Washington and Lee Law Review

Volume 38 | Issue 1 Article 8

Winter 1-1-1981

Tax Breaks for Law Students

TAX BREAKS FOR LAW STUDENTS

Another man conceives the notion that he will be able to practice his vocation with greater ease and profit if he has an opportunity to enrich his culture. Forthwith the price of his education becomes an expense of the business, reducing the income subject to taxation.[1]

—Mr. Justice Cardozo

Justice Cardozo's "other" man is one who repays stolen money to clear the family name and then deducts the payments as ordinary business expenses.[2] Although the repayment of money stolen by another apparently remains nondeductible,[3] Justice Cardozo probably would be surprised to learn that some of the costs of a legal education may qualify as business expenses that reduce taxable income.[4] The purpose of this article is to provide a practical guide to the law of federal income taxation as it affects law students.[5]

Section 1 of the Internal Revenue Code (Code) imposes a tax on the taxable income of every individual.[6] The tax rate increases progressively in proportion to the amount of taxable income.[7] The conscientious taxpayer, therefore, seeks to reduce his tax burden by reducing his taxable income.[8] An individual's taxable income is his adjusted gross income

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[1] Welch v. Helvering, 290 U.S. 111, 115 (1933).

[2] *Id.*

[3] *See generally* Luther Wallin, 32 B.T.A. 697 (1935); San-Knit-Ary Textile Mills, Inc., 22 B.T.A. 754 (1931). *But cf.* Spitz v. United States, 432 F. Supp. 148, 150 (E.D. Wis. 1977) (restitution payment by employee after his conviction for theft deductible).

[4] In Welch v. Helvering, 290 U.S. 111 (1933), Justice Cardozo declared that holding the payment of another's debts to be an ordinary and necessary business expense would open the door to many "bizarre" analogies, including an analogy to educational costs. *Id.* at 115. Even if educational costs are analogous to payments for another's debts, educational costs are deductible under some circumstances. *See* text accompanying notes 37-62 *infra*.

[5] All statutory references are to the Internal Revenue Code of 1954 unless otherwise stated.

[6] I.R.C. § 1. Section 1 addresses four categories of individual taxpayers: married individuals filing joint returns and surviving spouses, heads of households, unmarried individuals, and married individuals filing separate returns. *Id.* § 1(a)-(d).

The constitutional basis for the federal government's taxing power is the sixteenth amendment. The sixteenth amendment empowers Congress to lay and collect taxes on incomes, from whatever source derived. U.S. CONST. amend. XVI.

[7] *See* I.R.C. § 1. All individuals of the same taxpayer status are taxed at the same rate on equivalent amounts of taxable income. For example, § 1(c) imposes upon an unmarried individual with a taxable income of more than $6,500, but not more than $8,500, a tax of $692 plus 19% of the excess over $6,500. An unmarried individual with a taxable income of more than $8,500, but not more than $10,800, is subject to a tax of $692 plus 19% of $2,000, or $1,072, plus 21% of the excess over $8,500. *Id.* § 1(c).

[8] Although tax evasion constitutes a felony, *see* I.R.C. § 7201, tax avoidance is perfectly acceptable. Lecture by Professor James William H. Stewart at Washington and Lee University (Aug. 22, 1979); *see* Jones v. Grinnell, 179 F.2d 873, 874 (10th Cir. 1950); [1980] 1 STAND. FED. TAX REP. (CCH) ¶ 637.13. *See also Matthew* 22:15-22.

minus the sum of his excess itemized deductions and personal exemptions.[9] Adjusted gross income is an individual's gross income[10] less certain deductions specified within section 62.[11] Itemized deductions are allowable deductions other than personal exemptions and other than those used to calculate adjusted gross income.[12] Excess itemized deductions are those itemized deductions in excess of the zero bracket amount.[13] Personal exemptions are ordinarily $1,000 per person.[14]

The section 62 deductions often are referred to as above-the-line deductions because they are utilized in deriving adjusted gross income.[15] With adjusted gross income marking the "line," itemized deductions are called below-the-line deductions because the taxpayer can subtract them after he has determined his adjusted gross income.[16] Itemized deductions are helpful to a taxpayer, however, only if they exceed the zero bracket amount[17] because a taxpayer may subtract only the excess from his adjusted gross income to reduce his taxable income.[18] Above-the-line deductions are not limited by any threshold requirement.[19] Every above-the-line deduction reduces a taxpayer's adjusted gross income, which in turn reduces his taxable income.[20] For law students, moving expenses and cer-

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[9] I.R.C. § 63(b); *see* note 13 *infra*.

[10] Except as otherwise provided in Subtitle A of the Internal Revenue Code, *see* I.R.C. §§ 101-128, gross income is all income from whatever source derived. *Id.* § 61(a).

[11] *See id.* § 62.

[12] *Id.* § 63(f). The taxpayer may not take deductions for personal, living, or family expenses, except as the Code otherwise provides. *Id.* § 262. Difficulties in determining the deductibility of particular expenses usually stem from a conflict between a particular provision of the Code and § 262.

[13] *Id.* § 63(c). The zero bracket amount is $3,400 on a tax return filed jointly by spouses, and $2,300 on the return of an unmarried individual. *Id.* § 63(d). Section 63(b) requires some individuals to include all or part of the zero bracket amount in their taxable income. For example, an unmarried individual who has earned income of less than $2,300 and whose parents claim him as a dependent must increase his taxable income by the lesser of $2,300 minus his earned income or $2,300 minus his itemized deductions. *See id.* § 63(b) & (e).

[14] *See id.* § 151(b). On a joint return, § 151(b) entitles both the husband and wife to personal exemptions of $1,000 each. If a couple does not file a joint return, the taxpayer may take an additional $1,000 personal exemption deduction for his spouse, provided the spouse has no gross income and is not the dependent of another taxpayer. *Id.* The Code also authorizes additional exemptions for the elderly, blindness, and dependents. *See id.* § 151(c)-(e). A taxpayer may claim an exemption for himself even if his parents claim him as a dependent. *See id.* § 151(b); [1980] 1 STAND. FED. TAX REP. (CCH) ¶ 1242.043.

[15] *See* I.R.C. § 62.

[16] *See id.* § 63(b).

[17] *See* note 13 *supra*.

[18] *See* I.R.C. § 63(b)-(c). A couple filing a joint return must itemize deductions amounting to more than $3,400 to benefit from the itemization of deductions; a single taxpayer must itemize more than $2,300 to benefit. *See id.* § 63(c)-(d). The zero bracket amount concept of § 63(d) has replaced the earlier standard deduction provision. The current Code effectively incorporates the standard deduction in the tax rate scales of § 1.

[19] *See id.* § 62.

[20] *See id.* §§ 62, 63(b).

tain other job-related costs may constitute valuable above-the-line deductions.[21]

MOVING EXPENSES

One of the first expenses a law student may incur is the cost of moving to the law school location. Moving expenses are above-the-line deductions under section 217 of the Code if the law student incurs them in connection with the commencement of work at a new principal place of employment.[22] The taxpayer must meet two conditions in order to claim a moving expense deduction.[23] First, the taxpayer's new principal place of work must be a certain distance from his former residence.[24] Second, the taxpayer must work as a full-time employee or as a self-employed individual for a specified length of time following his arrival at his new location.[25]

Section 217 does not benefit most law students at the start of law school because students ordinarily are not employed full-time while attending law school.[26] Nevertheless, the spouse of a married law student may be able to satisfy section 217 requirements.[27] If a couple's move ful-

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[21] *See id.* § 62(1), (2), (8). *See also* text accompanying notes 22, 62, 105 *infra*.

