



Medical Expenses: Testing the Limits

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I. Medical Expenses and the Doctor

Today we look at a case that examined the limits involved in a deduction for medical expenses under §213 of the Code. The case involved *in vitro* fertilization in the case of *Magdalin v. Commissioner*, TC Memo 2008-293. In this case, a male physician was attempting to claim as medical expenses fees he had paid for *in vitro* fertilization procedures for fathering two children using his sperm that was implanted into eggs from anonymous donors, with the resulting fertilized eggs being implanted into two women with which he entered into a “Gestational Carrier Agreement.”

The taxpayer pointed to a 2003 IRS Private Letter Ruling (PLR 200318017) where the Service had ruled that a woman who was unable to conceive using her own eggs was able to deduct the expense of paying for an egg donor, ruling such a payment was a medical expense under §213. He argued that he should have the same right under the law to obtain the tax benefits for his procedures—but the IRS (and eventually the Tax Court) did not agree.

II. Medical Expenses and Reproductive Assistance

Medical expenses are generally governed by §213. As well, the IRS has issued over the years a number of rulings, both published as Revenue Rulings and issued in

response to specific taxpayer requests as private letter rulings.

A. Code Definition of Medical Expenses

Generally, a deduction for personal expenses is blocked by IRC §262. Section 262(a) provides that “except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.” One of the exceptions Congress has elected to allow are certain medical expenses, as governed by §213.

IRC §213(a) provides:

(a) Allowance of deduction

There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), to the extent that such expenses exceed 7.5 percent of adjusted gross income.

The key issue then becomes what is “medical care,” the expenses for which are eligible for a deduction. This Code section contains its own definition for such expenses, which is found at §213(d)(1) and reads:

(d) Definitions

For purposes of this section--

(1) The term "medical care" means amounts paid--

(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,

(B) for transportation primarily for and essential to medical care referred to in subparagraph (A),

(C) for qualified long-term care services (as defined in section 7702B(c)), or

(D) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in subparagraphs (A) and (B) or for any qualified long-term care insurance contract (as defined in section 7702B(b)).

The key issue in the case we will look at, as well as the older private letter ruling, deals with the first listed item, which presents a two part test. In order to be

“medical care” the amount must be paid for:

- the diagnosis, cure, mitigation, treatment, or prevention of disease *or*
- the purpose of affecting any structure or function of the body

The first category requires there exist a recognized disease—a key issue that drove the IRS’s 2002 ruling on weight loss programs (Revenue Ruling 2002-19) when the IRS noted that obesity was now deemed to be a disease in its own right.

The second category is necessarily broader—it looks at items that affect any structure or function of the body, and it does not require that there currently be any disease involved. However, that provision is limited by IRC §213(d)(9) which was enacted to remove cosmetic procedures from that list of allowed items, and provides the following limitation on the definition of medical care:

(9) Cosmetic surgery

(A) In general

The term "medical care" does not include cosmetic surgery or other similar procedures, unless the surgery or procedure is necessary to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or disfiguring disease.

(B) Cosmetic surgery defined

For purposes of this paragraph, the term "cosmetic surgery" means any procedure which is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease.

The provision was enacted in 1990 in response to the reality that the IRS and courts had rather broadly interpreted this provision to allow a rather large number of procedures to come under its purview. But it should be noted that procedures that aren't proscribed by this provision (that is, aren't “cosmetic surgery” as defined by §213(d)(9)(B)) will still be allowed, presumably under the same expansive view of this provision as had previously allowed for cosmetic procedures.

The Tax Court notes in the case today that we apply a “but for” test generally to expenses, a test that it outlined in the case of *Jacobs v. Commissioner*, 62 TC 813. Under that test, an expense must be both:

- An essential element of the treatment *and*

- The expense would not have otherwise been incurred for nonmedical reasons.

B. IRS Private Letter Ruling 200318017

In 2003, the IRS issued a letter ruling dealing with the issue of expenses incurred related to egg donation, this time in the context of a woman who was looking to pay a fee to an egg donor to obtain eggs that would be fertilized and then implanted into the taxpayer. The taxpayer in question had been treated for fertility issues for a period of time, and it appears that the decision was made that an egg donor with *in vitro* fertilization gave the best chance of conception.

The facts of the situation were explained as follows in the ruling:

You have unsuccessfully undergone repeated assisted reproductive technology procedures to enable you to conceive a child using your own eggs. You desire to attempt pregnancy using donated eggs. Your health plan will pay expenses to fertilize and transfer an egg or embryo to you but will not cover expenses to obtain an egg donor. You request a ruling that the following expenses are medical expenses for purposes of § 213:

- The donor's fee for her time and expense in following proper procedures to ensure a successful egg retrieval.
- The agency fee for procuring the donor and coordinating the transaction between the donor and recipient.
- Expenses for medical and psychological testing of the donor prior to the procedure and insurance for any medical or psychological assistance that the donor may require after the procedure.
- Legal fees for preparing a contract between you and the egg donor.

