
Section 162.—Trade or Business Expenses

26 CFR 1.162-1: *Business expenses.*
(Also section 263; 1.263(a)-1.)

Training costs; business expenses. The Supreme Court's decision in *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992), does not affect the treatment of training costs as business expenses which are generally deductible under section 162 of the Code.

Rev. Rul. 96-62

ISSUE

Does the Supreme Court's decision in *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992), affect the treatment of training costs as business expenses, which are generally deductible under § 162 of the Internal Revenue Code?

LAW AND ANALYSIS

Section 162 and § 1.162-1(a) of the Income Tax Regulations allow a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 263(a) and § 1.263(a)-1(a) provide that no deduction is allowed for any amount paid out for permanent improvements or betterments made to increase the value of any property.

Through provisions such as §§ 162(a), 263(a), and related sections, the Internal Revenue Code generally endeavors to match expenses with the revenues of the taxable period to which the expenses are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes. See *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *Commissioner v. Idaho Power Co.*, 418 U.S. 1, 16 (1974).

In *INDOPCO*, the Supreme Court concluded that certain legal and professional fees incurred by a target corporation to facilitate a friendly merger created significant long-term benefits for the taxpayer and, therefore, were capital expenditures. In reaching this decision, the Court specifically rejected the argument that its decision in *Commissioner v. Lincoln Savings and Loan Association*, 403 U.S. 345 (1971), should be read as holding “that *only* expenditures that create or enhance separate and distinct assets are to be capitalized under § 263.” *INDOPCO* at 86-87 (emphasis in original).

The *INDOPCO* decision clarifies that the creation or enhancement of a separate and distinct asset is not a prerequisite to capitalization. That clarification does not, however, change the fundamental legal principles for determining whether a particular expenditure can be deducted or must be capitalized. As the Supreme Court has specifically recognized, the “decisive distinctions [between capital and ordinary expenditures] are those of degree and not of kind. . . .” *Welch v. Helvering*, 290 U.S. 111, 114 (1933); *Deputy v. du Pont*, 308 U.S. 488, 496 (1940). Therefore, with respect to expenditures that produce benefits both in the current year and in future years, the determination of whether such expenditures must be capitalized or may be deducted requires a careful examination of all the facts. Although the mere presence of some future benefit may not warrant capitalization, a taxpayer’s realization of future benefits is undeniably important in determining whether an expenditure is immediately deductible or must be capitalized. See *INDOPCO* at 87-88.

The *INDOPCO* decision does not affect the treatment of training costs under

§ 162. Amounts paid or incurred for training, including the costs of trainers and routine updates of training materials, are generally deductible as business expenses under that section even though they may have some future benefit. *INDOPCO* at 87. See, e.g., *Cleveland Electric Illuminating Co. v. United States*, 7 Cl. Ct. 220 (1985) (deduction for costs of training employees to operate new equipment in an existing business); Rev. Rul. 58-238, 1958-1 C.B. 90, 91 (deduction for costs of training employees that relate to the regular conduct of the employer’s business); see also *Ithaca Industries, Inc. v. Commissioner*, 97 T.C. 253, 271 (1991) (deduction for costs of training new employees to keep the assembled workforce unchanged), *aff’d*, 17 F.3d 684 (4th Cir.), *cert. denied*, 115 S. Ct. 83 (1994). Training costs must be capitalized only in the unusual circumstance where the training is intended primarily to obtain future benefits significantly beyond those traditionally associated with training provided in the ordinary course of a taxpayer’s trade or business. See, e.g., *Cleveland Electric*, 7 Cl. Ct. at 227-29 (capitalization of costs for training employees of an electric utility to operate a new nuclear power plant, which were akin to start-up costs of a new business).

HOLDING

The *INDOPCO* decision does not affect the treatment of training costs as business expenses, which are generally deductible under § 162.

DRAFTING INFORMATION

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26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

The rules for substantiating the amount of a deduction or expense for business use of an automobile that most nearly represents current costs are set forth. See Rev. Proc. 96-63, page 46.

The rules for substantiating the amount of a deduction or expense for lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home that most nearly represents current costs are set forth. See Rev. Proc. 96-64, page 52.