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Deductions For Legal Education

Welsh v. United States and Condit v. Commissioner

Income tax deductions for education expenses have normally been sought under section 162(a) of the 1954 Internal Revenue Code and its predecessors. Two recent cases, Welsh v. United States and Condit v. Commissioner indicate the problems encountered by individuals attempting to secure deductions for legal education.

Welsh, an Internal Revenue agent assigned to the Intelligence Division, sought a deduction for his expenditures in attending law

1. INT. Rev. CODE of 1954, § 162(a). "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business..."
5. "Whether professionals may deduct the costs of gaining further knowledge in their field as 'ordinary and necessary' business expenses is a question which has vexed the courts since the 1920's." 6 STAN. L. REV. 547 (1954).
school at night. He was not enrolled in any particular program that would enhance his familiarity with tax problems, but rather was pursuing the ordinary law school curriculum. Several of his co-workers were pursuing the same program. In his law school application, he indicated an intent to practice law; that is, to enter an entirely new profession. A few months after passing the Ohio bar, he left the Internal Revenue Service (IRS) and entered private practice. Nevertheless, Welsh's request for a deduction was allowed. Welsh convinced the court that his primary purpose in undertaking the education was to maintain and/or improve his skill as an Internal Revenue agent and not to enter a new profession.

In holding that Welsh's primary purpose was improvement in the skills needed in his job, the court had to overcome two points asserted by the government. First, as to Welsh's avowed intent to practice law, the court took judicial notice of the fact that people, in filling out applications, will often express themselves in a manner that will most likely please the reader. Also, his intent could have changed by the time the education was actually begun. Second, as to Welsh's quick departure from the IRS to private practice, the court decided that petitioner's intent, at the time he undertook the education was to stay with the IRS, and that it is quite common for an individual to vacillate before deciding upon a career.

Condit, a combination office manager, accountant, and assistant treasurer, was in frequent contact with lawyers through workmen's compensation claims and contract negotiations. Condit's answer to questions concerning his future plans on his law school application were the same as Welsh's; but before matriculating in law school, he requested permission to take only those courses which would be of direct assistance to him in his work. The request was denied, and petitioner undertook the regular law school curriculum. After passing the bar, Condit remained with the same employer. Nevertheless, the deduction was denied, the court holding that he intended to qualify for a new position.

Both of Condit's arguments were summarily dismissed. The fact that he remained with the same employer was held to be of no legal significance because a person can remain at his job, and, in his pursuit of education, be motivated by a desire to better himself for purposes of promotion or to obtain a position with the same employer as a lawyer. The fact that he requested particular courses was held to be unimportant, the court ruling instead that there was no showing that the courses actually undertaken were directed to the improvement and maintenance of skills (a point deemed irrelevant in the Welsh case). The court also found that the answer on the application form relating to post-graduation plans was a factor to be considered in determining the petitioner's primary purpose.

It has been said that until the decision in the Welsh case (1962), "one proposition seemed certain in the area of educational deductions. The expenses of attending law school were not deductible."6 The real

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Impeetus to the more liberal approach was the 1958 Regulations,\(^7\) which, while easing the availability of deductions, have produced a labyrinth of confusing decisions based on "slight factual nuances and seemingly 'indistinguishable distinctions'. . .\(^8\) As one comment writer rather discouragingly noted, "... the post-Regulations developments have demonstrated, . . . [that] the area of education expenses is peculiarly resistant to the drawing of precise lines."\(^9\) The Welsh and Condit cases justify these apprehensions.

Perhaps, the reason for these seemingly contradictory results is that each case turns on the taxpayer's ability to sustain his burden of proof. In order to be allowed an educational deduction, the taxpayer must affirmatively prove that his primary purpose, at the time he undertook the education, was to maintain and/or improve the skills

\(^7\) Treas. Reg. § 1.162-5(a)-(b) (1958). The Regulations read as follows:

"(a) Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of:

1. Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or
2. Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status, or employment.

