JANUARY 3, 2023

Taxation of Infertility Treatments and Surrogacy Benefits

by Martha L. Sewell

Many people, for one reason or another, are unable to start or expand a family. Some people look to assisted reproductive technologies ("ARTs") to conceive a child. These ART treatments include in vitro fertilization ("IVF"), intracytoplasmic sperm injection ("ICSI"), egg donation, and gestational surrogacy. ARTs can be performed on the intended parents or for the benefit of intended parents with the help of unrelated egg donors or surrogates. The costs of ARTs, which are often substantial, will always be covered by the intended parents (never the unrelated egg donors or surrogates) and often will not be covered by health insurance. Although, increasingly employers are offering benefit programs that seek to cover the costs of ARTs and other infertility-related treatments.

While ARTs are available to a variety of individuals, the tax treatment of the ARTs will differ among similarly situated individuals. Under current guidance, treatments associated with infertility likely constitute medical care under the Internal Revenue Code of 1986, as amended ("Code"). But ARTs related to surrogacy are not considered medical care for many individuals who may otherwise be unable to conceive. This unequal and inconsistent tax treatment means that many individuals will be unable to deduct the high costs of surrogacy benefits. Additionally, many individuals may be unable to obtain tax-favored reimbursements from their employer for reimbursements related to ARTs.

This article provides a brief background of the tax treatment of medical fertility and surrogacy benefits, highlights considerations for plan sponsors looking to offer these benefits, and summarizes recently proposed legislation that would significantly change the tax treatment of what constitutes medical care under the Code.

Medical Care

Code Section 213 provides that taxpayers can deduct costs for medical care of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent. As relevant to this article, medical care includes amounts paid (1) "for the diagnosis, cure, mitigation, treatment, or prevention of disease" ("disease prong") or (2) "for the purpose of affecting any structure or function of the body" ("structure or function prong"). Medical care does not include expenses that "merely benefit . . . the general health of an individual." Treas. Reg. § 1.213-1(e)(1)(ii). For example, a taxpayer cannot deduct the costs of a vacation even if the taxpayer's doctor said it was medically appropriate to take that vacation. *See Havey v. Commissioner*, 12 T.C. 409, 412-13 (1949).

The IRS ruled previously that expenses that affect a person's ability to have children (including vasectomies and abortions) affect a structure or function of the body. *See* Rev. Rul. 73-201. Preparatory expenses that are directly related to a procedure that affects a structure or function of the body also constitute medical care. *See, e.g.,* Rev. Rul. 68-452. Furthermore, legal expenses that have a direct or proximate relationship between the expense and the provision of medical care to the taxpayer also

constitute medical care. *See, e.g., Gerstacker v. Commissioner*, 414 F.2d 448 (6th Cir. 1969); *Jacobs v. Commissioner*, 62 T.C. 813 (1974); *Lenn v. Commissioner*, T.C. Memo 1998-85.

Treatments for ARTs and Infertility

The more straightforward part of this analysis is when a taxpayer (or a taxpayer's spouse or dependent) incurs costs associated with a medical inability to have children. In Publication 502, the IRS clearly states that IVF (including temporary storage of eggs or sperm) and surgery costs performed constitute medical care under the Code (either under the disease prong or the structure or function prong). In 2005, the IRS Office of Chief Counsel sent a letter to a taxpayer in which it stated 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." IRS Info. Ltr. 2005-0102 (Mar. 29, 2005).

Costs associated with procedures or treatments involving third parties are also likely medical care as long as the procedures are performed for the purpose of allowing a medically infertile person the ability to conceive a child. In PLR 200318017, the IRS concluded that a married women could deduct costs associated with egg donation (including the donor's fees, agency fees, expenses for medical and psychological testing, and legal fees for preparing a contract between the taxpayer and the egg donor). Put differently, under the rationale of PLR 200318017, expenses are medical care because they directly relate to a medical inability to conceive (which should satisfy the disease prong or the structure or function prong). It should not matter whether the costs involve procedures performed on the taxpayer or a third party.

Courts have rejected taxpayer's arguments to define infertility based on a person's sexuality or relationship status and have instead narrowly construed infertility to apply only when there is a medical inability to conceive. In *Morrisey v. United States*, the Eleventh Circuit rejected a claim by a male taxpayer in a same-sex union that he was effectively infertile because it was physiologically impossible for him to conceive a child with his partner. 871 F.3d 1260 (11th Cir. 2014). The *Morrisey* court rejected the taxpayer's argument because the taxpayer was able to produce and provide healthy sperm. Furthermore, in *Longino v. Commissioner*, a taxpayer was unable to deduct the costs of IVF treatment incurred from his ex-fiancé because he had five children from previous relationships and could not prove that he was infertile. T.C. Memo 2013-80 (2013), *aff'd* , 593 Fed. Appx. 965 (11th Cir. 2014).