[22] I.R.C. §§ 217(a), 62(8). An individual's principal place of employment normally is the place where he spends most of his working time. Treas. Reg. § 1.217-2(c)(3) (1979).

[23] *See* I.R.C. § 217(c).

[24] *See id.* § 217(c)(1). The distance from the taxpayer's new principal place of work to his former residence must be at least 35 miles greater than the distance from his former place of work to his former residence. *Id.* If, for example, the taxpayer's former place of work was 15 miles from his former residence, § 217 requires that the taxpayer's new place of work be at least 50 miles from his former residence in order for his moving expenses to be deductible. *See id. See also* Treas. Reg. § 1.217-2(a)(3), (c)(2) (1979). If the taxpayer had no former place of work, the distance from his new place of work must be at least 35 miles from his former residence. I.R.C. § 217(c)(1)(B).

[25] *See* I.R.C. § 217(c)(2). To deduct moving expenses, the taxpayer must work as a full-time employee for at least 39 weeks of the 12-month period immediately following his arrival at his new location. *Id.* § 217(c)(2)(A). If the taxpayer is self-employed, he must work on a full-time basis for at least 78 weeks of the 24-month period immediately following his arrival. *Id.* § 217(c)(2)(B). Thirty-nine of those 78 work weeks must be during the first 12 months. *Id.* If the taxpayer cannot satisfy the § 217 time requirement by reason of death, disability, or involuntary separation from his job, the employment condition is waived. *Id.* § 217(d)(1). If the taxpayer is unable to satisfy the employment condition for other reasons, he must include the amount previously deducted in his current gross income or file an amended return. *See id.* § 217(d)(3); Treas. Reg. § 1.217-2(d)(3) (1979).

According to Alvin L. Goldman, 32 T.C.M. (CCH) 574, *aff'd*, 497 F.2d 382 (6th Cir. 1973), *cert. denied*, 419 U.S. 1021 (1974), a taxpayer may not maintain the inconsistent positions that he has moved for § 217 purposes and that he is stationed only temporarily for § 162(a)(2) purposes. *Id.* at 577; *see* Treas. Reg. § 1.217-2(c)(3)(iii) (1979); text accompanying notes 80-90 *infra*.

[26] Attending law school is not a full-time job for tax purposes. *See* Benjamin Taylor, Jr., 71 T.C. 124, 128 (1978). *See generally* I.R.C. §§ 217(f)(1), 3121(d).

[27] Direct expenses, *see* text accompanying note 29 *infra*, and costs of residence sale, purchase, or lease arrangements are deductible whether or not the spouse has secured

fills the distance condition, and if the spouse is employed for an appropriate time period, the spouse may deduct all direct and a limited amount of indirect moving expenses.[28] Direct expenses include the reasonable costs of moving household goods and costs of transportation, meals, and lodging for the family during the actual move.[29] Deductible indirect expenses include the reasonable costs of temporary quarters,[30] searching for a new residence,[31] and certain residence sale, purchase, or lease transactions.[32]

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employment prior to the move. *See* I.R.C. § 217(b)(1)(A), (B), (E); Treas. Reg. § 1.217-2(a)(3) (1979). Costs attributable to temporary quarters and residence-hunting, *see* text accompanying notes 30 & 31 *infra*, are deductible only if the spouse obtained his or her job prior to the move. *See* I.R.C. § 217(b)(1)(C), (D); Treas. Reg. § 1.217-2(a)(3) (1979). In order for any moving expenses to be deductible, the spouse must commence work within one year of the couple's move. *See* Treas. Reg. § 1.217-2(a)(3) (1979).

[28] *See* notes 29-32 *infra*. *See generally* Treas. Reg. § 1.217-2(b) (1979). If the law student and his spouse file a joint return, the student also benefits from the moving expense deduction. *See* Treas. Reg. § 1.217-2(c)(4)(v) (1979).

[29] *See* I.R.C. § 217(b)(1)(A), (B). *See also* Treas. Reg. § 1.217-2(b)(2)-(4), (10) (1979). For a specific list of deductible moving expenses, see English & Jackson, *Moving Expenses Due to a Change of Job Location May Qualify For Moving Expense Deduction*, 19 TAX. ACCOUNTANTS 370, 372-73 (1977) [hereinafter cited as English & Jackson]. Direct moving expenses are not subject to any dollar limitation. *See* I.R.C. § 217(b)(3).

[30] *See* I.R.C. § 217(b)(1)(D). *See also* Treas. Reg. § 1.217-2(b)(6) (1979). The costs of meals and lodging are deductible while the taxpayer and his family occupy temporary quarters during any period of 30 consecutive days after he has obtained employment. I.R.C. § 217(b)(1)(D), (3)(C).

[31] *See* I.R.C. § 217(b)(1)(C). *See also* Treas. Reg. § 1.217-2(b)(5) (1979). The taxpayer may deduct the costs of residence-hunting trips only if he obtained employment prior to the trips. *See* I.R.C. § 217(b)(1)(C). Deductible residence-hunting expenses include the costs of meals and lodging. *Id.*

[32] *See* I.R.C. § 217(b)(1)(E). *See also* Treas. Reg. § 1.217-2(b)(7) (1979). The sale and purchase expenses of a residence are deductible if the expenses are reasonable and incident to the sale of the former residence or the purchase of the new residence. These expenses include the expenditures that the taxpayer would take into account in determining the amount realized on his former residence, such as sales commission, and the adjusted basis on his new residence, such as the cost of a loan. I.R.C. § 217(b)(2)(A), (B). Deductible lease expenses include those costs incident to the settlement of an unexpired lease or the acquisition of a new lease. *Id.* § 217(b)(2)(C), (D).

Although direct expense deductions, *see* text accompanying note 29 *supra*, are not subject to a dollar limitation, the deduction for indirect expenses is subject to an upper limit of $3,000. *See* I.R.C. § 217(b)(3). No more than $1,500 of that $3,000 may consist of expenses attributable to residence-hunting trips or the occupation of temporary quarters. *See id.*; notes 30 & 31 *supra*. Assume, for example, that a taxpayer incurs $700 in direct expenses and $3,500 in indirect expenses, $1600 of which is attributable to a residence-hunting trip and temporary living quarters, and $1900 of which is attributable to residence sale and purchase. The taxpayer may deduct the total $700 in direct expenses. He may deduct, however, only $1500 of the indirect expenses attributable to residence-hunting and temporary quarters. The taxpayer may deduct an additional $1500 for residence sale and purchase. The taxpayer, therefore, is precluded from deducting $500 worth of indirect expenses. Nevertheless, the taxpayer may capitalize the remaining $400 in indirect expenses attributable to sale and purchase. *See* English & Jackson, *supra* note 29, at 372. Capitalization of the excess sale and purchase expenses either reduces the amount realized on the former residence or increases the adjusted basis of the new residence. *See id.*

Single and married law students may be able to deduct the expense of moving to a permanent place of employment upon graduation.[33] The move must satisfy the same distance and time conditions,[34] and the same dollar limitations apply.[35] If the student's employer reimburses the student for any moving expenses, the student must include the amounts reimbursed in his gross income.[36]

EDUCATIONAL EXPENSES

Upon a student's arrival at law school, and throughout his legal career, a law student faces a substantial number of unavoidable expenses. Tuition and books, bar review courses and bar exam fees, journals, and seminars are very costly. Naturally, law students and attorneys seek to deduct these educational expenses. Although the courts have not always agreed with the taxpayers' interpretations of the Code,[37] judges have afforded students and attorneys a number of significant tax breaks for educational costs.[38]

Section 162 is central to the deductibility of educational expenses. Section 162 allows a deduction for all the "ordinary and necessary" expenses paid or incurred in carrying on any trade or business.[39] Ordinary expenses are those expenses that are not uncommon.[40] Expenses are necessary if they are appropriate or helpful.[41] A law student's educational costs are deductible only if the student is carrying on a trade or business for which his educational costs are ordinary and necessary.

