

Education Expenses

The secret to success

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Core Competencies:

- Attorney and Managing Member in Footer & Associates LLC's Philadelphia office. His expertise lies in the following areas:
 - ✓ Business Law
 - ✓ Taxation
 - ✓ Estates & Trusts
 - ✓ Corporate & Commercial Litigation
- Licenced to practice in the United States Tax Court
- Serves as a mediator in the Philadelphia Arbitrator Program

Prior positions held:

- Attorney with Anderson, Kill & Olick PC in the Philadelphia office
- Associate with Prickett, Jones & Elliott in Wilmington, Delaware
- Judicial law clerk to The Honorable Frederica Massiah-Jackson and The Honorable Mark I. Bernstein, in the Philadelphia Court of Common Pleas

Education:

- Case Western Reserve University School of Law (J.D.)
- Colby College (B.A)

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➤ What are the options?

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Education Credits & Deductions

American Opportunity Credit – \$2,500 per eligible student (amount made permanent in 2015 extender).

Offset tax liability, dollar for dollar, with any excess resulting in a refund up to \$1000.

Can be claimed for four years.

Available if AGI is below \$90,000 (\$180,000 for MFJ). Credit phases out between \$80,000 – \$90,000.

Only may be claimed for four years per eligible student.

Student himself may not claim credit if he is a dependent on another return. Consider gifting if payor AGI exceeds threshold.

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Education Credits & Deductions

Lifetime Learning Credit – \$2,000 credit per return

Offset tax liability, dollar for dollar, *no* refund.

Can be claimed for unlimited number of years

Available if AGI is below \$52,000 (\$104,000 for MFJ). Credit phases out between \$52,000 – \$62,000

Student himself may not claim credit if he is a dependent on another return. Consider gifting if payor AGI exceeds threshold.

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Tuition and Fees- \$4,000 Deduction

Deduction rather than a credit. Not refundable.

Can be claimed for unlimited number of years

Available if AGI is below \$80,000 (\$160,000 for MFJ). No phase-out threshold.

Student himself may not claim credit if he is a dependent on another return. Consider gifting if payor AGI exceeds threshold.

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Education Credits & Deductions

<https://www.etc.irs.gov/Other-Refundable-Credits/educompchart>

Criteria	AOTC	LLC	Tuition and Fees Deduction
Maximum credit or benefit	Up to \$2,500 credit per eligible student	Up to \$2,000 credit per return	Up to \$4,000 taxable income reduction per return
Refundable or nonrefundable	40% of credit	Not refundable	Does not apply
Limit on MAGI* for married filing jointly	\$180,000	\$128,000	\$160,000
Limit on MAGI* for single, head of household, or qualifying widow(er)	\$90,000	\$64,000	\$80,000
Can you file married filing separately?	No		
Dependent status	Cannot claim credit if you are claimed as a dependent on someone else's return		
Must you or your spouse be a U.S. Citizen or Resident Alien?	Yes, unless nonresident alien is treated as resident alien for tax purposes (see Publication 519 for information on nonresident alien status)		
Number of years of post-secondary education available	Only if student hasn't completed 4 years of post secondary education before 2014	All years of post secondary education and for courses to acquire or improve job skills	All years of post secondary education
Number of tax years credit available	4 tax years per eligible student including any years former Hope credit claimed	Unlimited	Unlimited

Criteria	AOTC	LLC	Tuition and Fees Deduction
Type of program required	Student must be pursuing a degree or other recognized education credential	Student does not need to be pursuing a degree or other recognized education credential	Student must be enrolled at eligible educational institution for one or more courses
Number of courses	Student must be enrolled at least half time for at least one academic period beginning in 2014	Available for one or more courses	Available for one or more courses at eligible educational institution
Felony drug conviction	No felony drug convictions as of the end of 2014	Does not apply	Does not apply
Qualified expenses	Tuition, required enrollment fees and course materials needed for course of study	Tuition and fees required for enrollment or attendance	Tuition and fees required for enrollment or attendance
Whom can you claim the benefit for?	<ul style="list-style-type: none"> You Your spouse Student you claim as a dependent on your return 	<ul style="list-style-type: none"> You Your spouse Student you claim as a dependent on your return 	<ul style="list-style-type: none"> You Your spouse Student you claim as a dependent on your return
Who must pay the qualified expenses?	<ul style="list-style-type: none"> You or your spouse Student <u>Third party</u> 	<ul style="list-style-type: none"> You or your spouse Student <u>Third party</u> 	<ul style="list-style-type: none"> You or your spouse
Payments for academic periods	Made in 2014 for academic periods beginning in 2014 or the first 3 months of 2015		
Do I need to claim the credit or deduction on a schedule or form?	Yes, Form 8863, Education Credits Form 8863 Instructions	Yes, Form 8863, Education Credits Form 8863 Instructions	Yes, Form 8917, Tuition and Fees Deduction

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- “A 529 plan is a tax-advantaged savings plan designed to encourage saving for future college costs. 529 plans, legally known as “qualified tuition plans,” are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code.”
- Some plans may allow for larger gifts to be split over several years to avoid gift tax. However, contribution to 529 plan counts as a gift to the beneficiary.
- Income tax plus 10% penalty if funds are not used for education. Consider changing beneficiary if plan allows.
- Possible state tax deduction.