Whether or not education is of the type referred to in subparagraph (1) of this paragraph shall be determined upon the basis of all the facts of each case. If it is customary for other established members of the taxpayer's trade or business to undertake such education, the taxpayer will ordinarily be considered to have undertaken this education for the purposes described in subparagraph (1) of this paragraph. Expenditures for education of the type described in subparagraph (2) of this paragraph are deductible under subparagraph (2) only to the extent that they are for the minimum education required by the taxpayer's employer, or by applicable law or regulations, as a condition to the retention of the taxpayer's salary, status, or employment. Expenditures for education other than those so required may be deductible under subparagraph (1) of this paragraph if the education meets the qualifications of subparagraph (1) of this paragraph. A taxpayer is considered to have made expenditures for education to meet the express requirements of his employer only if the requirement is imposed primarily for a bona fide business purpose of the taxpayer's employer and not primarily for the taxpayer's benefit. Except as provided in the last sentence of paragraph (b) of this section, in the case of teachers, a written statement from an authorized official or school officer to the effect that the education was required as a condition to the retention of the taxpayer's salary, status, or employment will be accepted for the purpose of meeting the requirements of this paragraph.

"(b) Expenditures made by a taxpayer for his education are not deductible if they are for education undertaken primarily for the purpose of obtaining a new position or substantial advancement in position, or primarily for the purpose of fulfilling the general educational aspirations or other personal purposes of the taxpayer. The fact that the education undertaken meets express requirements for the new position or substantial advancement in position will be an important factor indicating that the education is undertaken primarily for the purpose of obtaining such position or advancement, unless such education is required as a condition to the retention by the taxpayer of his present employment. In any event, if education is required of the taxpayer in order to meet the minimum requirements for qualification or establishment in his intended trade or business or specialty therein, the expense of such education is personal in nature and therefore is not deductible."


9. Shaw, supra note 6, at 9.
required by him in his employment.\textsuperscript{10} If the court finds the taxpayer’s primary purpose was to either obtain a new position, to enhance his opportunities for promotion or salary increases, to fulfill his personal educational aspirations, or to serve any other personal purpose, then a deduction will be denied.\textsuperscript{11} The best way for the taxpayer to indicate that his primary purpose was to maintain and/or improve his skills is to show that the education was customary for other established members of his trade or business.\textsuperscript{12} If primary purpose cannot be shown through customariness then the taxpayer must adduce other evidence to support his claim.\textsuperscript{13}

In the \textit{Welsh} case, for example, the court, ruling on the taxpayer’s primary purpose, was satisfied with his proof that he never intended to leave the government service, since the security it offered was necessary for his health, Welsh having suffered seriously as a result of the war. The court felt that the private practice of law did not satisfy this need, but that the government service did. In attempting to explain, then, why Welsh \textit{did leave} the IRS for private practice shortly after passing the bar, the court discussed its impression of the taxpayer:

“The case was heard before the Court without a jury, and this Court had the opportunity to listen to the testimony of the taxpayer and observe his demeanor upon the stand. His credibility was called squarely into issue, and this Court finds his testimony logical, consistent and true.”\textsuperscript{14}

The \textit{Condit} case, on the other hand, seems a stronger one for a deduction, since the taxpayer remained with the same employer and

\textsuperscript{10} See the \textit{Welsh} case \textsuperscript{supra} note 3, and Treas. Reg. § 1.162-5(a)(1), \textsuperscript{supra} note 7.

\textsuperscript{11} Treas. Reg. § 1.162-5(b), \textsuperscript{supra} note 7.

\textsuperscript{12} Treas. Reg. § 1.162-5(a), \textsuperscript{supra} note 7.

\textsuperscript{13} See generally Rev. Rul. 60-97, 1960-1 \textit{Cum. Bull.} 69, 70. The Commissioner suggests the following order of questions to determine the deductibility of educational expenses:

\begin{itemize}
  \item Has the taxpayer met the minimum requirements for qualification or establishment in his intended position?
  \item If ‘no,’ no deductions are allowable.
  \item If ‘yes,’ is education undertaken primarily to meet employer requirements to retain taxpayer’s position?
  \item If ‘yes,’ the taxpayer is entitled to deductions unless (1) the education leads to qualifying the taxpayer in his intended trade or business and taxpayer knew of this employer requirement before assuming his position with his employer, or (2) the employer’s requirement is imposed primarily for the benefit of the taxpayer and not primarily for a bona fide business purpose.
  \item If ‘no,’ it is customary for other established members of taxpayer’s trade or business occupying positions similar to that of the taxpayer to undertake education of the type pursued by the taxpayer?
  \item If ‘yes,’ the taxpayer is considered to have undertaken education for the purpose of maintaining or improving needed skills and is entitled to deductions.
  \item If ‘no,’ the taxpayer must show by other means that his primary purpose was to maintain or improve needed skills. If the education undertaken meets express requirements for a new position or substantial advancement, the taxpayer must show that the education was not undertaken primarily for the purpose of meeting those requirements.” \textit{Id.} at 74.

