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IRS ADVISES NO MEDICAL EXPENSE DEDUCTION FOR SEXUAL REASSIGNMENT SURGERY

By KATIE D. FLETCHER

In early 2006, Rhiannon O'Donnabhain filed suit challenging the IRS' policy that, for tax purposes, expenses associated with sexual reassignment surgery ("SRS") cannot be deducted as medical expenses. This issue has become controversial in recent years.

In June 2001, Rhiannon O'Donnabhain had sexual reassignment surgery under the advice and consent of her physicians, the costs of which she deducted on her federal income tax return.¹ Six months later she was audited,

and during the audit, a tax examiner denied her claimed deduction.² Ms. O'Donnabhain then requested consideration by the Internal Revenue Service ("IRS") Appeals Office in Boston, Massachusetts.³ The Appeals branch, following advice it requested from the IRS Chief Counsel's office in Washington, D.C., reaffirmed the denial of Ms. O'Donnabhain's medical expenses, which became the final decision of the IRS.⁴

In the past, sexual reassignment surgery expenses have been quietly allowed with only occasional denials by audit examiners; generally those denials were subsequently approved by an Appeals officer.⁵ However, this is changing as evinced by the fact that, in Ms. O'Donnabhain's case, the Appeals officer asked for and received advice from IRS General Counsel, who issued a memorandum detailing reasons why the taxpayer's deduction should not be allowed.⁶ Gay & Lesbian Advocates & Defenders ("GLAD"), attorneys for Ms. O'Donnabhain, have appealed to the United States Tax Court.⁷

The main question that the United States Tax Court will decide when hearing Ms. O'Donnabhain's case is whether sexual reassignment surgery is cosmetic or medically necessary.⁸ Cosmetic surgery is a non-deductible expense⁹ whereas medically necessary surgery is a deductible expense.¹⁰ The Internal Revenue Code ("IRC") allows, as a deduction, expenses for "medical care" paid during the taxable year that are not otherwise compensated for by insurance or otherwise.¹¹

The IRC defines "medical care" as "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."¹² The IRC also defines cosmetic surgery as "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."¹³

Counsel for Ms. O'Donnabhain asserts that her sex reassignment surgery was "medically necessary and directed toward the cure, mitigation and treatment of Ms. O'Donnabhain's diagnosed gender identity disorder ("GID")."¹⁴ Ms. O'Donnabhain's counsel further states that "[b]ecause the discordance between anatomical birth sex and gender identity causes significant psychological distress, the medical community has developed clear standards of care for the treatment of GID."¹⁵

In addition, the American Diagnostic and Statistical Manual for Psychiatric Disorders (“DSM IV”) recognizes gender identity disorder as a psychiatric diagnosis as does the International Classification of Diseases, Tenth Edition.¹⁶ The Harry Benjamin International Gender Dysphoria Association’s Standard of Care for Gender Identity Disorder, Sixth Version, recommends surgery as a viable treatment for profound Gender Identity Disorder.¹⁷

Advocates on both sides of the issue began sounding off shortly after the IRS Memorandum was made public in January, 2006.¹⁸ The IRS immediately began receiving criticisms because the Chief Counsel Memorandum relied on a Catholic journal for a portion of its analysis.¹⁹ Responses to the 2004 religious journal article surfaced, including a Letter to the Editor as well as blog discussions and numerous other online articles.²⁰

Lynn Conway, a transgender activist,²¹ finds the IRS’s ruling “very troubling because of its citation of anti-transsexual teachings in a Catholic religious journal as a principal basis for the particular Executive decision.”²² Conway believes “the ruling provides a PR victory (and possible political currency) for religious zealots within the current administration who wish to depict SRS as merely cosmetic and not a serious medical condition for which treatment is medically necessary.”²³

Another portion of the IRS Memorandum that is under attack is the statement that they found “no case law, regulation, or revenue ruling that specifically address[ed] medical expense deductions for GRS²⁴ or similar procedures.”²⁵ “I would think that in light of the 8th Amendment prison rights cases holding that GID²⁶ is a serious medical condition, treatment for GID should not be considered merely cosmetic for tax law purposes,”²⁷ stated Arthur Leonard, a Professor at New York Law School.

