

# TAX COURT EXPANDS DEFINITION OF DEDUCTIBLE MEDICAL EXPENSES

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## **ABSTRACT**

*In a case of first impression, the United States Tax Court recently held that expenses relating to hormone therapy and sex reassignment surgery can be deducted for federal income tax purposes as medical expenses. Decided February 2, 2010, O'Donnabhain v. Commissioner was reviewed by the entire court.*

## **INTRODUCTION**

By legislative grace, taxpayers are allowed to deduct certain costs from income to compute their tax liability. One such deduction relates to medical expenses. While most medical expenses easily fall within the range of deductible expenses, the deductibility of other types of expenses is less clear. The U.S. Tax Court was recently asked to decide whether the costs of hormone therapy and sex reassignment surgery could be deducted as a medical expense, and the court answered in the affirmative.

## **GENDER IDENTITY DISORDER**

Gender Identity Disorder (GID) is a condition where an individual's self-identification as a man or a woman does not match his or her anatomical gender. It is listed in the Diagnostic and Statistical Manual of Mental Disorders (Manual), which is published by the American Psychiatric Association. The Manual states that a diagnosis of GID is indicated where an individual exhibits the following symptoms:

1. A strong and persistent desire to be, or belief that he or she is, the other sex;
2. Persistent discomfort with his or her anatomical sex, including a preoccupation with getting rid of primary or secondary sex characteristics;
3. An absence of any physical intersex (hermaphroditic) condition; and
4. Clinically significant distress or impairment in social, occupational, or other important areas of functioning as a result of the discomfort arising from the perceived incongruence between anatomical sex and perceived gender identity

The accepted approach to treating GID is prescribed by the World Professional Association for Transgender Health (WPATH). WPATH was formerly called the Harry Benjamin International Gender Dysphoria Association, named for the German endocrinologist Harry Benjamin whose 1966 book "The Transsexual Phenomenon" shed light on the condition and its proper treatment. WPATH is comprised of medical, surgical and mental health professionals who specialize in understanding and treating GID. WPATH first published Standards of Care for treating GID in 1979. Those standards have undergone six revisions and are currently known as the Benjamin Standards.

The Benjamin Standards call for a triadic sequence to treat GID. In the first phase, the patient undergoes hormonal sex reassignment, which requires the recommendation of a licensed psychotherapist. During this phase, the patient is administered cross-gender hormones in order to cause changes in physical appearance to more closely resemble the opposite sex. The second stage of treatment is known as the real-life experience, in which the patient attempts to live as a member of the opposite sex full-time in society. If the symptoms of GID persist after hormonal treatment and at least twelve months of living as the opposite sex, the Benjamin Standards recommend the third stage of treatment, which is sex reassignment surgery. The patient is not permitted to have the surgery, however, without the recommendations of two licensed psychotherapists.

**FACTS**

Rhiannon G. O'Donnabhain (Taxpayer) was born a genetic male, however from a very young age she was uncomfortable in a male body (court documents reflect Taxpayer's preference to be referred to using the feminine pronoun). Feeling like "a female trapped in a male body," she secretly began wearing women's clothing at about the age of ten, a practice she continued into adulthood. Despite her discomfort, Taxpayer served the country in the U.S. Coast Guard, and eventually married and fathered three children. After her marriage of over twenty years ended, her desire to be a female intensified and she sought counseling. She began psychotherapy sessions in August 1996 with Diane Ellaborn, a psychotherapist and licensed independent clinical social worker who was authorized under Massachusetts law to diagnose and treat psychiatric illness. After approximately twenty weekly therapy sessions, Ms. Ellaborn diagnosed Taxpayer with Gender Identity Disorder.

Following diagnosis, Ms. Ellaborn recommended a course of treatment which was consistent with the Benjamin Standards. Taxpayer began taking feminizing hormones in September 1997 and continued through 2001, the tax year at issue. The hormone therapy had positive effects on Taxpayer; namely she was calmer and happy with the physical changes caused by the hormones. Taxpayer began her real-life experience in March 2000. She legally changed her name, presented as a female at her place of employment, and underwent procedures to feminize her facial features (nose reshaping, facelift, tracheal shave to reduce the cartilage of the Adam's apple). Taxpayer described her real-life experience as "incredibly easy." Ms. Ellaborn found Taxpayer's positive reactions to both the hormone therapy and real-life experience to be further substantiation of the GID diagnosis.

Although Taxpayer's response to the first two stages of treatment was positive, she experienced continued anxiety from the incongruence between her perceived gender and her male genitalia. Believing that this anxiety impaired Taxpayer's ability to function normally in society, Ms. Ellaborn formally recommended Taxpayer for sex reassignment surgery in July 2001. She contacted a plastic surgeon on behalf of Taxpayer, and certified Taxpayer's diagnosis as well as her compliance with the Benjamin Standards. As required by those standards, Taxpayer obtained a second recommendation for surgery and underwent the procedure on October 19, 2001. During the surgery, Taxpayer's male genitalia were reconfigured to create female genitalia, both in appearance and function. In addition, Taxpayer received breast augmentation surgery to make her breasts resemble those of a genetic female.