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[33] Moving expenses are deductible only for the year in which they are paid. *See* Della M. Meadows, 66 T.C. 51, 53 (1976); I.R.C. § 217(a). Therefore, the taxpayer must deduct residence-hunting expenses paid in the year prior to graduation from the gross income of the prior year. *See generally id.* §§ 62(8), 217(a), (b)(1)(C). If a law student has accepted an offer of employment, he may deduct indirect expenses of residence-hunting and temporary living quarters incurred subsequent to his acceptance. *See id.* § 217(b)(1)(C), (D).

[34] *See* notes 24 & 25 *supra*.

[35] *See* note 32 *supra*.

[36] I.R.C. § 82; *see id.* § 61.

[37] *See* text accompanying notes 47-49 *infra*.

[38] The judiciary first approved the deductibility of educational costs in Hill v. Commissioner, 181 F.2d 906 (4th Cir. 1950). *See* Niswander, *Tax Aspects of Education: When Ordinary and Necessary; When Personal*, 26 N.Y.U. INST. FED. TAX. 27, 27 (1968) [hereinafter cited as Niswander]. In *Hill*, an established teacher attended summer school in order to fulfill current state certification requirements. 181 F.2d at 908. Although the taxpayer had the option of reading five books and submitting to examination on their content, the Fourth Circuit ruled that the taxpayer's summer costs were ordinary and necessary expenses and thus deductible. *Id.* at 911. The *Hill* court reasoned that the statutory requirements were satisfied because the teacher's choice was normal and natural for a reasonable person. *Id.* at 908. The court recognized that the taxpayer incurred the summer expenses to maintain her present position, not to attain a new one. *Id.* at 909.

[39] I.R.C. § 162(a).

[40] *See* Welch v. Helvering, 290 U.S. 111, 114 (1933). Although ordinary expenses are those expenses which are not uncommon, expenses need not be incurred often in order to be ordinary. *Id. See also* Deputy v. DuPont, 308 U.S. 488, 495 (1940).

[41] *See* Welch v. Helvering, 290 U.S. 111, 113 (1933).

Treasury Regulation 1.162-5 outlines the specific requirements that the taxpayer must meet in order to deduct his educational expenses under section 162.[42] As a general rule, educational costs are deductible in two contexts. If the education maintains or improves skills required by the taxpayer in his employment or other trade or business, the costs are deductible.[43] The taxpayer may also deduct educational expenses if the applicable law or regulations or the taxpayer's employer requires the education as a condition of continued employment.[44] The deductibility of educational costs is subject, however, to two further stipulations. First, educational costs are not deductible if the education satisfies the minimum educational requirements for qualification in the taxpayer's trade or business.[45] Second, the costs of education that qualifies the taxpayer for a new trade or business are not deductible.[46]

Degree Expenses

Attempts by J.D. degree candidates to deduct their educational expenses have been uniformly unsuccessful.[47] In denying the deduction for educational costs, the courts stress that the law students are qualifying for a new trade or business.[48] Since a law degree is essential to qualification for the trade or business of the practice of law, a law student does not incur his educational expenses in the "carrying on" of a trade or business pursuant to section 162.[49]

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[42] Treas. Reg. § 1.162-5 (1967). Regulation 1.162-5 codifies the decisions in Hill v. Commissioner, 181 F.2d 906 (4th Cir. 1950), and Coughlin v. Commissioner, 203 F.2d 307 (2d Cir. 1953). *See* note 38 *supra*; text accompanying notes 58-61 *infra*.

[43] Treas. Reg. § 1.162-5(a)(1) (1967). Vocational courses or seminars on current developments may be educational because these courses maintain or improve employment skills. *See id.* § 1.162-5(c)(1). Skills are required for the taxpayer's employment when the skills are appropriate, helpful, or necessary. *See* Niswander, *supra* note 38, at 37.

[44] Treas. Reg. § 1.162-5(a)(2) (1967). *See also id.* § 1.162-5(c)(2).

[45] *Id.* § 1.162-5(b)(2).

[46] *Id.* § 1.162-5(b)(3). Costs for educational courses that meet the minimum educational requirements for qualification in the taxpayer's trade or business, or that qualify the taxpayer for a new trade or business, are either personal expenditures or an inseparable combination of personal and capital expenditures. *Id.* § 1.162-5(b)(1).

[47] *See, e.g.*, Orrin Grover, 68 T.C. 598, 602 (1977); Albert C. Ruehmann, III, 30 T.C.M. (CCH) 675, 679 (1971). *See also* Joel A. Sharon, 66 T.C. 515, 525-26 (1976), *aff'd per curiam*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979); note 49 *infra*. The efforts of J.D. degree candidates to deduct educational costs will continue to be unsuccessful in the future. One commentator has noted that law school expenses are always nondeductible because the education qualifies the taxpayer for a new trade or business. *See* Barr, *Not All Professional Education Expenses Are Deductible: Analysis of Current Tests*, 16 TAX. ACCOUNTANTS 154, 155 (1976) [hereinafter cited as Barr]. *But see* note 48 *infra*.

[48] *See* Melnik v. United States, 521 F.2d 1065, 1065 (1975); Barr, *supra* note 47, at 155. One commentator has suggested that the I.R.S. should allow a deduction for law school expenses if the taxpayer seeks only to increase his effectiveness in his present trade or business and has no intention of practicing law. *See* Niswander, *supra* note 38, at 41.

[49] The "carrying on" language of § 162 is crucial for determining whether trade or business expenses are deductible. *See* I.R.C. § 162(a). In Albert C. Ruehmann, III, 30 T.C.M.

Other graduate degree candidates have been more successful at deducting their educational costs under section 162.[50] In order to deduct his educational expenses, the degree candidate must be actively engaged in the trade or business to which his studies pertain before he enters the graduate program.[51] An LL.M. degree candidate, therefore, must establish that he was carrying on the practice of law prior to the start of his graduate law studies.[52] The LL.M. degree candidate may be able to

(CCH) 675 (1971), a law student sought to deduct his educational expenses for the spring semester of his third year. *Id.* at 678. Although the state bar had admitted the student prior to his last semester, and the student had engaged in law-related employment while a student, the Tax Court disallowed the deduction. *Id.* at 679. The court reasoned that the taxpayer was not in the trade or business of being a lawyer, and that he had incurred his expenses to satisfy minimum educational requirements for employment. *Id. See generally* Treas. Reg. § 1.162-5(b) (1967); *see also* notes 52 & 53 *infra*.

Similarly, in Orrin Grover, 68 T.C. 598 (1977), the Tax Court denied a deduction to a Marine officer of "basic lawyer" status who had attended law school while on extended leave. *Id.* at 602. The court held that the officer's legal education qualified him for a new trade or business because his degree would enable him to engage in tasks and activities substantially different from those of a Marine officer. *Id.* at 601-02. The *Grover* court contrasted the tasks and activities that the taxpayer was qualified to perform before he completed his legal education with those he was qualified to perform after he completed his legal education. Since the tasks and activities differed substantially, the court held that the costs were nondeductible personal expenses within the meaning of § 262. *Id.* at 602. In Joel A. Sharon, 66 T.C. 515 (1976), the Tax Court held that costs of legal education constitute an "inseparable aggregate" of personal and capital expenditures within the meaning of Regulation 1.162-5(b). *Id.* at 526; *see* note 46 *supra*. Consequently, the *Sharon* court denied the taxpayer's effort to amortize the expenses. 66 T.C. at 526.