Prepaid Tuition Plan	College Savings Plan
Locks in tuition prices at eligible public and private colleges and universities.	No lock on college costs.
All plans cover tuition and mandatory fees only. Some plans allow you to purchase a room & board option or use excess tuition credits for other qualified expenses.	Covers all "qualified higher education expenses," including: <ul style="list-style-type: none">• Tuition• Room & board• Mandatory fees• Books, computers (if required)
Most plans set lump sum and installment payments prior to purchase based on age of beneficiary and number of years of college tuition purchased.	Many plans have contribution limits in excess of \$200,000.
Many state plans guaranteed or backed by state.	No state guarantee. Most investment options are subject to market risk. Your investment may make no profit or even decline in value.
Most plans have age/grade limit for beneficiary.	No age limits. Open to adults and children.
Most state plans require either owner or beneficiary of plan to be a state resident.	No residency requirement. However, nonresidents may only be able to purchase some plans through financial advisers or brokers.
Most plans have limited enrollment period.	Enrollment open all year.

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- Grandparent owned 529 plans are not reportable on student's FAFSA. BUT, when the funds are distributed, they become part of student assets in the following year.
 - Only distribute in the final year of college.
 - Transfer 529 to parent. This will result in ~5.5% inclusion on student FAFSA.

- Greater flexibility – Ability to use the funds for anything without worry of penalty.
 - Full scholarship
 - Beneficiary chooses not to pursue college
 - Larger choice of investment options

- Greater control – Trust document can be used to affect the funds well past college for the beneficiary.
 - Allows for trustee to make fiduciary decisions
 - Can plan for contingencies like substance abuse, incarceration or mental health issues
 - Phase in income and principal payments

- Larger burden – Taxes, fees and administration.
 - Accounting and Fiduciary fees
 - Trust tax rate maximizes faster than individual rate
 - Requirement to keep track of distributions and yearly filings

Price tag for an MBA? Nearly \$125,000 for tuition.

Best case:

\$125,000 X 25% bracket = \$31,250 deduction

May also be able to take a deduction at state level

The MBA Education Expense Conundrum



Section 162: Deduction for ordinary and necessary business expenses for a trade or business.

Deduction most likely taken as an unreimbursed employee business expense.

The hurdle: Treasury Regulation 1.162-5

- In order to qualify for deduction taxpayer must demonstrate:
 - Education maintains or improves skills required by the taxpayer in his employment trade or business;
 - Education is not required in order to meet the minimum education requirements for the qualification in the taxpayer's employment; and
 - Expenses must not be part of a program of study being pursued by the taxpayer which will lead to qualifying him in a new trade or business.

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The MBA Education Expense Conundrum



- Education maintains or improves skills required by the taxpayer in his employment, trade, or business;
- Education is not required in order to meet the minimum education requirements for the qualification in the taxpayer's employment

MBA programs easily “maintain or improve skills”. Moreover, unlike law or medicine, and MBA is not a “required” degree or certification to have in order to work as a consultant, manager or in a banking capacity.

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Expenses must not be part of a program of study being pursued by the taxpayer which will lead to qualifying him in a new trade or business.

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The MBA Education Expense Conundrum



Pitfalls – Cases in which taxpayer is unsuccessful in deducting MBA expenses.

1. Not working long enough at previous position to establish an existing trade or business.

Link v. Comm’r 90 T.C.M. 197 (2005) Taxpayer was a recent college graduate. He left his research analyst position, his first job after college, after three months to pursue an MBA. Court held he had not engaged in “considerable, continuous, and regular activity” sufficient to establish him in *any* trade or business prior to pursuing an MBA.

2. New position too dissimilar to old position.

Schneider v. Comm’r 45 T.C.M. 675 (1983). Army officer who became a business strategy consultant. Taxpayer argued he was a “manager” in the army and was a “manager” in the new position. Court disagreed finding the military skills were insufficiently related to skills acquired during MBA.

McEuen v. Comm’r T.C. Summ. Op. 2004-107. Financial analyst at investment bank who became a brand manager. Court found that MBA education “led to qualifying her to perform significantly different tasks and activities than she performed before the education.”

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The MBA Education Expense Conundrum



Successes – Taxpayer prevails in deducting MBA expenses for part-time program.

Blair v. Commissioner 70 T.C. 1067 (1978) – Taxpayer completed part-time MBA while continuing employment at Sherwin Williams. Taxpayer was promoted from personnel representative to personnel manager while still in school. IRS challenged MBA deduction. Court held the expenses were deductible because the promotion was “a change of duties as opposed to a transition into a new trade or business.”

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The MBA Education Expense Conundrum



Successes – Taxpayer prevails in deducting MBA expenses for FULL TIME program.

Sherman v. Commissioner 36 T.C.M 1191 (1977) – Army officer employed in the Chief, Plans and Programs office. He requested a leave of absence to pursue an MBA at Harvard and was denied. Taxpayer attended Harvard anyway and, upon completion, applied for a position at his former employer. CPP office elected not to rehire. Taxpayer finally secured employment with Radix Corporation as Director of Planning and Research. Court finds MBA expenses are deductible.

1. “We conclude on the facts that [two years] was a sufficient time for petitioner to have established himself [in a trade or business]...
2. ... as a business manager”
3. “A Taxpayer who leaves his position temporarily to attend school **full time** (emphasis added) may be “carrying on” a trade or business while in school”
4. “The course of instruction for the MBA was quite definite in length – two years...Petitioner’s two-year suspension of active participation in his business was temporary and definite”

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We would be delighted to help.

We are often called to assist at the office audit, appellate and Tax Court level. We draft legal memoranda, which have been incorporated in the examining or appellant agent's report, that resulted in a favorable disposition for the taxpayer.

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