taxpayer must qualify as either a Trader in Securities or a Mark-to-Market trader before educational expenses become deductible. In this writer's opinion, it would also be very beneficial if a taxpayer had filed a tax return as a TIS or MTMT in a prior year (Business Code 523110)

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Sec 162(a) allows for ordinary and necessary expenses paid or incurred in carrying on any trade or business.

Sec 262 provides that no deduction is allowed for personal expenses.

Regs Sec 1.162-2(a) provides that only such travel expenses that are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted.

Regs Sec 1.162-2(b)(1) provides that if a taxpayer travels to a destination and engages in both business and personal activities, travel expenses are deductible only if the trip is related primarily to the taxpayer's trade or business. If the travel is primarily personal then:

- travel expenses to and from the destination are not deductible, but
- expenses while at the destination properly allocable to the taxpayer's trade or business are deductible

Regs Sec 1.162-2(b)(2) provides that the determination of the travel being business or personal depends upon facts and circumstances. The amount of time spent on business activities compared to those spent on personal activities is an important factor.

Sec 274(h) provides that for the disallowance of travel expenses incurred to attend a convention, seminar or similar meeting outside the North American area unless the taxpayer establishes that the meeting is directly related to the active conduct of the taxpayer's trade or business and it is reasonable that the meeting be held outside the North American area.

So, to add some perspective to this, would a responsible parent be willing to pay travel and meal expenses and a substantial, or even a modest fee, for their college-aged child to attend a two-hour per day educational seminar held at a resort in Daytona Beach FL during a week of the spring semester, when the seminar is described as an essential aid to their degree plan?