Summer employment, or part-time employment during the school year, does not qualify the student to deduct educational costs under § 162 because the student taxpayer still is preparing for a new trade or business. The taxpayer, therefore, cannot satisfy the carrying on requirement of § 162(a). *See* I.R.C. § 162(a).

[50] *See, e.g.*, Stephen G. Sherman, 36 T.C.M. (CCH) 1191, 1193 (1977); Albert C. Ruehmann, III, 30 T.C.M. (CCH) 675, 680 (1971); *see* notes 51-53 *infra*.

[51] In Johnson v. United States, 332 F. Supp. 906 (E.D. La. 1971), the court denied a deduction for LL.M. expenses because the taxpayer had never actively engaged in the practice of law. *Id.* at 908-09. The court held that professional status alone did not amount to the carrying on of a trade or business. *Id.* at 908. In Stephen G. Sherman, 36 T.C.M. (CCH) 1191 (1977), the court approved the deduction of $6,800 in tuition for a two-year M.B.A. program, reasoning that the taxpayer was carrying on the business of being a business manager. *Id.* at 1193. The taxpayer in *Sherman* had been involved in business administration both before and after his graduate study. *Id.* In Robert John Picknally, 36 T.C.M. (CCH) 1292 (1977), the taxpayer pursued a Ph.D. program during a nine-year period of unemployment. *Id.* at 1294. The court allowed a deduction for the educational expenses on the grounds that the taxpayer previously had been engaged in a trade or business and intended to return to that same trade or business. *Id.*

Nevertheless, active engagement in a trade or business may be insufficient. In Barry Reisine, 29 T.C.M. (CCH) 1429 (1970), the taxpayer worked for almost a year as an engineer before resigning to pursue graduate study in engineering. *Id.* at 1429. The court held that the taxpayer was not sufficiently established in a trade or business and, therefore, could not deduct his educational expenses. *Id.* at 1430. *See generally* Pusker, *Education Expenses Now Easier to Deduct Due to Wider View of 'Trade or Business,'* 21 TAX. ACCOUNTANTS 180 (1978).

[52] *See* note 51 *supra*; note 53 *infra*. In Albert C. Ruehmann, III, 30 T.C.M. (CCH) 675 (1971), the taxpayer entered an LL.M. program in the fall semester subsequent to his

satisfy this requirement by demonstrating that he joined the bar and worked during the summer after law school graduation.[53]

Bar Review and Other Costs

Under most circumstances, the costs of bar review courses are not deductible because the taxpayer incurs these expenses to qualify for a new trade or business.[54] Bar review costs, like law school tuition, ordinarily are personal expenses, which section 262 precludes as a deduction.[55] Bar exam fees and expenses incurred to gain admission to practice before particular courts also are not deductible under section 162 because they are capital expenditures.[56] Although these capital expenditures are not deductible, the taxpayer may amortize them.[57]

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graduation from law school. *Id.* at 677. The taxpayer worked as an attorney in a law firm during the intervening summer months. *Id.* The court allowed the deduction, reasoning that the taxpayer's membership in the bar and his summer employment established him in the trade or business of practicing law. *Id.* at 680. *Ruehmann* indicates that the graduate law student must show that he was employed at least briefly as a practicing attorney in order to deduct his educational costs.

[53] The *Ruehmann* court, 30 T.C.M. (CCH) 675 (1971), based its decision on all the facts in the record. The court noted that the graduate student had been offered permanent employment whether or not he obtained an LL.M. degree. *Id.* at 677, 680. Nevertheless, the court emphasized the taxpayer's bar membership prior to the start of his summer work and that the taxpayer did the same work during the summer as other lawyers in the firm with his experience. *Id.* at 680. If the firm's offer of permanent employment had been contingent on the taxpayer's completion of the LL.M. requirements, the LL.M. expenses would not have been deductible. *See* Treas. Reg. § 1.162-5(b)(2) (1967).

[54] *See* Joel A. Sharon, 66 T.C. 515, 526, 529-30 (1976); Treas. Reg. § 1.162-5(b) (1967).

[55] Joel A. Sharon, 66 T.C. 515, 526 (1976). In *Sharon*, Judge Irwin made a persuasive argument in dissent. Judge Irwin argued that once an individual has qualified to practice law in one state, a bar review course for another state does not lead to his qualification for a new trade or business. *Id.* at 537 (Irwin, J., dissenting); *cf.* Rev. Rul. 58, 1971-1 C.B. 55, 56 (teacher becoming certified in another state not qualifying for new trade or business).

[56] *See* Avery v. United States, 419 F. Supp. 105, 108 (N.D. Iowa 1976); Joel A. Sharon, 66 T.C. 515, 526, 531 (1976). A taxpayer may not deduct capital expenditures. I.R.C. § 263. Expenditures are capital in nature when the benefits extend over a relatively long period of time. One test for determining the capital nature of expenditures is the "accrual of benefits" test. *See* Avery v. United States, 419 F. Supp. 105, 108 (N.D. Iowa 1976). Usually, an expenditure is capital in nature when its benefits extend beyond one year. *Id.*

[57] In Joel A. Sharon, 66 T.C. 515 (1976), the Tax Court noted that the taxpayer's licenses to practice law in particular states and before specific courts were intangible assets. *See id.* at 531. Furthermore, the court determined that these assets amounted to property used in the taxpayer's trade or business within the meaning of § 167. *See id.* at 531-32. Section 167 provides for a depreciation deduction for the exhaustion, wear and tear of property used in a trade or business. I.R.C. § 167(a)(1). As a result, the Tax Court allowed the taxpayer to amortize his bar exam fees and court admission costs. 66 T.C. at 532. The court, however, required the taxpayer to amortize these capital expenditures over his life expectancy because he had failed to convince the court that the useful life of his licenses would terminate when he reached the age of 65. *Id.* at 530. In the interest of administrative convenience, the *Sharon* court indicated that although the taxpayer's $25 New York bar exam fee was a capital expenditure, such a small fee ordinarily could be deducted. *Id.* at 527.

By comparison, an established attorney's educational costs frequently are deductible. In *Coughlin v. Commissioner*,[58] the Second Circuit held that an attorney's tuition, travel, meals, and lodging expenses, incurred while attending a special institute on taxation, constituted ordinary and necessary trade or business expenses.[59] The court based its decision on Regulations relating to analogous expenses for professional society dues, subscriptions to professional journals, and books of short useful life.[60] The Second Circuit also emphasized the taxpayer's need to keep abreast of current developments in his area of expertise.[61] As a general rule, once an individual establishes that he is carrying on the trade or business of practicing law, virtually all of his business related educational costs are deductible. If the individual is a sole practitioner or a partner, rather than an employee, he may deduct these expenses above the line.[62]

SCHOLARSHIPS, GRANTS, LOANS

Many law students depend on scholarships or fellowship grants. Section 117 provides that an individual's gross income does not include scholarships or fellowship grants.[63] The exclusion does not apply, how-

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[58] 203 F.2d 307 (2d Cir. 1953).

[59] *Id.* at 308-10.