Additionally, there are at least two cases from California addressing the issue of whether sex reassignment surgery is cosmetic, both in the context of health insurance coverage.²⁸ Judge Posner of the Seventh Circuit authored an opinion that includes the language “[t]he disjunction between sexual identity and sexual organs is a source of acute psychological suffering that can, in some cases anyway, be cured or at least [be] alleviated by sex reassignment” acknowledging that sex reassignment surgery is a medical treatment for Transsexualism or Gender Dysphoria.²⁹ While there may not be any Tax Court case law, revenue

rulings or revenue procedures, there are many examples of courts holding that sex reassignment surgery is a medically necessary treatment.³⁰

There are those who do not agree with this position. For example, Dr. Paul McHugh, advisor to the Vatican on sexual issues and a member of President Bush's Council on Bioethics, claims that "human sexual identity is mostly built into our constitution by the genes we inherit and the embryogenesis we undergo"³¹ and that those who seek sex reassignment surgery suffer from "mental misdirections."³² "We have wasted scientific and technical resources and damaged our professional credibility by collaborating with madness rather than trying to study, cure, and ultimately prevent it,"³³ states McHugh.

Transgender advocates disagree — "[t]he International Olympic Committee spent three decades learning that the chromosome medical model does not work" states Phyllis Randolph Frye, an attorney who represents transgendered clients.³⁴ Frye further explains that Jewish leaders recognized the non-binary nature of sex over 3000 years ago.³⁵ "Even the British, who began the chromosome legal model in 1970 with *In re Corbett*,³⁶ discarded it recently with the Gender Recognition Act of 2004,"³⁷ explains Frye. Additionally, there are brain studies and scientific evidence supporting the view that sex is not necessarily binary or easily distinguished upon visual examination.³⁸

The IRS Mission Statement to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all" calls for hearing Ms. O'Donnabhain's case without prejudice and without regard to religious texts.³⁹ Ultimately, this case must come down to whether sex reassignment surgery is medically necessary according to the Internal Revenue Code.⁴⁰

Two cases from 1949 explain the Congressional intent of medically necessary.⁴¹ First, *Stringham v. Commissioner* addresses the Congressional intent behind now § 213 of the Internal Revenue Code by stating "[t]he Congressional intent is sufficiently evident to require the showing of the present existence or the imminent probability of a disease, physical or mental defect, or illness as the initial step in qualifying an expenditure as a medical expense"⁴² and must be incurred 'primarily' for the prevention or mitigation of a particular physical or mental defect or illness.⁴³

The other 1949 case, *Havey v. Commissioner*, further clarified the rule in stating “[t]o be deductible as medical expense, there must be a direct or proximate relation between the expense and the diagnosis, cure, mitigation, treatment, or prevention of disease or the expense must have been incurred for the purpose of affecting some structure or function of the body.”⁴⁴

The United States Tax Court itself has ruled on other “medically necessary” questions, allowing as deductible, expenses associated with hair transplantation for a taxpayer suffering from premature baldness.⁴⁵ In finding for the taxpayer, the Tax Court held that “[t]he hair transplant operation was a specific medical treatment to alleviate a specific condition of the body.”⁴⁶ The court further explained that the procedure involved local anesthesia and required specialized training.⁴⁷

The Tax Court has also approved deduction as medical expenses for the cost of hair removal through electrolysis.⁴⁸ The Tax Court has denied, however, the cost of tattooing and ear piercing, even if performed by a physician.⁴⁹

Currently, all attorneys for transgender clients can do is advise their transitioning clients to understand that if sex reassignment expenses are deducted as medical expenses on a federal tax return, and an audit ensues, the IRS will require them to prove their medical necessity.⁵⁰