The IRS noted that previously they had ruled in Revenue Rulings 73-201 and 73-603 that vasectomies and procedures to render a woman incapable of having children qualified as medical expenses. The IRS noted that procedures to facilitate a pregnancy would similarly affect the structure or function of the body.

But since the question involved the fee being paid to the third party, the IRS continued the analysis:

Expenses preparatory to the performance of a procedure that qualifies as medical care that are directly related to the procedure may also constitute medical care for purposes of § 213. For example, Rev. Rul. 68-452, 1968-2 C.B. 111, holds that surgical, hospital, and transportation expenses incurred by a donor in connection with donating a kidney to the taxpayer are deductible medical expenses of the taxpayer-recipient for the years in which the taxpayer pays them, subject to the limits of § 213. Similarly, expenses the taxpayer pays to obtain an egg donor, including the donor's expenses, are directly related and preparatory to the taxpayer's receiving the donated egg or embryo. The expenses are therefore the taxpayer's medical expenses and are deductible by the taxpayer in the year paid.

Like other preparatory expenses, legal expenses may be deductible as medical expenses under § 213 if there is a direct or proximate relationship between the legal expenses and the provision of medical care to a taxpayer. *Lenn v. Commissioner*, T.C. Memo 1998-85. For example, legal expenses incurred to create a guardianship in order to involuntarily hospitalize a mentally ill taxpayer were held to be deductible medical expenses because the medical treatment could not otherwise have occurred. *Gerstacker v. Commissioner*, 414 F.2d 448 (6th Cir. 1969). In contrast, the court in *Jacobs v. Commissioner*, 62 T.C. 813 (1974), held that legal expenses related to obtaining a divorce that the taxpayer claimed was necessary for his mental health were not deductible because the divorce would have occurred regardless of the petitioner's depression. Thus, the legal expenses were not directly related to the taxpayer's medical treatment.

You have represented that you will pay the fee to the donor, the fee to the agency that procured the donor, the donor's medical and psychological testing expenses, the insurance for post- procedure medical or psychological assistance to the donor, and the cost of the legal contract between you and the donor, in order to enable you to obtain a donated egg for implantation into your body. Because these costs are preparatory to the performance of your own medical procedure, the expenses are medical care for purposes of § 213.

Thus, the IRS held that all of the following were allowable as medical deductions for this individual:

- Fee to the doctor
- Fee to the agency that procured the donor
- Donor's medical and psychological testing expenses
- Insurance for post-procedure medical or psychological assistance to the donor
- Legal costs related to the contract with the donor

However, these expenses were specifically allowed because they were “preparatory to the performance” of the taxpayer's own medical procedure. As we'll note below, this became a crucial issue in the case at hand.

III. The Case of William Magdalin

In today's case, we are looking at a slightly different set of facts. First, and most obvious, the individual in this case is male, so unlike the case in the PLR above, in this case donor eggs are obviously not going to be implanted into the taxpayer. Rather, in this case, the donor eggs are going to end up being implanted into an individual that will be compensated for the pregnancy.

A. The Facts of the Case

Mr. Magdalin argued that this should not make a difference in the result—after all, in his view, it “unfair” to deny him the benefits of the deduction simply because he was a man—the Court summarized his arguments this way:

Petitioner argues that it was his civil right to reproduce, that he should have the freedom to choose the method of reproduction, and that it is sex discrimination to allow women but not men to choose how they will reproduce.

Mr. Magadlin had entered into the following arrangements that were at issue in this case:

In July 2004 petitioner entered into an Anonymous Egg Donor Agreement under which an anonymous donor was to donate eggs to be fertilized with petitioner's sperm and transferred to a gestational carrier using the IVF process. That same month, petitioner also entered into a Gestational Carrier Agreement in which a woman (the first carrier) agreed to become impregnated through the IVF embryo transfer process with the embryo created from the anonymous donor's egg and petitioner's sperm and to bear a child for petitioner. The first carrier gave birth to a child on September 17, 2005.

On November 18, 2005, petitioner entered into a similar Gestational Carrier Agreement with another woman (the second carrier). The second carrier gave birth to a child on August 12, 2006. The donor was not the spouse or dependent of petitioner. Nor was either of the carriers. Both IVF procedures occurred at the Reproduction Science Center (IVF clinic) in Lexington, Massachusetts.

Mr. Magdalin incurred a number of expenses related to these procedures. Those were summarized by the Court as follows:

Petitioner paid the following expenses in 2004 relating to the aforementioned agreements: (1) \$3,500 for petitioner's legal fees relating to the first donation cycle under the Anonymous Egg Donor Agreement; (2) \$500 for the donor's legal fees relating to the Anonymous Egg Donor Agreement; (3) \$10,750 for the donor's fees and expenses; (4) \$8,000 for the first carrier's fees and expenses; (5) \$25,400 to the IVF clinic; and (6) \$2,815 for prescription drugs for the first carrier.