[60] *Id.* at 309; *see* Treas. Reg. § 1.162-6 (1960). Professional expenses for items with short useful lives are deductible under the general language of § 162(a). *See* I.R.C. § 162(a); Treas. Reg. § 1.162-6 (1960). In *Coughlin*, the court determined that the taxpayer's expenses in attending the tax institute were too short-term and ill-defined in nature to be capital expenditures. *See* 203 F.2d at 309-10. *See generally* Barr, *supra* note 47, at 156-57; Treas. Reg. § 162-5(b)(3)(ii), (e)(1) (1967). Section 212(3) allows a deduction for all ordinary and necessary expenses incurred in connection with the determination, collection, or refund of any tax. I.R.C. § 212(3). Although the costs of law school tax books might appear to be deductible under § 212(3), instead of § 162(a), the courts' restrictive interpretation of the provision and the requirement of ordinariness make deductibility unlikely. *See generally* Treas. Reg. § 1.212-1(f) (1975); Vogel & Halperin, *Has Dentist Merians Pulled the Teeth From Section 212(3)?*, 27 TAX. LAW. 435 (1974).

[61] 203 F.2d at 309. In *Coughlin*, the taxpayer was a member of a law firm that required at least one member to be especially knowledgeable on federal taxation. The court noted that the *Coughlin* circumstances differed from those in Hill v. Commissioner, 181 F.2d 906 (4th Cir. 1950), only in that *Coughlin* involved a lesser degree of necessity. 203 F.2d at 309. In *Hill*, a teacher incurred summer school expenses in order to satisfy certification requirements. *See* note 38 *supra*.

[62] *See* I.R.C. § 62(1), (2); text accompanying notes 15-20 *supra*. Section 62(1) allows deductions above the line for § 162(a) expenses if the taxpayer's trade or business does not consist of being an employee. *See* I.R.C. § 62(1); Treas. Reg. § 1.62-1(c)(1) (1976). In addition, to be deductible under § 62(1), an expense must be "directly . . . connected with the conduct of a trade or business." Treas. Reg. § 1.62-1(d) (1976). A taxpayer who is an employee, however, must deduct his educational costs below the line. *See* I.R.C. § 62(2). *See also* [1980] 2 STAND. FED. TAX REP. (CCH) ¶ 1360.01.

[63] I.R.C. § 117. Section 61 states that gross income includes all income from whatever source derived, *except as otherwise provided*. *Id.* § 61. The Code specifically provides for the exclusion of some items from gross income. *See id.* §§ 101-128. The practical difference between a deduction and an exclusion is that the taxpayer does not report an exclusion. *See*

ever, to any portion received as compensation for services,[64] unless all candidates for a particular degree must render such services.[65]

Most student teaching assistants are not involved in programs that require teaching services of all degree candidates. Section 117's effect, therefore, is unclear in the case of teaching assistants who receive payments that are designed to compensate for services as well as to aid in the pursuit of studies.[66] The Internal Revenue Service has adopted a "primary purpose" approach.[67] The Service maintains that payments are excludible from gross income only if the primary purpose of the payments is to further the education and training of the recipient.[68] If the primary purpose of the payments is to further the grantor's interest, the student must include the payments in his gross income.[69] In *Hembree v. United States*,[70] the Fourth Circuit took a different approach. The court held that funds that are in substantial measure a *quid pro quo* for services do not qualify for exclusion under section 117.[71] Nevertheless, under either the primary purpose test or the *quid pro quo* test, third-year law student assistantships are more like compensation than scholarships.[72] Consequently, section 117 does not exclude third-year assistantship funds from gross income.

Commissioner v. Mendel, 351 F.2d 580, 582-83 (4th Cir. 1965). The Code limits the exclusion for scholarships to those scholarships received at typical educational institutions satisfying the broad requirements of § 170(b)(1)(A)(ii). All accredited law schools apparently would satisfy the criteria. *See* Treas. Reg. § 1.117-3(b) (1960).

[64] I.R.C. § 117(b)(1). Non-degree candidates are subject to other specified conditions for and limitations upon the exclusion of scholarships. *See id.* § 117(b)(2). A non-degree candidate may exclude only those scholarships from particular grantors and only within specified time and amount limitations. *See id.*

[65] *Id.* § 117(b)(1).

[66] *See generally* Randall, *Teaching Assistants and Taxes—Paid to Study, or Paid to Work?*, 8 GONZ. L. REV. 33, 33-34 (1972) [hereinafter cited as Randall]. At least two commentators have recommended that Congress clarify § 117. *See* Myers & Hopkins, *IRS Is Limiting the Scope of Exclusion for Fellowship and Scholarship Grants*, 42 J. TAX. 212, 212-213, 215 (1975) [hereinafter cited as Myers & Hopkins]. *See generally* Bingler v. Johnson, 394 U.S. 741 (1969).

[67] *See* Treas. Reg. § 1.117-4(c) (1960); Myers & Hopkins, *supra* note 66, at 214-15. The Internal Revenue Service interprets § 117 restrictively. *See* Myers & Hopkins, *supra* note 66, at 213, 215.

[68] *See* Treas. Reg. § 1.117-4(c) (1960); Myers & Hopkins, *supra* note 66, at 214-16; Randall, *supra* note 66, at 38.

[69] *See* Steven M. Weinberg, 64 T.C. 771, 776-77 (1975); Treas. Reg. § 1.117-4(c) (1960); Myers & Hopkins, *supra* note 66, at 214-15.

[70] 464 F.2d 1262 (4th Cir. 1972).

[71] *Id.* at 1265; *see* Randall, *supra* note 66, at 36. *See also* Bingler v. Johnson, 394 U.S. 741, 751 (1969).

[72] At least one commentator has suggested that the *Hembree* decision, *see* text accompanying notes 70 & 71 *supra*, creates increased uncertainties for teaching assistants in determining whether they may exclude their funds from gross income. *See* Randall, *supra* note 66, at 38. Discussions regarding the excludibility of teaching assistantship grants often revolve around whether the funds are designed to attract qualified students or to compensate for services. *See generally* Logan v. United States, 518 F.2d 143 (6th Cir. 1975); Robert

Unconditional grants of financial aid are excludible from gross income.[73] Funds received pursuant to loan agreements also do not constitute gross income.[74] Furthermore, interest payments on educational loans are deductible.[75] The Service takes the position, however, that a loan cancellation, or a loan forgiveness conditioned on the student borrower's following a course of action that the lender prescribed, is income.[76]

SUMMER EMPLOYMENT*

Summer law clerks incur many expenses at locations that are wonderfully distant from law school. Section 162, however, may ease the financial burden of travel costs and additional living expenses.[77] In the recent case of *Soterios Hantzis*,[78] the Tax Court allowed a law student to deduct $3,204 in expenses incurred during the summer after her second year.[79]

Section 162(a)(2) provides that traveling costs incurred while away from home in the pursuit of a trade or business are deductible as ordinary and necessary trade or business expenses.[80] Traveling expenses include transportation, meals, and lodging.[81] To deduct his traveling ex-

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H. Steiman, 56 T.C. 1350 (1971); Treas. Reg. § 1.117-4(c) (1960); Myers & Hopkins, *supra* note 66; Randall, *supra* note 66, at 36. Third-year assistantships are not essential to inducing third-year students to continue their legal education at a particular institution. While the possibility of receiving an assistantship only remotely serves to attract students to the school initially, the grantor institution derives considerable benefit from awarding such funds.

[73] *See* I.R.C. § 117(a), (b)(1).

[74] *See* William H. Stayton, Jr., 32 B.T.A. 940, 943 (1935); Lorenzo C. Dilks, 15 B.T.A. 1294, 1300-01 (1929).

[75] Section 163 allows a deduction for all interest on loans paid within the taxable year. I.R.C. § 163(a). Interest deductions are below-the-line deductions and, therefore, are valuable only if the total itemized deductions exceed the zero bracket amount. *See id.* § 62; text accompanying notes 16-18 *supra*.

[76] *See* Rev. Rul. 256, 1973-1 C.B. 56, 56, *modified*, Rev. Rul. 540, 1974-2 C.B. 38; Myers & Hopkins, *supra* note 66, at 215-16. *See generally* Note, *Taxation—Scholarship and Fellowship Exclusion—Forgiveness of Educational Loans*, 1974 WIS. L. REV. 237.