On the other hand, “a win in Tax Court for Ms. O’Donnabhain would be a step in the right direction for transgender rights,” according to D’Arcy Kemnitz, Executive Director of the National Lesbian and Gay Law Association.⁵¹

The IRS allows for the deduction of medical expenses in excess of 7.5% of a taxpayer’s income.⁵² The taxpayer in this case argues that sex reassignment surgery is medical treatment directed toward the cure, mitigation and treatment of her GID.⁵³ Opponents declare that transsexuals have psychiatric conditions that can be treated with therapy and should not be treated with surgery thus concluding that sex reassignment surgery is not medically necessary.⁵⁴ Soon it will be up to the United States Tax Court to decide.

NOTES

1 Press Release, Gay and Lesbian Advocates and Defenders, GLAD Wins Tax Deduction for G.R.S. Genital Reconstruction Surgery, (Nov. 30, 2004), available at http://www.glad.org/News_Room/press83-11-30-04.html.

2 *Id.*

3 Petition of Petitioner at 2, O'Donnabhain v. Comm'r, Docket No. 006402-06 (T.C., Mar. 31, 2006).

4 Advice was given in the form of I.R.S. Gen. Couns. Mem. 200603025 (Oct. 14, 2005) [hereinafter IRS memo], available at <http://www.irs.gov/pub/irs-wd/0603025.pdf#search=%22IRS%20Memorandum%20200603025%20%22>. The IRS memo states that GRS is cosmetic surgery and not deductible. GRS stands for gender reassignment surgery and SRS stands for sex reassignment surgery. Generally, they are referred to synonymously. However, sex and gender are not interchangeable. Differentiating sex and gender is beyond the scope of this article. For further information see Julie A. Greenberg, *Defining Male and Female: Intersexuality and the Collision Between Law and Biology*, 41 ARIZ. L. REV. 265 (1999); Milton Diamond, *Sex and Gender: Same or Different?*, 10 FEMINISM & PSYCHOL. 46 (2000).

5 Lynn Conway, *IRS Disallows a Woman's Tax Deduction for SRS – Citing Teaching in a Catholic Religious Journal as a Basis for its Decision*, available at <http://ai.eecs.umich.edu/people/conway/TS/Legal%20Issues/Taxes/IRS%20SRS%20Rulings.pdf>.

6 *Id.*

7 Petition of Petitioner, *supra* note 3, at 1.

8 *See id.* at 2 (explaining that Ms. O'Donnabhain's sex reassignment surgery was medically necessary and not cosmetic).

9 Except in rare instances such as breast reconstruction following mastectomy, for example. IRS Memo, *supra* note 4.

10 *Id.*

11 I.R.C. § 213 (2006).

12 I.R.C. § 213(d)(1)(A) (emphasis added).

13 I.R.C. § 213(d)(9)(B).

14 Petition of Petitioner, *supra* note 3, at 2.

15 *Id.* at 4.

16 DSM IV, available at <http://www.mental-health-today.com/gender/dsm.htm>; International Classification of Diseases, Tenth Edition, available at <http://www.who.int/classifications/icd/en/>.

17 THE HARRY BENJAMIN INTERNATIONAL GENDER DYSPHORIA ASSOCIATION'S STANDARDS OF CARE FOR GENDER IDENTITY DISORDERS, SIXTH VERSION, 18 (2001).

18 IRS Memo, *supra* note 4.

19 The questionable portion of the I.R.S. Gen. Couns. Mem. 200603025 reads, "Whether gender reassignment is a treatment for an illness or disease is controversial. For instance, Johns Hopkins Hospital has closed its gender reassignment clinic and ceased performing these operations. See, *Surgical Sex*, Dr. Paul McHugh, 2004 First Things 147 (November 2004) 34-48." IRS Memo, *supra* note 4.

