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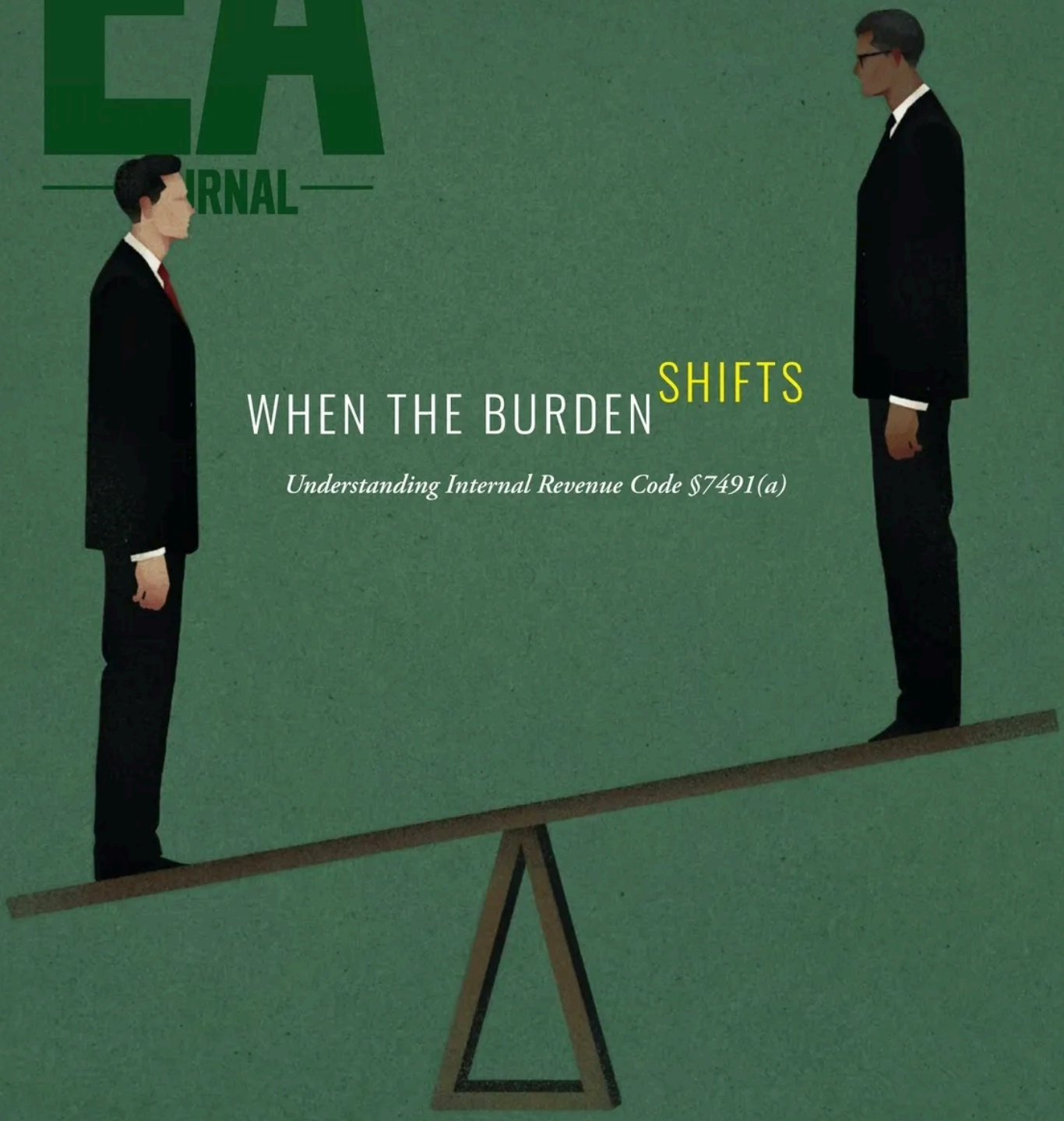

WHEN THE BURDEN SHIFTS

Understanding Internal Revenue Code §7491(a)