*After this article went to press, the First Circuit reversed the Tax Court's decision in Soterios Hantzis, 38 T.C.M. (CCH) 1169 (1979), *rev'd*, No. 80-1140 (1st Cir. Jan. 7, 1981). *See* text accompanying notes 78-105 *infra*. The First Circuit denied the taxpayer's deduction, holding that her expenses were not incurred while away from home. No. 80-1140, slip op. at 13. The court of appeals reasoned that since the taxpayer had no business connection with her school location, she could not claim the situs of her school as her home for § 162(a)(2) purposes. *See id.* at 15-16. Nevertheless, the Tax Court is free to follow its decision in *Hantzis* in cases not appealable to the First Circuit. *See* Jack E. Golsen, 54 T.C. 742, 756-57 (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971).

[77] *See* I.R.C. § 162(a); text accompanying notes 39-41 *supra*.

[78] 38 T.C.M. (CCH) 1169 (1979).

[79] *Id.* at 1171.

[80] I.R.C. § 162(a)(2).

[81] *Id.*; Treas. Reg. § 1.162-2 (1960). Amounts expended for meals and lodging that are lavish or extravagant under the circumstances are not deductible. I.R.C. § 162(a)(2).

penses under section 162(a)(2), a taxpayer normally must satisfy three conditions.[82] First, the expense must be a reasonable and necessary traveling expense.[83] Second, the taxpayer must incur the expense while away from home.[84] Third, the expense must be directly connected with the carrying on of the taxpayer's trade or business.[85]

The second and third conditions are subject to an exception when the job is temporary in nature. The Internal Revenue Service ordinarily defines home as the taxpayer's principal or regular place of business.[86] The courts, however, have not accepted the Service's definition when the taxpayer's job is only temporary.[87] When the taxpayer's job is temporary and at a location other than his permanent residence, the courts have defined home as the taxpayer's permanent residence.[88] A temporary job, therefore, can satisfy the away from home requirement notwithstanding the Service's definition of home. Furthermore, when the employment is temporary, the taxpayer need not establish a direct connection between the expense and the carrying on of the trade or business. The taxpayer must show only that to expect him to move his home would be unreasonable.[89] If the taxpayer can show that a move would be

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[82] Commissioner v. Flowers, 326 U.S. 465, 470 (1946). The Supreme Court decided the *Flowers* case under § 23(a)(1)(A) of the 1939 Code, the forerunner of § 162(a)(2). *See* 326 U.S. at 467; Int. Rev. Code of 1939, ch. 1, § 23(a)(1)(A), 53 Stat. 12 (current version at I.R.C. § 162(a)(2)).

[83] Commissioner v. Flowers, 326 U.S. 465, 470 (1946).

[84] *Id.*

[85] *Id.* A taxpayer's performance of services as an employee constitutes his trade or business. *See* Treas. Reg. § 1.162-2(d) (1960); Rev. Rul. 189, 1960-1 C.B. 60, 65; [1980] 2 STAND. FED. TAX REP. (CCH) ¶ 1342.01.

[86] *See* Six v. United States, 450 F.2d 66, 68 (2d Cir. 1971); [1980] 2 STAND. FED. TAX REP. (CCH) ¶ 1352.01. *But see* Rev. Rul. 432, 1975-2 C.B. 60, 61 (taxpayer's place of abode regarded as tax home when he has no principal place of business); Rev. Rul. 189, 1960-1 C.B. 60, 62-64 (exception to I.R.S. concept of home when employment is temporary). The Tax Court normally accepts the Internal Revenue Service's definition of home as the taxpayer's principal or regular place of business. *See* Emil J. Michaels, 53 T.C. 269, 273 (1969). *But see* text accompanying note 87 *infra*.

[87] *See* Soterios Hantzis, 38 T.C.M. (CCH) 1169, 1171 (1979); Emil J. Michaels, 53 T.C. 269, 273 (1969); Harry F. Schurer, 3 T.C. 544, 546-47 (1944). *See also* Six v. United States, 450 F.2d 66, 69 (2d Cir. 1971); Laurence P. Dowd, 37 T.C. 399, 409-10 (1961); Rev. Rul. 189, 1960-1 C.B. 60, 62-64; note 88 *infra*.

[88] *See* Soterios Hantzis, 38 T.C.M. (CCH) 1169, 1171 (1979); Emil J. Michaels, 53 T.C. 269, 274 (1969); Harry F. Schurer, 3 T.C. 544, 546-47 (1944). The Second Circuit has rejected the Service's definition of home as the principal place of business. According to the Second Circuit, home means a taxpayer's permanent abode or residence. *See* Six v. United States, 450 F.2d 66, 69 (2d Cir. 1971); Rosenspan v. United States, 438 F.2d 905, 908-10 (2d Cir.), *cert. denied*, 404 U.S. 864 (1971). If the taxpayer's employment is indefinite in nature, however, the Second Circuit will consider the taxpayer's place of employment as his permanent residence. *See* 450 F.2d at 69. One commentator has suggested that the Second Circuit's view is preferable because treating the taxpayer's abode as his home eliminates the need for strained exceptions to the away from home rule. *See* Comment, *Travel, Transportation, and Commuting Expenses: Problems Involving Deductibility*, 43 MO. L. REV. 525, 543-44 (1978) [hereinafter cited as *Travel*].

[89] *See* Six v. United States, 450 F.2d 66, 69 & n.1, 70 (2d Cir. 1971); Rosenspan v. United States, 438 F.2d 905, 911-12 (2d Cir. 1971).

unreasonable, his living expenses satisfy the third condition of section 162(a)(2) because they are deemed compelled by business exigencies.[90]

In the *Hantzis* case, a Harvard law student resided in Boston with her husband. During the summer after her second year, the student clerked for a law firm in New York City. She rented an apartment in New York and worked for ten weeks. During the course of the summer, the student spent $3,204 for traveling expenses, $3,080 of which was attributable to meals and lodging.[91] Noting that the taxpayer's stay in New York was temporary,[92] the Tax Court held that her summer expenses were deductible under section 162(a)(2).[93]

The *Hantzis* court properly rejected the government's arguments that the taxpayer failed to satisfy the away from home requirement and that she did not incur the expenses in the pursuit of a trade or business.[94] The court reasoned that since the taxpayer's time in New York was not indefinite in duration[95] and the taxpayer had a bona fide home in Boston, the I.R.S. could not have reasonably expected her to move her permanent residence to New York.[96] The court also emphasized that section 162(a)(2) was intended to afford relief for the duplication of living expenses incurred by the student.[97] Furthermore, the taxpayer incurred her expenses in the pursuit of a trade or business because her employment necessitated the expenses.[98]

The *Hantzis* case demonstrates that a law student must fulfill two requirements in order to deduct his summer clerking expenses.[99] First, his employment must be temporary, rather than indefinite.[100] Virtually all

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[90] *See* Rosenspan v. United States, 438 F.2d 905, 912 (2d Cir. 1971); text accompanying note 85 *supra.*

[91] 38 T.C.M. at 1170. Transportation between Boston and New York accounted for $124 of the student's expenses in *Hantzis. Id.*

[92] *Id.* at 1171.

[93] *Id.*

[94] *Id.*

[95] *Id. See generally* Ronald D. Kroll, 49 T.C. 557 (1968).

