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WHEN YOUR BODY IS YOUR BUSINESS

Morgan Holcomb* & Mary Patricia Byrn†

Abstract: Surrogacy in the United States is a multi-million dollar industry in which well paid professionals seek out specially qualified women to fill the difficult job of being a surrogate. Surrogates enter lengthy contracts in which they agree, in intricate and intimate detail, to provide a service for significant compensation—as a group, surrogates in the United States are paid well over \$22 million per year. This Article argues that surrogates are professionals in this for-profit industry and are required to report surrogacy compensation as income. As a corollary, surrogates may deduct most of their surrogacy-related expenses as business deductions. Being a surrogate is a highly personal service and the expenses the surrogate incurs—such as for maternity clothes or medical care—are typically treated as nondeductible personal expenses, but when your body is your business, the personal is business.

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INTRODUCTION

“Death, taxes, and childbirth! There’s never any convenient time for any of them . . .”

— Margaret Mitchell¹

Surrogacy first gained national attention in 1987 when surrogate Mary Beth Whitehead entered a very public custody dispute with intended parents² William and Elizabeth Stern.³ Since then, surrogacy has become a multi-million dollar industry in the United States.⁴ Lawyers, doctors, agency directors, gamete donors, and surrogates⁵ work

1. MARGARET MITCHELL, *GONE WITH THE WIND* 471 (1936).

2. Intended parents are individuals who intend to be the legal parents of any child conceived through assisted reproductive technology. CHARLES P. KINDREGAN, JR. & MAUREEN MCBRIEN, *ASSISTED REPRODUCTIVE TECHNOLOGY: A LAWYER’S GUIDE TO EMERGING LAW AND SCIENCE* (2006). Throughout this Article, we use the term “intended parents” rather than “intended parent.” By doing so, we do not assert that every child must have two parents. Our use of “intended parents” merely simplifies the text.

3. Surrogacy is the “process of carrying and delivering a child for another person.” BLACK’S LAW DICTIONARY 1485 (8th ed. 2004). *In re Baby M*, 537 A.2d 1227 (N.J. 1988).

4. It is estimated that there are over 400 fertility clinics in the United States and that the assisted reproductive technology industry as a whole, of which surrogacy is a part, has annual revenues of nearly seven billion dollars. Judith F. Daar, *Accessing Reproductive Technologies: Invisible Barriers, Indelible Harms*, 23 BERKELEY J. GENDER L. & JUST. 18, 25–26 (2008).

5. The terms used to identify women who act as surrogates vary widely and can easily become confusing. Some professionals use the term “surrogate” only to refer to a woman who provides her

together to meet the needs of intended parents. A typical surrogacy costs the intended parents between \$75,000 and \$150,000, which includes payment to a surrogate of roughly \$20,000 plus expenses.⁶

Academic discussion of the cost of surrogacy, and of Assisted Reproductive Technology (ART)⁷ in general, has focused primarily on the intended parents.⁸ Calls for including ART in insurance plans and for allowing intended parents to deduct ART expenses from gross income for tax purposes have been heard in both academic literature and the popular press.⁹ What have been discussed less frequently, however, are the financial implications of surrogacy for the surrogates themselves.¹⁰

It is readily accepted that the lawyers, doctors, and agency directors involved in the ART industry are professionals and are in business to make a profit. In contrast, most people do not describe surrogacy—that

own ovum (egg) and gestates a child for another person (also referred to as artificial insemination (or AI) surrogacy). These professionals use the term “gestational carrier” to refer to a woman who gestates a child for another person using either the intended mother’s or a donor’s egg (also referred to as *in vitro* fertilization (or IVF) surrogacy). For simplicity’s sake, we refer collectively to all women who gestate a child for another person as “surrogates,” distinguishing between the two types by referring to them as “traditional surrogates” (those who use their own egg) and “gestational surrogates” (those who use the intended mother’s or a donor’s egg).

6. LIZA MUNDY, EVERYTHING CONCEIVABLE 129 (2007) (“[P]arenting through surrogacy costs between \$100,000 and \$150,000, including payments to a surrogate, an egg donor, one or even two brokering agencies, a fertility clinic, lawyers, and assorted facilitators.”); *see also* DEBRA SPAR, THE BABY BUSINESS 92 (2006); *Surrogacy and Egg Donation*, NORTHEAST ASSISTED FERTILITY GROUP, <http://www.assistedfertility.com/faqs/fee.shtml> (last visited June 2, 2010) (estimating the average cost for gestational surrogacy to be between \$90,000 and \$130,000); *Anticipated Program Costs for Gestational Surrogacy*, CIRCLE SURROGACY, <http://www.circlesurrogacy.com/index.php/en/costs> (last visited June 2, 2010) (discussing a detailed estimate of total program costs including agency fees, attorney’s fees, screening fees, surrogate fees, and IVF insurance coverage totaling \$80,000 to \$120,000); *Surrogacy*, ADOPTION.COM, <http://adopting.adoption.com/child/surrogacy.html> (last visited Sept. 21, 2010) (estimating the average cost of gestational surrogacy to be between \$75,000 and \$100,000). Reports vary, but the average surrogate appears to be paid between \$13,000 and \$24,000. Katherine Drabiak et al., *Ethics, Law, and Commercial Surrogacy: A Call For Uniformity*, 35 J.L. MED. & ETHICS 300, 303 (2007); Lorraine Ali and Raina Kelly, *The Curious Lives of Surrogates*, NEWSWEEK, Apr. 7, 2008, at 45; MUNDY, *supra* note 6, at 133.

