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## Are Training Costs Exempt from *INDOPCO*?

by Robert W. Wood • San Francisco

It seems as if the *INDOPCO* "capitalize everything" mantra is being applied with increasing frequency, and being applied in fields quite far flung from its original

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the Service found in both cases to be deductible as business expenses. Significantly, the Service acknowledged in the ruling that such costs could have some future benefit. "Future benefit," we must recall, is a dreaded moniker to all of us who would prefer to exorcise *INDOPCO* from the tax literature. Of course, in the relatively brief ruling the Service was able to cite a sizable pile of authority that seems to say that a little future benefit just doesn't matter.

For example, in Revenue Ruling 96-62 the IRS cites *Cleveland Electric Illuminating Co. v. United States*, 7 Cl. Ct. 220 (1985) (indicating that a deduction for the costs of training employees to operate equipment in an existing business is appropriate); and Revenue Ruling 58-238, 1958-1 C.B. 90 (upholding a deduction for the costs of training employees that relate to the regular conduct of the employer's business). Perhaps most significantly, the IRS cites *Ithaca Industries, Inc. v. Commissioner*, 97 T.C. 253 (1991), *aff'd*, 17 F.3d 684 (4th Cir. 1994), *cert. denied*, 115 S.Ct. 83 (1994). The *Ithaca Industries* case upheld a deduction for the costs of training new

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## TRAINING COSTS

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takeover expense genre. Indeed, we recently witnessed the expansion of *INDOPCO* into aircraft maintenance costs. (For discussion, see Schiffhouer and Chambers, "*INDOPCO* Takes Flight: The Capitalization of Aircraft Maintenance Costs," *The M&A Tax Report*, Vol. 5, Nos. 5 and 6, (Dec. 1996, Jan. 1997), p. 1.) Now, however, the Service has issued a published ruling, Revenue Ruling 96-62, 1996-53 I.R.B. 1, exempting training costs. The ruling concludes that the *INDOPCO* decision does not affect the deductibility of training costs under Section 162. (But careful, read on.)

The costs in question included the costs of trainers, as well as routine updates of training materials, which

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## TRAINING COSTS

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employees to keep an assembled workforce unchanged. (For prior coverage of the *Ithaca Industries* case, see Wood, "Fourth Circuit Upholds Denial of Work Force Depreciation," Vol. 2, No. 9 *M&A Tax Report* (April 1994), p. 1.)

### Future Benefit Training?

All in all, the IRS had to acknowledge that there was substantial authority (one of my favorite phrases) for the notion that training costs are deductible—*INDOPCO* or no *INDOPCO*. Still, it is a bit troubling that at the conclusion of the ruling (and after the recitation of all of the significant authority), the IRS states that: "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." For this rather loosey-goosey proposition, the ruling cites *Cleveland Electric Illuminating Co.*, 7 Cl.Ct. 220 (1985), treated training costs for employees of an electric utility to operate its new nuclear power plant as akin to start-up costs of a new business, therefore requiring capitalization for the training.

Some feel that the Service has issued an "*INDOPCO* doesn't apply ruling" with one hand and then at its conclusion, taken away more than what it gives. Indeed, in what can only be described as the old "one-two," it seems we now need to worry about what

kinds of training costs will produce a significant future benefit and, perhaps more importantly, what kinds of training costs will lead to a new product. If one must now analyze training costs both by reference to just **how much** future benefits are worth, coupled with whether the training will result in (or affect) a new business, maybe we are all in trouble.

Shortly after the ruling was issued, the *Wall Street Journal* ran an interesting article in which a variety of companies are quoted with training cost horror stories. See MacDonald, "Tax Rule May Crimp Firms' Expansion—IRS Makes Some Training Costs Harder to Deduct," *Wall Street Journal*, Jan. 14, 1997, p. A2. Among various industry and professional sources who give their own account of how much *INDOPCO* has invaded the training cost regimen, is *M&A Tax Report* Advisory Board Member Bob Willens of Lehman Brothers. Just how one quantifies how much in the way of training costs will be effected both by the good and by the bad side of this ruling, is not yet clear.

### Conclusion

Whether one looks to start-up costs as an analog, or specifically to the amorphous future benefit notion, it is troubling to many of us. After all, doesn't everything have some future benefit? Anyway, cynical readers may well conclude that Revenue Ruling 96-62 proves a little too much.

Does the fact that the IRS now singles out training costs (despite what the IRS acknowledges are future benefits), mean that virtually everything else will be required to be capitalized? I hope that question answers itself. ■

### TAXATION OF INTANGIBLE ASSETS

by Mark A. Muntean

This book fills an important void in tax literature concerning a complicated and controversial issue. Covering many topics from the general principles of intangible treatment, alternative minimum tax and intangibles, research and development expenditures to a thorough and straightforward discussion of covenants not to compete. Compression bound, \$99 (plus \$10 shipping and handling and \$8.42 California sales tax on California orders).



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