**RELEVANT LAW**

Section 262 of the Internal Revenue Code of 1986, as amended (Code) disallows deductions for "personal, living, or family expenses." However, an exception in Code § 213 provides a deduction for expenses relating to "medical care." Medical care is defined as amounts paid:

- (1) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or
- (2) for the purpose of affecting any structure or function of the body.

The Code specifically states that the term medical care does not include expenses relating to cosmetic surgery, unless the surgery is necessary to ameliorate a deformity arising from a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease. Cosmetic surgery is defined 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."

Congress first provided the deduction for medical care in 1942. At the time, the Senate Committee on Finance commented on the new deduction for medical expenses, in relevant part, as follows:

The term "medical care" is broadly defined to include 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. It is not intended, however, that a deduction should be

allowed for any expense that is not incurred primarily for the prevention or alleviation of *a physical or mental defect or illness*. (Emphasis added)

Accordingly, the legislative history to Code § 213 equated the word “disease,” as that term is used in the statutory authority, with “physical or mental defect or illness.”

Treasury Regulations were issued soon after the medical care deduction was created, and the language of the regulation mirrors the language of the Finance Committee’s report. Specifically, Treasury Regulation § 1.213-1 states that “deductions for expenditures for medical care allowable under section 213 will be confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness.”

### **ISSUE AND ARGUMENTS**

Taxpayer incurred and paid expenses of \$21,741 during 2001 relating to sex reassignment surgery and related expenses. Taxpayer classified these expenses as medical expenses and claimed an itemized deduction on her 2001 return. The Internal Revenue Service (IRS) disallowed the deduction, and Taxpayer petitioned the Tax Court for review.

The IRS’s primary reason for disallowing the deduction was that it considered Taxpayer’s sex reassignment surgery to be cosmetic surgery, expenses for which are categorically disallowed by Code § 213. Specifically, the IRS argued that (1) GID is not a disease, (2) Taxpayer did not have GID, and (3) the procedures undergone by Taxpayer did not treat a disease.

### **COURT’S ANALYSIS AND HOLDING**

The IRS claimed that Gender Identity Disorder is not a disease within Code § 213 but rather a mental disorder that is a “social phenomenon” which has been “medicalized.” According to the IRS’s expert witness at trial, to be a disease a mental disorder must have a demonstrated organic or physiological origin in the individual. Under this view, conditions such as bulimia or post-traumatic stress disorder would not be considered diseases because an organic origin has yet to be proven. The Tax Court rejected the organic-origin definition of the term disease, however, stating that it is “flatly contradicted by nearly a half century of caselaw” which has considered mental disorders to be diseases for purposes of section 213 without reference to the disorders’ origins or causes. Rather, caselaw has indicated that a mental disorder is considered a disease where there was evidence that “mental health professionals regarded the condition as creating a significant impairment to normal functioning and warranting treatment.” Using the standard established by prior caselaw, the Tax Court found that GID is a disease. GID is listed in the Manual, which is the primary psychiatric diagnostic tool, and it is a widely recognized and accepted diagnosis in medical literature. Further, GID is a serious and debilitating condition, which can result in autocastration and suicide when left untreated.

The IRS next argued that Taxpayer did not have GID. As it has in prior cases, the Tax Court deferred to the judgment of the professionals who treated Taxpayer. Noting that Taxpayer had been diagnosed by a licensed professional, and that such diagnosis was concurred with by both a second licensed professional and Taxpayer’s expert witness at trial, the court held there was sufficient evidence to support Taxpayer’s GID diagnosis.

Finally, the IRS argued that the procedures undergone by Taxpayer did not treat GID. The IRS described the Benjamin Standards as merely guidelines, and that the effectiveness of treating GID with the Benjamin Standards lacked scientific evidence. The court noted, however, that the Benjamin Standards – including hormone therapy and sex reassignment surgery – are listed in every authoritative text as the appropriate treatment for GID. Further, there is no requirement for a complete consensus that a procedure is effective in order for the related expenses to be deductible. Citing cases holding acupuncture,

naturopathic cancer treatments and Navajo “sings” deductible, the Tax Court states there need only be a reasonable belief that a treatment will be effective, a standard which was easily satisfied in this case given the wide acceptance of the Benjamin Standards by the psychiatric profession.

### **CONCLUSION**

The Tax Court held that Gender Identity Disorder is a disease and therefore Taxpayer’s hormone therapy and sex reassignment surgery, which treated the disease, were not cosmetic in nature. Accordingly, Taxpayer’s expenses for these procedures related to “medical care” within the meaning of Code § 213 and a deduction was proper. Expenses relating to the breast augmentation surgery, however, were not deductible in this case. The Benjamin Standards provide that breast augmentation may be proper for male-to-female patients if hormone treatment does not sufficiently alter the breasts to make the patient comfortable in her new gender role. However, since hormone therapy altered Taxpayer’s breasts such that they were within a normal range of female appearance, the augmentation surgery was considered cosmetic in nature.

### **REFERENCES**

Code § 213.

Code § 262.

Treasury Regulation § 1.213-1(e)(1)(ii).

*O’Donnabhain v. Commissioner*, 134 T.C. No. 4 (2010).