One Big Beautiful Bill Act Provisions / Preventing Payroll Tax Catastrophes

Navigating the Contested Terrain of SURROGACY EXPEN$ES

A Case for Deductibility Under Internal Revenue Code §213

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The landscape of family formation has undergone a profound transformation with the advent of assisted reproductive technologies (ARTs), including in vitro fertilization (IVF), egg donation, and gestational surrogacy. For many individuals and couples, these medical advancements offer the only path to biological parenthood. However, the substantial costs associated with ARTs, particularly surrogacy, present a significant financial burden, and their deductibility as medical expenses under Internal Revenue Code (IRC) §213 remains a hotly contested issue among tax professionals and the Internal Revenue Service (IRS) alike. While the IRS has historically adopted a narrow construction of the medical expense deduction, a closer examination of existing statutory language, administrative guidance, and judicial precedents, coupled with recent political and legislative trends, suggests a compelling argument for greater deductibility, especially in cases of medical necessity. This article will delve into the nuances of IRC §213 and related authorities to argue that surrogacy expenses, when medically necessary, should qualify as deductible medical care.

The Legal Framework of Medical Expense Deductions

At the heart of the debate lies IRC §213, which generally allows taxpayers to deduct expenses paid during the taxable year for "medical care" of the taxpayers, their spouse, or a dependent, to the extent these expenses exceed 7.5 percent of their adjusted gross income (AGI). The crucial definition of "medical care" is provided in IRC §213(d)(1)(A), encompassing amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body."[i] The disjunctive "or" between the "disease" prong and the "structure or function" prong is critical to a comprehensive interpretation.

Treasury Regulation §1.213-1(e)(1)(ii) further specifies that deductible medical expenses are those "incurred primarily for the prevention or alleviation of a physical or mental defect or illness," and not merely for the "general health" or "well-being" of an individual.[ii] This regulation often underpins the IRS's narrow construction of the deduction. However, the context of expenses is vital. Legal fees, for instance, are generally nondeductible personal expenses. Yet, under "very limited circumstances," they can be allowable as medical care expenses if there is a "direct or proximate relationship" between the legal fees and the provision of medical care to a taxpayer.[iii] For example, legal expenses incurred to create a guardianship to involuntarily hospitalize a medically ill taxpayer were held deductible because the medical treatment could not otherwise have occurred.[iv] In contrast, legal fees for a divorce, even if claimed as necessary for mental health, were not deductible because the divorce would have occurred regardless of the petitioner's depression.[v] This "but for" test is crucial: If the expense would not have been incurred but for the medical condition, it strengthens the case for deductibility.

The IRC also explicitly excludes certain procedures from "medical care," such as cosmetic surgery, unless necessary to ameliorate a deformity from a congenital abnormality, injury, or disfiguring disease.[vi] This specific exclusion implicitly suggests that other procedures affecting "structure or function" are generally includible, even without a "disease" diagnosis, unless specifically carved out.

Internal Revenue Service and Judicial Interpretations of Fertility Treatment and Surrogacy Expenses

The IRS and courts have provided varying, sometimes contradictory, interpretations regarding the deductibility of fertility treatments and, more specifically, surrogacy expenses.

General Fertility Treatment

A consistent thread in IRS guidance is that procedures affecting a person's ability to have children qualify as medical care because they affect a structure or function of the body. This includes vasectomies[vii] and operations rendering a woman incapable of having children.[viii] Notably, IRS Publication 502, *Medical and Dental Expenses*, explicitly states that "fertility enhancement" procedures, such as IVF (including temporary storage of eggs or sperm) are deductible to "overcome an inability to have children." While Publication 502 is not legally binding authority, it reflects the IRS's longstanding position and is often relied upon by taxpayers and tax professionals. An IRS information letter from 2005 reiterated this, stating that "fertility is a function of the body, and treatment to overcome infertility is within the definition of 'medical care'" and that "obtaining an egg or embryo to be inserted into the taxpayer's body is medical care of the taxpayer."[ix]

Egg Donation

The deductibility of egg donation expenses, especially for a medically infertile taxpayer, finds support in a private letter ruling (PLR).[x] This PLR allowed the deduction of various costs, including the egg donor fee, agency fees, donor's medical and psychological testing, insurance for post-procedure assistance, and legal fees for the contract, reasoning that these expenses were "directly related and preparatory" to the taxpayer's medical procedure.