20 *See e.g.* Jennifer Usher, *Letter to the Editor, Transsexual Truths?*, 150 First Things, 2-4 (Feb. 2005); Arthur Leonard, *IRS vs. Transgender People*, Leonard Link, (Jan. 24, 2006) available at http://newyorklawschool.typepad.com/leonardlink/2006/01/irs_vs_transgen.html.

21 Conway has a website devoted to illuminating and normalizing the issues of gender identity and the process of gender transition. <http://ai.eecs.umich.edu/people/conway/conway.html>.

- 22 Lynn Conway, *supra* note 5.
- 23 *Id.*
- 24 Gender reassignment surgery.
- 25 IRS Memo, *supra* note 4.
- 26 Gender Identity Disorder.
- 27 Arthur Leonard, Comment to Posting, Leonard Link, (Jan. 24, 2006), http://newyorklaw-school.typepad.com/leonardlink/2006/01/irs_vs_transgen.html.
- 28 *See*, G.B. v. Lackner, 145 Cal. Rptr. 555, 559 (Cal. Ct. App. 1978) (holding that sex reassignment surgery was medically reasonable and necessary and the state could not arbitrarily decide the surgery was cosmetic); J.D. v. Lackner, 145 Cal. Rptr. 570, 572 (Cal. Ct. App. 1978) (holding that transsexual surgery was medically reasonable and necessary).
- 29 Farmer v. Haas, 990 F.2d 319, 320 (7th Cir. 1993).
- 30 *See*, G.B., 145 Cal. Rptr. at 559 (holding that sex reassignment surgery was medically reasonable and necessary); J.D., 145 Cal. Rptr. at 572 (holding that transsexual surgery was medically reasonable and necessary).
- 31 Paul McHugh, *Surgical Sex*, 147 FIRST THINGS 34, 37 2004.
- 32 *Id.* at 38.
- 33 *Id.*
- 34 Email from Phyllis Randolph Frye, Attorney, to Katie Fletcher, Staff Writer, Loyola University Chicago School of Law Public Interest Law Reporter (Sept. 24, 2006) (on file with author).
- 35 *Id.*
- 36 Corbett v. Corbett, 2 All E.R. 33 (1970).
- 37 Email from Phyllis Randolph Frye, *supra* note 34.
- 38 *See e.g.*, Julie A. Greenberg, *Defining Male and Female: Intersexuality and the Collision Between Law and Biology*, 41 ARIZ. L. REV. 265 (1999); Milton Diamond, *Sex and Gender: Same or Different?*, 10 FEMINISM & PSYCHOL. 46 (2000); Jiang-Ning Zhou et. Al., *A Sex Difference in the Human Brain and its Relation to Transsexuality*, 378 NATURE 68 (Nov. 2, 1995).
- 39 IRS Mission Statement, available at <http://www.irs.gov/irs/article/0,,id=98141,00.html>.
- 40 *See e.g.* Petition of Petitioner, *supra* note 3, at 7.
- 41 Havey v. Comm'r, 12 T.C. 409 (1949); Stringham v. Comm'r, 12 T.C. 580 (1949), *aff'd* 183 F.2d 579, (6th Cir. 1950).
- 42 *Stringham*, 12 T.C. at 584.
- 43 *Id.*
- 44 *Havey*, 12 T.C. at 412.
- 45 *Mattes v. Comm'r*, 77 T.C. 650 (1981).
- 46 *Id.* at 655.
- 47 *Id.*
- 48 Rev. Rul. 82-111, 1982-1 C.B. 48.
- 49 *Id.*
- 50 Lynn Conway, *supra* note 5.
- 51 Phone Interview with D'Arcy Kemnitz, Executive Director, National Lesbian and Gay Law Association in Washington, D.C. (September 25, 2006).
- 52 I.R.C. § 213 (2006).
- 53 Petition of Petitioner, *supra* note 3, at 7.
- 54 McHugh, *supra* note 31, at 35.