\textsuperscript{14} 210 F. Supp. 597, 599 (N.D. Ohio 1962). \textit{Accord}, Sabino F. Ciorciari, 22 \textit{CCH} Tax Ct. Mem. 784, 785 (1963). “Petitioner impressed us as a conscientious person, sincerely interested in doing a good job, who regarded seriously the official encouragement to take additional courses.”
requested permission to take only certain courses — both of which arguments weigh against a conclusion that his primary purpose was to qualify for a new position or satisfy any other personal goals. The court, however, questioned the significance of the former argument holding that Condit’s primary purpose could have been to become a lawyer while still remaining with his present employer. Had Condit shown that his employer in fact hired outside lawyers only, this finding would have been obviated.

In the recent case of Richard M. Baum, petitioner, an insurance claims adjuster and evening law student, did show that the company’s legal work was handled only by lawyers engaged in private practice. In support of its finding that Baum’s primary purpose was maintenance and improvement of skills, the court relied on two other additional factors: petitioner’s proof that his intention was to remain with the same company and his showing that legal education was customary among claims adjusters employed by the company.

It is interesting to note that petitioner’s attorney in the Welsh case failed to mention the fact that legal education was common in Welsh’s department of the IRS, but, nevertheless, the court, in granting the deduction, did recognize the customariness of the education. Condit was not as fortunate. Being the only person employed in his particular capacity, coupled with the fact that his area of responsibility was unique, he could not have produced evidence indicating that legal education was customary among people similarly employed. As stated above, none of the other evidence offered by Condit was sufficient to support deductibility.

The importance of showing customariness is illustrated by two cases very similar to Welsh and Condit, William J. Brennan and James J. Engel. Both petitioners were employed by the IRS. Brennan held a higher classification and dealt more closely with attorneys than did Engel, but both did considerable legal work for which courses were offered within their respective departments. Both petitioners enrolled in law school after indicating an intent to enter the private practice of law. Upon graduation, Engel remained with the IRS and Brennan departed for private practice. Engel’s deduction was denied and Brennan’s was granted.

In Engel’s department of the IRS, employees were encouraged by the supervisor to take law courses, and also a notice was posted by the employer explaining the regulations and tax deductions accruing to an employee if his primary purpose was improvement of job skills.

17. But see John S. Watson, 31 T.C. 1014, 1016 (1959), where the court belittled the importance of affirmatively proving customariness. Compare the recent Maryland case Walter T. Charlton, 23 CCH Tax Ct. Rep. [Dec. 26,688; CCH Tax Ct. Mem.] (1964), where petitioner, an accountant employed by his father, was the only member of the accounting firm to have received a law degree. Yet, a deduction was granted upon proof that many accountants, including leaders in the field, had completed law school and still remained in their original capacities — an indication that legal education has been and can be used for purposes of maintenance and improvement.
But despite these encouragements, only eight of the seventy-five people in Engel's department decided to attend law school. Three others already had their degrees. The court held that this percentage was inadequate to be considered customary, and petitioner was unable to produce other facts indicating a satisfactory primary purpose.

In Brennan's department of the IRS, all employees had obtained or were in the process of obtaining their law degrees. The court, temporarily ignoring the easy solution based on customariness, engaged in a desultory analysis of other factors that might be relevant to the petitioner's primary purpose. To support this analysis the court observed that the "... summit of knowledge, like the fruit of Tantalus is never reached," but realizing that this adage was of somewhat doubtful legal significance, reverted to its original feeling that customariness was the best indicator of Brennan's primary purpose.

It must be remembered that customariness, as a factor in the ascertaining of the taxpayer's primary purpose, is only one point to be considered in the over-all analysis of each case. In fact, situations frequently arise in which deductions are denied even though the education is not only customary but compulsory. The combined cases of Sandt v. Commissioner and Hines v. Commissioner illustrate this point. Both petitioners were research chemists, who were told that they would become patent chemists if they first agreed to attend law school. Upon graduation, they would then become patent attorneys. This procedure was followed by all employees desiring promotion to patent work. Yet it was obvious, despite the customariness, that the primary purpose of both taxpayers was to qualify for the new position rather than to improve present skills.