In 2005 petitioner paid the following relevant expenses: (1) \$750 for petitioner's legal fees relating to the second donation cycle under the Anonymous Egg Donor Agreement; (2) \$17,000 for the first carrier's fees and expenses; (3) \$14,270 for petitioner's legal fees relating to the Gestational Carrier Agreement with the second carrier; (4) \$1,000 for the second carrier's legal fees relating to the Gestational Carrier Agreement; (5) \$2,615.10 to the IVF clinic; (6) \$300 to Lawrence General Hospital for costs relating to the first carrier's stay during delivery of the first child; (7) \$1,181.25 for the first carrier's legal fees relating to legal proceedings concerning a dispute over the issuance of the first child's

birth certificate; and (8) \$838 for prescription drugs for both carriers. There is no evidence that petitioner was compensated for any of those expenses by insurance or otherwise.

Mr Magdalin claimed the expenses on his personal income tax returns for the years in question. The IRS examined his return and disallowed all of these expenses.

B. The Tax Court's Analysis

The question is whether or not these expenses constitute payments for medical care or not. As noted above, there are two tests noted above for qualifying a payment for medical care.

In this case, there was no issue regarding treatment of a disease. The Tax Court noted at the beginning of the case that

At all relevant times, his (Mr. Magdalin's) sperm count and motility were found to be within normal limits. He has twin sons from a marriage to his former spouse, Deborah Magdalin. The twins were born through natural processes and without the use of in vitro fertilization (IVF).

The Tax Court noted:

The expenses at issue were not paid for medical care under the first portion of section 213(d)(1)(A) because the requisite causal relationship is absent. None of the expenses at issue was "incurred primarily for the prevention or alleviation of a physical or mental defect or illness." Sec. 1.213-1(e)(1)(ii), Income Tax Regs. In other words, petitioner had no medical condition or defect, such as, for example, infertility, that required treatment or mitigation through IVF procedures. We therefore need not answer lurking questions as to whether (and, if so, to what extent) expenditures for IVF procedures and associated costs (e.g., a taxpayer's legal fees and fees paid to, or on behalf of, a surrogate or gestational carrier) would be deductible in the presence of an underlying medical condition.

So the remaining option is the second clause found at §213(d)(1)(B) that discusses affecting a structure or function of the body.

The IRS stated its position, as summarized by the Court, as follows:

"Although respondent believes that amounts paid for procedures to mitigate infertility may qualify as deductible medical care", respondent argues that "Petitioner had no physical or mental defect or illness which prohibited him from procreating naturally", as he in fact has, and that "the procedures were not medically indicated." Respondent's position is that the expenses at issue are nondeductible under section 262 because "Petitioner's choice to undertake these procedures was an entirely personal/nonmedical decision."

In a footnote reference, the Court specifically discusses the IRS position

regarding the “affecting a structure of function” clause in this case, noting:

Respondent also argues that "the expenses paid by petitioner were not for the purpose of affecting any structure or function of petitioner's male body" and that "the procedures at issue only affected the structures or functions of the bodies of the unrelated surrogate mothers."

In the IRS view, to the extent there were medical expenses, they were medical expenses of the mothers—parties for whom the taxpayer did not have a right to claim medical expense deductions on his return.

The Tax Court agreed with the IRS's view and dismissed the taxpayer's attempt to argue Constitutional matters to justify the deduction. The Court noted:

Although petitioner at times attempts to frame the deductibility of the relevant expenses as an issue of constitutional dimensions, under the facts and circumstances of his case, it does not rise to that level. Petitioner's gender, marital status, and sexual orientation do not bear on whether he can deduct the expenses at issue. He cannot deduct those expenses because he has no medical condition or defect to which those expenses relate and because they did not affect a structure or function of his body. Expenses incurred in the absence of the requisite underlying medical condition or defect and that do not affect a structure or function of the taxpayer's body are nondeductible personal expenses within the meaning of section 262.

In the Court's view, Section 262 blocks a deduction unless the taxpayer meets the narrow exception carved out by Section 213—and the fact that the expense in question did not treat a disease of, nor affect the functioning of the body of, Mr. Magdalin or one of the limited set of individuals for which the Code allowed him to claim a deduction was fatal to the deduction.

IV. Conclusions

It's important to note that the fact that the treatment did not impact Mr. Magdalin was crucial in this case. The lack on an effect on *his* body was crucial in the decision.

The Court also specifically refused to rule on the question of whether the situation would have turned out differently if Mr. Magdalin had been infertile—or if the taxpayer had been female, but for medical reasons it was determined that a surrogate mother needed to be used to carry the child.

The IRS letter ruling noted above specifically indicated that the payments for issues related to the donor were deductible because they were in preparation for a medical procedure on the taxpayer—but if, in fact, the taxpayer does not plan to have the egg implanted in herself, then that justification would seem to go away and a question remains on whether the expenses in that case could be deducted.

As well, it's important to remember that other provisions of the law, such as those affecting payments from flexible spending accounts and health savings account, make reference to expenses that are allowed under §213. So the answer to these questions

is important in those matters as well—and there's a much better chance a taxpayer would receive a real tax benefit. And administrators of FSA plans are likely going to want assurance that the amounts are truly allowable before granting access to funds.