This ruling draws a crucial analogy to organ donation, where expenses paid by the recipient for a donor's medical and transportation costs are deductible.[xi] The principle is that medical expenses incurred for a third party are deductible by the taxpayer if they are for the medical care of the taxpayer.

Surrogacy - The Contested Area

Despite the guidance supporting the deductibility of general fertility treatments and egg donation, the IRS has traditionally taken a narrow view on surrogacy expenses. Information letters from 2002 and 2004 explicitly state that medical expenses paid for a surrogate mother and her unborn child are not deductible under §213(a) because a surrogate is generally "neither the taxpayer nor the taxpayer's spouse," and an "unborn child" is not a dependent. These letters also assert that legal fees related to surrogacy are typically not deductible. This is again reiterated in Publication 502.

Several key court cases, primarily involving male taxpayers without a medical diagnosis of infertility, have upheld the IRS's narrow interpretation:

- ***Magdalin v. Commissioner (2008)*:** A single, heterosexual male taxpayer sought to deduct expenses for egg donor, surrogacy, IVF clinic fees, and legal fees. The Tax Court denied these deductions, holding there was "no causal relationship between an underlying medical condition or defect and the taxpayer's expenses," nor were the costs incurred "for the purpose of affecting a structure or function of the taxpayer's body." The court noted that Magdalin was not medically infertile.[xii]
- ***Longino v. Commissioner (2013):*** A fertile male taxpayer with children from prior marriages sought to deduct IVF costs incurred for his former fiancée. The court held that a taxpayer cannot

deduct IVF costs of an "unrelated person" if the taxpayer "does not have a defect which prevents him from naturally conceiving children."[xiii]

- ***Morrissey v. United States (2017)***: A male taxpayer in a same-sex union, who conceded he was not medically infertile but "effectively" infertile due to his homosexuality, sought to deduct costs for an egg donor, gestational surrogate, and IVF. The Eleventh Circuit affirmed the denial, stating the expenses were not for the purpose of affecting *his own body's reproductive function* (as his sperm production was unaffected). The court distinguished his situation from the PLR allowing egg donor deductions, noting that in the PLR, the donated eggs were implanted in the *taxpayer's* or *spouse's* body.[xiv]
- ***PLR 202114001:*** Most recently, this ruling for a male same-sex couple explicitly concluded that costs related to egg donation, IVF procedures, and gestational surrogacy incurred for "third parties" were "not incurred for treatment of disease nor are they for the purpose of affecting any structure or function of taxpayers' bodies," and, therefore, not deductible. However, the IRS allowed deductions for sperm donation and freezing, as these were "directly attributable to taxpayers."[xv]
- ***PLR 202505002:*** This recent ruling involved a heterosexual married couple where the wife had diseases that required them to take medication that is contraindicated in pregnancy. As a result, the taxpayers used a surrogate and IVF with her husband's sperm and a donated egg from a third party. Despite these facts, the IRS concluded that most costs and fees related to assisted reproductive technology incurred for third parties, including childbirth expenses for the surrogate pregnancy, medical insurance related to the surrogate pregnancy, and egg donation, do not qualify as deductible medical expenses under §213, completely casting aside the "mitigation" prong.

The court held that a taxpayer cannot deduct IVF costs of an “unrelated person” if the taxpayer “does not have a defect which prevents him from naturally conceiving children.”

These cases and rulings largely hinge on two main points: (1) the absence of a *medical condition or defect* in the taxpayer preventing conception or gestation, and (2) the services being performed on a *third party* who is not the taxpayer, spouse, or dependent.

The Counterarguments: Medical Necessity and "Substitute for Normal Functioning"

While the IRS's position has been largely upheld in recent court cases involving fertile male taxpayers, a strong argument for deductibility exists in cases of medical necessity, particularly for intended parents with a confirmed medical inability to carry a pregnancy.