Surrogacy Benefits

The less straightforward part of this analysis is the tax treatment of surrogacy benefits (including related ART costs, like IVF and egg donor expenses, that may be associated with surrogacy). In a 2002 memorandum, the IRS plainly said that surrogacy costs did not constitute medical care because a "surrogate mother is, of course, neither the taxpayer nor the taxpayer's spouse, and typically is not a dependent of the taxpayers" and "an unborn child" is not a dependent. IRS Info. Ltr. 2002-0291 (Dec. 31, 2002). The courts that have considered the issue have largely adopted this narrow view.

The three published tax cases that have considered surrogacy benefits involved men who attempted to deduct the costs of ART and were not shown to be medically infertile. The most recent decision on this topic was *Morrisey*, an Eleventh Circuit case that held the costs of ARTs used by a man that enabled him and his now-husband to become parents were not deductible under Code Section 213. 871 F.3d at 1260. The Eleventh Circuit, taking a narrow view of the statute, concluded that the taxpayer did not satisfy the

structure or function prong because the terms "affect" and "function" did not apply to the taxpayer's IVF, surrogacy, and egg donor costs as those costs were not used for an action for which the taxpayer's own body was fitted, used, or responsible. *Id.* at 1265. (The taxpayer could have deducted the costs related to his own bloodwork and sperm collection, but his medical expenses did not exceed the 7.5% threshold for deduction.) Thus, under the *Morrisey* court's analysis, a person in a same-sex relationship would never be able to deduct the costs related to IVF (other than those expenses relating to the taxpayer's own reproductive function), surrogacy, and egg donors if a person who was not the taxpayer's spouse or dependent carried the baby to term.

In *Longino*, the Tax Court held that a taxpayer could not deduct IVF costs incurred by his ex-fiancé because the taxpayer was unable to establish that there was a defect that prevented him from naturally conceiving children. T.C. Memo 2013-80 at *32. Although not explicitly stated, this analysis would suggest that the taxpayer would still be unable to claim the deduction even if he presented evidence that his fiancé was medically infertile (because his fiancé was not his spouse or dependent). Thus, the rationale of the *Longino* would suggest that an unmarried taxpayer would never be able to deduct the costs of IVF, surrogacy, and egg donors of the taxpayer's unmarried partner, even if the taxpayer had legal custody over the child.

In *Magdalin v. Commissioner*, T.C. Memo 2008-293, *aff'd* , No. 09-1153 (1st Cir. 2009), the Tax Court held that an unmarried man's IVF, egg donation, and surrogacy expenses was not medical care under Code Section 213. The *Magdalin* court reasoned that there was no causal relationship between the taxpayer's expenses because he was medically fertile and the treatments affected the structures or functions of the bodies of the surrogate mothers and not his own body. The *Magdalin* court noted in its opinion that no federal case has decided whether expenses for a different-sex couple that is medically infertile constitutes medical care under Code Section 213. That said, the IRS settled two cases where different-sex couples claimed a Code Section 213 deduction for the costs of surrogacy and egg-donor expenses. *See Sedgwick v. Comm'r* , No. 10133-94, (T.C. filed June 14, 1994); *Osius v. Comm'r* , No. 15472-11S (T.C. filed June 30, 2011). One can speculate that the IRS settled these cases for hazards of litigation because the IRS feared setting a bad precedent in Tax Court. Nevertheless, a settlement is not conclusive and the settlement of these two cases was not considered evidence by the *Morrisey* court.

Most recently, in 2021, the IRS released PLR 202114001, in which the IRS concluded that a same-sex married couple's ARTs costs related to the surrogate (including egg donation, IVF, and surrogacy) did not constitute medical care of the taxpayer and, therefore, were not deductible. However, the IRS concluded that certain medical costs and fees attributable to sperm donation and sperm freezing were deductible because they did satisfy the structure or function prong. The IRS reasoning in the PLR is largely consistent with the case law above, including the analysis in *Morrisey* that expenses incurred for third parties cannot be deductible unless they affect any structure or function of the *taxpayer's* body.

Employer Considerations

Medical fertility and surrogacy treatments can be an expensive financial undertaking (for example, the taxpayer in *Morrisey* spent over $100,000 in IVF and surrogacy costs). To help defray the costs of fertility and surrogacy treatments, employers may provide financial benefits or reimbursements in a way to incentivize and retain an inclusive and supportive workplace.

Employers will typically adopt a plan or policy setting forth eligibility and the types of expenses that may

be reimbursed – some of which will not be considered medical care. Some employers refer to these plans or policies as a "Lifestyle Plan" or a "Fertility/Surrogacy Plan." A third-party administrator will be essential to reduce the administrative burden of these types of plans. In many cases, the third-party administrator can determine whether reimbursements are considered to be "medical care" and inform the employer of such amounts. Reimbursements that are not considered "medical care" will need to be considered as taxable wages and added to the employee's W-2 compensation.

Employers who do not want the burden of reporting certain reimbursements as taxable compensation can certainly limit the reimbursements to only those expenses that are considered tax-free medical care. However, due the current narrow interpretation of medical care as noted earlier, this will eliminate many typical expenses from reimbursement.

In addition to the tax considerations, employers will need to determine whether to adopt a separate plan or policy or include such reimbursement program under its existing medical plan. Further, COBRA continuation coverage considerations also come into play as well.