[96] 38 T.C.M. at 1171. *See* Six v. United States, 450 F.2d 66, 69 (2d Cir. 1971); Harvey v. Commissioner, 283 F.2d 491 (9th Cir. 1960); Ronald D. Kroll, 49 T.C. 557, 562 (1968). The *Hantzis* court also reasoned that the taxpayer had a home to be away from, and that long distance commutation for personal reasons was not involved. 38 T.C.M. at 1171. In *Flowers*, the Supreme Court established the principle that expenses resulting from personal preference are not deductible. Commissioner v. Flowers, 326 U.S. 465, 473-74 (1946).

[97] 38 T.C.M. at 1171; *see* James v. United States, 308 F.2d 204, 206 (9th Cir. 1962); Lee E. Daly, 72 T.C. 190, 195 (1979); Charles W. Rambo, 69 T.C. 920, 924 (1978). *See also* note 102 *infra.* The *Hantzis* court noted additionally that the taxpayer had minimal contacts with New York City. 38 T.C.M. at 1171. *See also* Commissioner v. Flowers, 326 U.S. 465, 473 (1946); *Travel, supra* note 88, at 547.

[98] 38 T.C.M. at 1171.

[99] *See id.* Regardless of the unique conditions that the taxpayer must satisfy for the deduction of specific expenses, all expenses must be reasonable and necessary in order to be deductible under § 162(a)(2). Commissioner v. Flowers, 326 U.S. 465, 470 (1946); *see* note 82 *supra.*

[100] *See* T.C.M. at 1171; text accompanying notes 86-88 *supra.*

summer jobs, by their very nature, satisfy this criterion. Second, the student must maintain a permanent residence in some location other than his place of summer employment.[101] Although the *Hantzis* decision does not expressly identify what constitutes maintaining a permanent residence, the opinion indicates that some showing of duplication of living expenses may be necessary.[102] As a result, a law student probably cannot satisfy the away from home requirement of section 162(a)(2) by claiming his parents' home as his permanent residence.[103] The typical law student, therefore, must establish the location of his law school as his permanent residence, the maintenance of which results in duplicative living expenses during the summer.[104] The section 162(a)(2) deduction is an above-the-line deduction.[105] Consequently, the student may deduct his summer expenses whether or not he itemizes his deductions.

JOB-SEEKING EXPENSES

A law student may be able to deduct expenses related to job-seeking under section 162.[106] Section 162 requires that the taxpayer incur the ex-

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[101] *See* 38 T.C.M. at 1171; text accompanying note 96 *supra*. The taxpayer must have a home to be away from. *See generally* Brandl v. Commissioner, 513 F.2d 697 (6th Cir. 1975); Rosenspan v. United States, 438 F.2d 905 (2d Cir. 1971); Charles W. Rambo, 69 T.C. 920 (1978); Andrzej T. Wirth, 61 T.C. 855 (1974).

[102] *See* 38 T.C.M. at 1171; J. B. Stewart, 30 T.C.M. (CCH) 1316, 1318-19 (1971), *aff'd per curiam*, 77-2 U.S.T.C. ¶ 9617 (10th Cir. 1972); Emil J. Michaels, 53 T.C. 269, 273-75 (1969); Laurence P. Dowd, 37 T.C. 399, 410 (1961). In *Hantzis*, the court noted that the taxpayer had incurred expenses which to some extent duplicated other living expenses. 38 T.C.M. at 1171. An absence of duplicated living expenses, however, may not preclude a student from deducting his summer expenses. *See* Emil J. Michaels, 53 T.C. 269, 275 (1969). In *Michaels*, the court emphasized the temporary nature of the taxpayer's employment, the retention of his house in the city from which he traveled, and the short period for which that house was rented. *Id.* In Charles W. Rambo, 69 T.C. 920 (1978), the court acknowledged that all expenses for meals and lodging, not just the expenses that duplicate, are deductible when § 162(a)(2) requirements are fulfilled. *Id.* at 924.

[103] In Andrzej T. Wirth, 61 T.C. 855 (1974), the court held that a taxpayer has a home for § 162(a)(2) purposes only "when he has incurred substantial living expenses at a permanent place of abode." *Id.* at 859; *see* Jerome M. Rosenblum, 29 T.C.M. (CCH) 495, 496-97 (1970); notes 101 & 102 *supra*.

[104] *See generally* Luke J. Monroe, 38 T.C.M. (CCH) 466 (1979); Berton N. Cross, 38 T.C.M. (CCH) 234 (1979). Evidence that the location of a law student's school is his permanent residence might include voter registration, driver's license, payment of property taxes, and home ownership or ongoing lease arrangements. If the law student cannot establish a permanent residence at his school location, arguably his round-trip transportation costs between his summer job location and his school are deductible above the line. *See* §§ 62(2)(c), 162(a).

[105] I.R.C. § 62(2)(B). If a taxpayer claims a deduction for summer expenses under § 162(a)(2), no deduction for moving expenses is allowable under § 217. The temporary job exception to the away from home requirement of § 162(a)(2) presupposes that the taxpayer has not moved his permanent residence in order to begin work at a new principal place of employment. *See* Treas. Reg. § 1.217-2(c)(3)(iii) (1979); text accompanying notes 86-90 *supra*.

[106] *See, e.g.*, Cecil R. Hundley, Jr., 48 T.C. 339 (1967); Rev. Rul. 120, 1975-1 C.B. 55.

penses in carrying on a trade or business.[107] Because of the time-consuming nature of law school and the lengthy intervals of unemployment, most law students are unable to establish that they are carrying on the business of being a law clerk. Without a law degree or admission to the bar, law students obviously cannot show that they are engaged in the business of practicing law.[108] As a result, law students seeking a J.D. degree may not deduct expenses incurred during their search for either summer or permanent employment.

The job-seeking expenses of a law student's spouse, however, may be deductible. If a spouse is engaged in a trade or business prior to the move to law school, the expenses he or she incurs to attain a position in that same trade or business after the move may be deductible.[109] Expenses incurred in seeking a position in a new trade or business are not deductible.[110] Job-seeking expenses also are not deductible when the spouse has not been employed previously[111] or returns to work after a long period of unemployment.[112] Nevertheless, if the spouse's payment of job-seeking expenses is contingent on and not payable until after securing employment, the spouse may deduct the expenses.[113] Otherwise, success in the job-seeking endeavor is irrelevant to deductibility.[114]

INCOME AVERAGING

The income of most law students varies markedly from year to year during the period between college graduation and the early years of employment as an attorney. For some students, both single and married, the income averaging provisions of sections 1301 to 1305 may allow a substantial reduction in tax liability.[115] Income averaging reduces the

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[107] I.R.C. § 162(a).

[108] *See* text accompanying notes 47-49 *supra*. *But see* text accompanying notes 51-53 *supra*.

[109] *See* Rev. Rul. 120, 1975-1 C.B. 55, 56. The length of time for which the spouse has been unemployed is important in the determination of whether he or she is carrying on a trade or business. *See id.* A spouse's success in procuring employment in his or her trade or business is irrelevant to the deductibility of expenses incurred in the effort. *See* Leonard F. Cremona, 58 T.C. 219, 221-22 (1972), *acq.*, 1975-1 C.B. 1. Therefore, the expenses of a spouse who obtains a job in a new trade or business while seeking a job in his or her old trade or business arguably are deductible. Whether a spouse is carrying on the same trade or business often will depend on the breadth of the characterization of his or her trade or business. *See* York v. Commissioner, 261 F.2d 421, 422 (4th Cir. 1958).

[110] Rev. Rul. 120, 1975-1 C.B. 55, 56.

[111] *Id.*

[112] *See id.*

[113] *See* Cecil R. Hundley, Jr., 48 T.C. 339, 350 (1967).