"Disease" Prong and Medically Necessary Surrogacy: The narrow interpretation of "disease" by the IRS, as seen in cases like *O'Donnabhain v. Commissioner*, where the IRS argued for a scientifically established pathology, would illogically exclude much reproductive care traditionally accepted as "medical." However, the Tax Court correctly rejected this extreme view in *O'Donnabhain*, confirming that "disease" can encompass conditions for which patients seek inherently medical care. In cases where a taxpayer receives a confirmed diagnosis from a doctor that they are unable to carry children due to complications from a medical condition or prior procedure, unequivocally qualifies as a medical "disease" or "defect" requiring treatment. The surrogacy expenses in such a scenario are directly incurred to "mitigate" this specific medical diagnosis, satisfying the "but for" test, as they would not have been necessary if not for the medical directive. This directly differentiates from the taxpayers in *Magdalin*, *Longino*, and *Morrissey*, who were found not to have a medical defect preventing them from conceiving.

"Structure or Function of the Body" and "Substitute for Normal Functioning:" Even without a strict "disease" diagnosis, the "structure or function" prong provides a basis for deductibility. Internal Revenue Service regulations clearly state that procedures affecting "any portion of the body, including obstetrical expenses...are deemed to be for the purpose of affecting any structure or function of the body."[xvi] Fertility itself is recognized as a function of the body.[xvii]

Katherine Pratt and others argue for a "substitute for normal functioning" interpretation, similar to organ donor rulings.[xviii] Just as a kidney donor provides a substitute for a diseased kidney, a gestational surrogate provides a substitute for a dysfunctional uterus, enabling the intended parent to achieve the "function" of carrying a child to term. This argument aligns with other "substitute" deductions, such as seeing-eye dogs for the blind or note-takers for the deaf, which are deductible even if they do not directly "affect the structure or function" of the taxpayer's body but rather mitigate a condition and approximate normal functioning.

While the IRS argued against this in the *Sedgwick v. Commissioner* case, claiming surrogacy did not affect the "structure or function of the petitioner wife's" body, the IRS ultimately settled *Sedgwick* in favor of the medically infertile heterosexual taxpayers. This settlement, along with a similar one in *Osius v. Commissioner*, suggests the IRS recognized the strength of the taxpayer's position when medical infertility was clearly established, even if they continue to challenge such deductions.

Whose "Body" and "Dependent" Revisited: The IRS's reliance on cases like *Cassman v. United States* (unborn child not a dependent) and *Kilpatrick v. Commissioner* (adoptive parents could not deduct birth mother's prenatal expenses) to deny surrogacy expenses is misplaced in cases of medically necessary ARTs. As Pratt argues, collaborative ARTs are medical procedures initiated by the intended parents, fundamentally different from traditional adoptions. The medical expenses in surrogacy are incurred *for the benefit* of the intended parents, directly addressing their medical inability to conceive or carry a child.

The "Hotly Contested" Landscape and Emerging Trends

The current state of deductibility for surrogacy expenses is, indeed, fraught with inconsistency and confusion. The conflicting signals from IRS information letters (generally denying deductibility) versus PLRs (allowing it for egg donation in medically infertile cases) and historical settlements (allowing surrogacy deductions for medically infertile couples) create an uncertain environment for taxpayers and professionals.

The *Morrissey* decision, while binding only in the Eleventh Circuit and specifically dealing with a fertile male taxpayer using a surrogate, introduced broad language about "IVF-related expenses" and even expressed moral objections to ARTs as "science fiction." This risks further muddling the waters by conflating distinct medical procedures and implying that moral and ethical considerations can influence tax deductibility, contrary to established principles where the legality of a procedure is the primary concern.

However, the trend is not uniformly against deductibility. The arguments for deductibility in cases of medical necessity are robust, rooted in the clear language of IRC §213(d)(1)(A). The IRS's own Publication 502 and prior rulings affirming that procedures affecting reproductive function are medical care provide a solid foundation.

Furthermore, recent legislative efforts signal a growing societal and potentially governmental recognition of ARTs as essential medical care. H.R. 8190, introduced in 2022, proposes to amend IRC §213(d) to explicitly include "assisted reproduction" in the definition of "medical care."[xix] Crucially, this proposed bill defines "assisted reproduction" broadly to mean "any methods, treatments, procedures, and services for the purpose of effectuating a pregnancy and carrying it to term, including gamete and embryo donation, intrauterine insemination, in vitro fertilization, intracervical insemination,

traditional reproductive surrogacy, and gestational reproductive surrogacy." More importantly for the present discussion, it specifies that "assisted reproduction shall be treated as medical care of the taxpayer or the taxpayer's spouse or dependent to the extent that the taxpayer or the taxpayer's spouse or dependent, respectively, intends to take legal custody or responsibility for any children born as a result of such assisted reproduction."