In two other cases involving patent work, John Lezdey and Robert H. Montgomery, legal education was likewise customary. Here, both taxpayers had been promoted to their new positions after a substantial part of their education was completed, and it was the skills of this new position which the education did in fact improve. A deduction was sought for only those expenses accruing subsequent to the promotion. In denying the deduction, the court looked only to the time of the commencement of the education to determine primary purpose, which was held to have been the fulfillment of personal intellectual aspirations, and, obviously, could not have been improvement of skills required in a position not yet obtained.

Perhaps, these four decisions can be reconciled with those in which customariness was present and the deduction was allowed. The Revenue Ruling suggests that the first question to be posed to resolve all cases is: "Is the educational activity 'customary?'" But this question is usually asked in the wrong order. Customariness is only one of many factors to be considered, and it can never be the sole determinative factor.

20. 22 CCH Tax Ct. Mem. at 1225.
22. For other factors see note 13 supra.
23. 303 F.2d 111 (3d Cir. 1962).
problems in this area is whether minimum requirements for the intended trade or business had been met.\footnote{27} If not, no deduction will be granted. This criterion applies easily to Sandt and Hines where the petitioners, as research chemists without law degrees, had clearly failed to meet the basic qualifications for employment as patent attorneys.\footnote{28} Comparing Welsh and Brennan, we find that petitioners intended to remain at their present position, for which they had met minimum requirements, and thus the customariness standard could be applied to prove primary purpose.

In at least one instance, Donald P. Frazee,\footnote{29} a deduction was allowed even though the legal education was not customary.\footnote{30} The petitioner, a civilian Air Force employee engaged in writing numerous regulations as well as policy and procedure documents, was the only person so employed attending law school. The court held that Frazee had adequately shown, through other means, that his primary purpose was to maintain and improve the skills required in his employment.\footnote{31}

The apparent inconsistencies encountered throughout the area of income tax deductions for legal education expenses is largely traceable to the failure of the courts to pinpoint the crucial factors. Too few of the cases have stressed the criteria of customariness, meeting minimum requirements, or sustaining the burden of proof which, in truth, have been the basis for many of the decisions. However, even if these factors were clarified, the area would still remain "peculiarly resistant to the drawing of precise lines"\footnote{32} since the ascertainment of primary purpose when customariness is not involved, is dependent to a great extent upon the court's subjective impression of the petitioner.

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\footnote{27. Ibid.}
\footnote{28. The only case in which this criterion is discussed as a factor in the granting of a deduction is Milton L. Schultz, 23 CCH Tax Ct. Rep. [Dec. 26,940; CCH Tax Ct. Mem.] (1964).}
\footnote{29. 22 CCH Tax Ct. Mem. 1086 (1963).}
\footnote{30. Even though the taxpayer can prove his primary purpose by means other than customariness there is no question that he is seriously handicapped by being unable to satisfy this criterion. In Welsh, taxpayer won without a showing of customariness, but the court did take judicial notice that customariness did, in fact, exist. Frazee is the only case in which a taxpayer has won without the presence of customariness.}
\footnote{31. Unable to succeed in similar circumstances was Louis Aronin, 20 CCH Tax Ct. Mem. 909 (1961), an NLRB examiner, who attended the University of Baltimore Law School. The education was not shown to be customary and petitioner was unable to prove in any other way a satisfactory primary purpose. Compare Joseph T. Booth III, 35 T.C. 1144 (1961). Perhaps the most difficult case in this entire area of educational expense deduction is David H. Pfeffer, 22 CCH Tax Ct. Mem. 785 (1963), where of four or five men similarly employed, "some" attended law school. The court, in denying the deduction, gave only passing notice to this possible customariness. Instead, it relied on the fact that petitioner entered private practice upon completion of his education, a fact completely overlooked in Welsh and Brennan. The court itself doubted the correctness of its decision (p. 787) and held: "The judicial ascertainment of someone's subjective interest or purpose motivating actions on his part is frequently difficult. One method by which such ascertainment may be made is to consider what the immediate, approximate, and reasonably to be anticipated consequences of such actions are and to reason that the person who takes such actions intends to accomplish their consequences. This reasoning is implicit in the Latin maxim 'acta exteri\'or\'a indicant interi\'or\'a secreta,' and in the more homely English adage 'actions speak louder than words'."
\footnote{32. Shaw, supra note 6, at 9.}