Revenue Law Journal

Volume 12 | Issue 1 Article 1

1-1-2002

Deductibility of Education Fees

Duncan Bentley
Bond University, Duncan_Bentley@bond.edu.au

Jim Corkery
Bond University, Jim_Corkery@bond.edu.au

Follow this and additional works at: http://epublications.bond.edu.au/rlj

Recommended Citation
Bentley, Duncan and Corkery, Jim (2002) "Deductibility of Education Fees," *Revenue Law Journal*: Vol. 12: Iss. 1, Article 1.
Available at: http://epublications.bond.edu.au/rlj/vol12/iss1/1

This Editorial is brought to you by the Faculty of Law at ePublications@bond. It has been accepted for inclusion in Revenue Law Journal by an authorized administrator of ePublications@bond. For more information, please contact Bond University's Repository Coordinator.

Deductibility of Education Fees

Abstract
[Extract]Education to acquire a skill is a capital asset. Expenditure to create this asset is distinct from the revenue-related expenditure to maintain education skills. The present law on deductibility requires that the taxpayer be in an established career already, and that the education expenditure be to ensure advancement in that career, and lead to promotion and increased income in that career. As the tax law stands, the cost of education to acquire new skills is not deductible.

Keywords
education, tax law

This editorial is available in Revenue Law Journal: http://epublications.bond.edu.au/rlj/vol12/iss1/1

EDITORIAL

DEDUCTIBILITY OF EDUCATION FEES

Education to acquire a skill is a capital asset. Expenditure to create this asset is distinct from the revenue-related expenditure to maintain education skills. The present law on deductibility requires that the taxpayer be in an established career already, and that the education expenditure be to ensure advancement in that career, and lead to promotion and increased income in that career. As the tax law stands, the cost of education to acquire *new* skills is not deductible.

Education leads to higher income generation by its recipients over a determinable period of time. French research shows that higher education has a multiplier effect in generating income. This has been charted and quantified in European economies. It follows that investment in higher education should be treated in tax policy like any other capital investment. If it is not, citizens will be deterred from investment in education and will place their capital where it is more favourably treated.

Australia's tax laws have been reshaped to encourage investment and savings, rather than consumption. Higher education should be encouraged with favourable tax treatment, because expenditure on education is expenditure on investment, which renders productive value to the economy. The existing laws impliedly recognise this, by allowing the deduction of education costs that lead to promotion or increases in income. Education expenses, already, are seen as business expenses for some taxpayers.

The 1975 *Asprey Committee* agreed: 'Those expenses denied deductions as expenses of deriving income because they relate to entry on an income-earning activity or substantial increase in standing could, in principle, be treated as costs of acquiring capital and as generating deductions by way of amortisation against income of the activity in future years. There are, however, no provisions that allow this treatment" (Para 7.98)

Vicki Beyer argued that education 'capital' costs should be depreciable, as if education were an asset used for a taxable purpose.[1] Higher or tertiary education is closely related to generation of income, so that nexus is there. And the tests for depreciating assets could apply, at least under the old provisions. Education could fall within the definition of 'depreciating asset' under s 40-30 now, for knowledge is an asset that has a limited effective life and is reasonably expected to decline in value over the time it is used. (However,

1 Vicki Beyer, 'A Tax Incentive For The Clever Country?' (1991) 2 *Revenue Law Journal* 70.

being an 'intangible asset' it is excluded by para (c)). The amortisation (depreciation deductions) could be spread over a normal period of income-producing years, or over some set time, say, 10 years, or even over some time that the taxpayer chooses. In the US intangible assets such as goodwill are amortised steadily over 15 years (s 197).

John K McNulty, a leading US tax specialist, also has run this argument.[2] A major attraction would be that, if the government were to support this approach, existing depreciation legislation, with minor amendment, would suffice; there may be no need for a special new enactment.

In the US, taxpayers are allowed to deduct the interest paid on educational loans secured by either a principal or secondary residence. While such an approach is potentially unfair, and discriminates in favour of home owners, the US is at least recognising the issue.

Jack McNulty wrote in May 2003 to the editors about US tax policy on education expenses:

> In the United States, the costs of higher education, such as a bachelor's degree in liberal arts at a college or university, or even a graduate degree such as an MD in medicine or a JD in law are not treated as costs of a depreciable, income producing asset. Expenses of some education for maintaining or improving skills required in the taxpayer's trade or business or employment are deductible currently as ordinary expenses of income producing activities, as has long been true: Treas. Regs. section 1.162-5(c). But recent changes have given several special tax subsidies for higher education expenses, not strictly along the lines of deducting or capitalizing and depreciating them as business expenses.
>
> Under recent s 530, the income in a so-called 'Coverdell education savings account' is exempt from Federal Income Tax, so long as it is set up to cover 'qualified education expenses of a designated beneficiary' and other tests are met. So, family saving for higher education expenses (and also elementary and secondary education expenses) can accumulate income without tax until disbursed, when it is included in the income of the distributee. So the deferral may be valuable, as well as the rate-bracket difference. But the allowance phases out quickly for any 'contributor' who has adjusted gross income over $95,000/$190,000 (single/joint return).
>
> Section 529 of the Code exempts from taxation a 'qualified tuition program' such as one established by a State or an eligible educational institution, under which individuals can purchase entitlements to tuition waiver or payment of