[114] Leonard F. Cremona, 58 T.C. 219, 222 (1972); *see* Rev. Rul. 120, 1975-1 C.B. 55, 56. Job-seeking expenses for transportation and travel that satisfy § 162(a)(2) requirements are above-the-line deductions, deductible from gross income. *See* I.R.C. § 62(2); Rev. Rul. 16, 1977-1 C.B. 37, 38. In most cases, expenses for resumes, typing, and postage are below-the-line deductions, which are valuable only if the taxpayer itemizes his deductions. *See* Rev. Rul. 16, 1977-1 C.B. 37, 38; [1980] 2 STAND. FED. TAX REP. (CCH) ¶ 1342.03.

[115] *See* I.R.C. §§ 1301-1305.

taxes otherwise payable for those years when income increases dramatically.[116] The taxes normally due in the current tax year are reduced according to a formula that refers to the lower annual income amounts for the four-year period prior to the current tax year.[117]

To qualify for income averaging, an eligible individual's[118] averagable income must exceed $3,000.[119] Averagable income is the amount by which taxable income for the current tax year exceeds 120% of the average income for the previous four years.[120] That amount which equals 120% of the average income for the prior four years is taxed according to the tax tables of section 1.[121] The excess, averagable income, is taxed according to a three-step formula.[122] First, 20% of the taxpayer's averagable income is added to 120% of the taxpayer's average income for the previous four years.[123] The tax that ordinarily would be due on this sum is then calculated from the tax tables.[124] Second, the tax that ordinarily would be due on 120% of the average income for the prior four years is subtracted from the tax amount derived in the first step.[125] Third, the difference is multiplied by five to arrive at the tax attributable to averagable income.[126] The taxpayer's total tax is the tax on 120% of the average income for the prior four years plus the tax attributable to averagable income.[127]

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[116] *See id. See generally* Berger, *Income Averaging Benefits Not Limited to a Taxpayer With One Exceptional Year*, 21 TAX. ACCOUNTANTS 214 (1978) [hereinafter cited as Berger].

[117] *See* I.R.C. §§ 1301-1302.

[118] *See* text accompanying notes 128-32 *infra*.

[119] *See* I.R.C. § 1301. One commentator has suggested a three-step shortcut for determining whether income averaging may be helpful. First, total the taxable income for the four years prior to the current tax year and, pursuant to § 1302(b)(3), add a zero bracket amount adjustment for years prior to 1977. Second, multiply that total by 30%. Third, add $3,000. If the taxable income for the computation year is greater than the figure arrived at through the above computations, income averaging may reduce the taxpayer's tax liability. *See* Berger, *supra* note 116, at 215.

[120] I.R.C. § 1302(a)(1). If any of the previous four years is prior to 1977, the taxpayer must increase the taxable income for that prior year by the appropriate zero bracket amount. *Id.* § 1302(b)(3).

[121] *See id.* §§ 1, 1301; note 120 *supra*.

[122] *See* I.R.C. § 1301. Section 1301 provides that the tax attributable to averagable income shall be five times the increase in tax that would result under § 1 from adding 20% of the taxpayer's averagable income to 120% of the taxpayer's average income for the previous four years. *See id.*

[123] *See id.*; note 120 *supra*.

[124] *See* I.R.C. § 1301.

[125] *See id.*; note 120 *supra*.

[126] *See* I.R.C. § 1301.

[127] *See id.*; note 120 *supra*. As an example of income averaging, assume that T, a married individual filing a joint return, has taxable income for the current year of $30,000 and average income for the previous four years of $10,000. T's averagable income is $30,000 less 120% of $10,000, or $18,000. According to the tax tables, the tax on $12,000 (120% of $10,000) is $1,425. The remaining $18,000, T's averagable income, is taxed according to § 1301. First, § 1301 requires that 20% of $18,000, or $3,600, be added to 120% of $10,000, or

To be eligible for income averaging, an individual must have furnished not less than one-half of his own support for each of the four years preceding the current tax year.[128] Many law students, therefore, are not eligible for income averaging because their parents have supported them for at least one of the previous four years. The support requirement does not apply, however, in three situations.[129] First, the support requirement is inapplicable if the taxpayer is at least twenty-five years old and for at least four years since reaching the age of twenty-one has not been a full-time student.[130] Second, if more than one-half of the individual's taxable income for the current tax year is attributable to work substantially performed during two or more of the previous four years, the support requirement is waived.[131] Third, the support requirement does not apply if the taxpayer files a joint return and no more than one-fourth of the couple's total adjusted gross income is attributable to that taxpayer.[132]

Sections 1302, 1303, and 1304 include other provisions covering special circumstances, such as changes in marital status.[133] These provisions are covered adequately in Schedule G, which the taxpayer attaches to his income tax return, Form 1040.[134] For those law students who qualify in a given year, income averaging can produce large tax savings.[135] Even if a student taxpayer does not qualify in his first year as an attorney, income averaging may be beneficial in future years.[136]

$12,000. The sum is $15,600. The tax normally due on $15,600 is $2,181. Second, $1,425 is subtracted from $2,181. The difference, $756, is multiplied by five. The product, $3,780, is the tax attributable to averagable income. T's total tax for the current year is therefore the sum of $1,425 and $3,780, or $5,205. Without income averaging, T's tax would be $6,238, an increase of $1,033.

[128] *Id.* § 1303(c)(1). *Cf.* Richard Sharvy, 67 T.C. 630 (1977), *aff'd*, 566 F.2d 1118 (9th Cir. 1977) (fellowship not support furnished by taxpayer). *See also* Rev. Rul. 40, 1975-1 C.B. 276.

[129] *Id.* § 1303(c)(2); *see* Berger, *supra* note 116, at 218.

[130] I.R.C. § 1303(c)(2)(A). The age exception for income averaging will be of little benefit to most law students because most law students have not been out of college for at least four years.

[131] *Id.* § 1303(c)(2)(B). *See generally* Smith, *How to Become Miss America Without Achieving Any "Major Accomplishment"—Some Thoughts on the Income Averaging Provisions of the Internal Revenue Code*, 54 MARQ. L. REV. 329 (1971).

[132] I.R.C. § 1303(c)(2)(C). To use income averaging on a joint return, both spouses must be eligible individuals. Treas. Reg. § 1.1303-1(a) (1972); *see* text accompanying notes 128-31 *supra*. If only one spouse is eligible for income averaging, however, the filing of separate returns, with the eligible spouse averaging his or her income, may produce substantial tax benefits. *See* Berger, *supra* note 116, at 219.

[133] *See, e.g.*, I.R.C. § 1304(c)(1), (2). *See generally* Berger, *supra* note 116.

[134] *See* Berger, *supra* note 116, at 214.

[135] *See id.* at 220.

[136] The taxpayer should consider income averaging each year because he may elect to average his income each year. *See* Goldberg & Litwin, *Choosing Between the Tax Benefits Offered by Income Averaging and Those of Maxi-Tax*, 20 TAX. ACCOUNTANTS 170, 170 (1978).

CONCLUSION

Careful analysis of the Internal Revenue Code sections[137] and their judicial interpretation reveals legitimate ways to reduce one's taxable income.[138] Even Justice Cardozo could not object to this approach.[139]

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[137] *See, e.g.*, I.R.C. §§ 62, 117, 162, 217, 1301.

[138] Above-the-line deductions are especially valuable because they serve to reduce taxable income without being contingent on a threshold level of itemized deductions. *See* text accompanying notes 15-20 *supra*.

[139] *See* text accompanying notes 1-4 *supra*. The taxpayer should collect receipts and maintain records of his deductible expenses. Treasury Regulation § 1.162-17 (1962) provides guidance for the taxpayer on keeping adequate records and on substantiating expenses in the absence of proper records.