This proposed legislation, while not yet law, reflects a significant legislative acknowledgement of evolving medical definitions and needs. It suggests a move toward a more inclusive interpretation of "medical care" that prioritizes the intent to parent and the medical means to achieve it, rather than solely focusing on a traditional "disease" model or the identity of the third-party recipient of medical services. This aligns with the argument that existing code and regulations, when interpreted with a modern understanding of medical necessity and reproductive function, already encompass these expenses.

Conclusion and Recommendations

The deductibility of surrogacy expenses under IRC §213 is a complex issue, marked by conflicting interpretations and evolving societal norms. While the IRS has, in general guidance and certain judicial outcomes, narrowly construed the medical expense deduction, particularly for third-party surrogacy, a strong legal argument for deductibility emerges in cases of medical necessity.

For taxpayers who possess a confirmed medical diagnosis preventing them from naturally carrying out a pregnancy, the surrogacy expenses are directly attributable to the "mitigation" of a "disease" or the affecting of a "structure or function of the body" that is inoperative. The "but for" test applies here: The expenses would not have been incurred were it not for the medical imperative. Analogies to organ donation and the IRS's own stance on other fertility treatments further bolster the case for treating medically necessary surrogacy as deductible medical care.

The legislative efforts exemplified by H.R. 8190 are a clear indication that lawmakers recognize the need for explicit clarity in this area, aiming to codify a broader understanding that aligns with modern medical practice and diverse family structures. Even without new legislation, tax professionals have a basis to argue that the existing Code and regulations, when thoroughly examined and interpreted in light of the "disease" and "structure or function" prongs and related administrative guidance, already support deductibility for medically necessary surrogacy.

Given the high costs involved and the deeply personal nature of these expenses, consistent and clear guidance from the IRS in the form of regulations or revenue rulings is urgently needed. Until such clarity is provided, tax professionals must carefully evaluate the specific facts and circumstances of each client's case, document medical necessity meticulously, and be prepared to advocate for a principled interpretation of IRC §213 that acknowledges the realities of modern family building. While "legislative grace" often dictates deductions, the fundamental principles underlying the medical expense deduction, which alleviate the burden of involuntary medical costs, should also extend to medically necessary assisted reproduction.

[i] *https://www.law.cornell.edu/uscode/text/26/213*

[ii] *https://www.law.cornell.edu/cfr/text/26/1.213-1*

[iii] *Lenn v. Commissioner, T.C. Memo 1998-85*

[iv] *Gerstacker v. Commissioner, 414 F.2d 448 (6th Cir. 1969)*

[v] *Jacobs v. Commissioner, 62 T.C. 813 (1974)*

[vi] *IRC §213(d)(9)*

[vii] *Rev. Rul. 73-201, 1973-1 C.B. 140*

[viii] *Rev. Rul. 73-603, 1973 C.B. 76*

[ix] *IRS INFO. LTR. 2005-0102 (Mar. 29, 2005)*

[x] *PLR 200318017*

[xi] *Rev. Rul. 68-452, 1968-2 C.B. 111*

[xii] Magdalin v. Commissioner, *T.C. Memo. 2008-293*

[xiii] Longino v. Commissioner, *T.C. Memo. 2013-80*

[xiv] *Morrissey v. United States, 871 F3d 1260 (11th Cir. 2017)*

[xv] *PLR 202114001*

[xvi] *Treas. Reg §1.213-1(e)*

[xvii] *IRS INFO. LTR. 2005-0102 (Mar. 29, 2005)*

[xviii] *Katherine Pratt,* Deducting the Costs of Fertility Treatment: Implications of Magdalin v. Commissioner for Opposite-Sex Couples, Gay and Lesbian Same-Sex Couples, and Single Women and Men, *2009 Wis. L. Rev. 1283 (2009)*

[xix] *H.R. 8190*

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