2 John K McNulty, 'Tax Policy and Tuition Credit Legislation' Federal Income Tax Allowances for Personal Costs of Higher Education' (1973) *California Law Review* 1. He has restated his arguments since this foundation article, but the essence is well expressed here.

qualified higher education expenses of a beneficiary, such as a child or grandchild, or may make contributions to an account established to meet such expenses. Upon distribution or use, the funds will be included in the income of the beneficiary. But given the time-value of money, contributions when a child is very young can accumulate income with no tax until distribution, and then at the beneficiary's applicable rate.

Also, under s 221 of the Internal Revenue Code, a deduction is allowed for interest paid on a qualified education loan, with dollar limits and with a phase-out with higher income. Under s 127, there is an exclusion from income of an employee for amounts paid or expenses incurred by his or her employer for educational assistance to the employee, with $5,200 maximum exclusion, and other limits. More important, a credit against tax is allowed for qualified tuition and related expenses of an eligible student, up to fairly low dollar limits, for 2 years of post-secondary education, called the 'Hope Scholarship Credit'. That section – s 25A - also allows a 'Lifetime Learning Credit' up to 20% of qualified tuition and related expenses up to $10,000, but with a quick phase-out for taxpayers above $40,000 income, a subsidy and incentive obviously aimed principally at relatively low-income taxpayers. In addition, the 10% penalty tax on early distributions from qualified retirement plans does not apply to distributions that are made for 'qualified higher education expenses' of the taxpayer or his/her spouse or child, another savings incentive and education subsidy.

The biggest and most general tax allowance is s 222, which allows a deduction for 'qualified tuition and related expenses' paid by the taxpayer during the taxable year. But again, because this provision is targeted at low-income taxpayers, there are strict and low dollar limits or ceilings on the amount of income that a taxpayer may have and still qualify for this deduction. Qualification phases out quickly for a taxpayer whose income exceeds $65,000 in 2003 and slightly higher amounts in 2004 and 2005. So, relatively low-income parents of one or more college or graduate students, for example, may benefit considerably from this deduction, which would also apply to expenses of the taxpayer or spouse for his or her own education. Also, s 135(c)(2) exempts from income tax the gain from redemption of any qualified U.S. savings bond to the extent the gains are used to pay qualified education expenses, again with limits based on the adjusted gross income of the taxpayer. (Coordination among these many separate provisions is provided in the Code.)

So, the US still does not treat the expenses of higher education as a deductible business expense, or as the purchase price of a depreciable asset used (possibly) for business or investment purposes. But it does recognize the desirability of such education for the population and the difficulty of financing it by savings or borrowing, especially for low income families and individuals. Accordingly, it has tried in the Federal Income Tax law to offer some tax relief and tax incentives and subsidies, particularly for relatively low-income individuals and families.

US education tax provisions are scattered through their statute. The trend is to allow deductions of the cost of the expenses of financing education, not of the education costs themselves.

The deductibility of the interest expenses of education loans is noteworthy. As the bulk of education costs is an investment in capital (only a small part of higher education is for personal satisfaction), the allowance of the interest expense is eminently justifiable. The matter would be administratively straightforward. Interest expenses would be allowable as they are paid. Education loans would be typically repaid over 10-15 years after graduation, when the taxpayer's income will reflect the benefit of that educational investment. This argument has been well put by Clifford Gross.[3]

A way forward?

Investment in human capital is of critical importance to a modern economy.[4] By prohibiting the deduction of most education expenses, investment in higher education is being treated less favourably than other capital investments.

Denying depreciation of educational capital is inequitable. It prevents cost recovery of capital expenses that are significant in the production of business income. If we lack the daring to allow education expenses as business deductions, we might pursue instead the issue of depreciation for education expenses, altering the legislation to allow such educational expenditure as a 'depreciating asset' within Div 40 of the *Income Tax Assessment Act 1997*.

A less demanding or expensive proposal again is that the interest expenses of education loans be deductible.

Duncan Bentley
Jim Corkery

---

3 'Tax Treatment of Education Expenses: Perspectives from Normative Theory' (1988) 55 *University of Chicago Law Review* 916.

4 This view is powerfully put by Loretta Argrett, 'Tax Treatment of Higher Education Expenditures: An Unfair Investment Disincentive' (1990) 41 *Syracuse Law Review* 621.