7. ART, broadly speaking, encompasses any means to achieve pregnancy other than sexual intercourse.

8. *See generally* Daar, *supra* note 4; Katherine T. Pratt, *Inconceivable? Deducting the Costs of Fertility Treatment*, 89 CORNELL L. REV. 1121 (2004).

9. Jennifer Thomas, *Money Woes Keeping Many Couples from Fertility Treatments*, HEALTH DAY, Oct. 22, 2009; Stephanie Saul, *Grievous Choice on Risky Path to Parenthood*, N.Y. TIMES, Oct. 12, 2009; Pratt, *supra* note 8.

10. At least one academic has addressed the tax implications of surrogacy to surrogates. *See generally* Bridget J. Crawford, *Taxation, Pregnancy and Privacy*, 16 WM. & MARY J. WOMEN & L. 327 (2010); Bridget J. Crawford, *Taxing Surrogacy*, SOC. SCI. RESEARCH NETWORK (Aug. 30, 2009), <http://ssrn.com/abstract=1422180>.

is, the act of gestating the child—as a job, and do not consider the women who perform this service to be surrogacy professionals. This Article views surrogacy through the lens of the Internal Revenue Code to establish that surrogacy is in fact a trade or business and that, despite the quintessentially reproductive nature of surrogacy, surrogates are ART professionals who seek to make a profit doing a unique job.

Part I of this Article demonstrates that surrogates are professional service providers in the surrogacy industry. Surrogacy agencies seek out specially qualified women to undertake the demanding, risky, and critical job of gestating a child for another person. Moreover, surrogates enter into complex contracts and are compensated for their labor just like other businesspeople. Part II shows that surrogacy compensation is taxable income. Surrogates and the ART industry seem to presume that payments to surrogates are not taxable income based on one of four theories: (1) that surrogacy payments are gifts, so they are not income; (2) that the payments are excludable from income because they qualify under the pain and suffering exception; (3) that the payments are pre-birth child support, so they need not be included in income; or (4) that the payments need not be reported because they are reimbursements.¹¹ This Part will show that all of these arguments fail and that surrogacy compensation is simply, and unmistakably, taxable income. In Part III, we demonstrate that because surrogacy is a “trade or business” under the Code, surrogacy-related expenses qualify as business deductions. Surrogates, whether they are independent contractors or employees, have ordinary and necessary expenses that are in fact deductible as business expenses despite their seemingly personal nature. As such, when a woman is a surrogate, her body is her business.

I. THE SURROGACY INDUSTRY

Surrogacy in the United States is a multi-million dollar business.¹² Lawyers, doctors, agency directors, and surrogates seek to meet the needs of their customers, intended parents, by providing surrogacy services for profit. The agencies recruit and rigorously screen surrogacy applicants, selecting only those women who have the necessary experience and aptitude to be a successful surrogate.¹³ The surrogate

11. See *infra* Part II.

12. Scholars estimate that the ART industry, of which surrogacy is a part, has annual revenues of nearly seven billion dollars. Daar, *supra* note 4, at 25–26.

13. Lori B. Andrews & Lisa Douglas, *Alternative Reproduction*, 65 S. CAL. L. REV. 623, 671 (1991); see also, e.g., *Fertility Helper Selection*, INT’L ASSISTED REPROD. CENTER,

then enters into a complex contract with the agency or intended parents in which the surrogate agrees to provide certain services for payment.

A. *Surrogates Are at the Center of a Multi-Million Dollar Industry*

Surrogacy statistics are difficult to obtain, but the U.S. government conservatively estimates that more than 1000 births from surrogacy occur every year.¹⁴ The average gestational surrogacy costs between \$75,000 and \$150,000, and the vast majority are facilitated by for-profit surrogacy agencies; these agencies are at the center of a \$75–150 million-per-year industry.¹⁵

Surrogacy agencies choreograph the entire process, from matching of the surrogate and intended parents to administration and enforcement of contractual matters.¹⁶ The agencies advertise in print media and on the

<http://www.fertilityhelp.com/index.php/FERTILITY-HELPER-SELECTION.html> (last visited Oct. 23, 2010) (“Our surrogate screening procedures include mandatory psychological testing, release of prior obstetrical information, criminal background checks, health insurance policy review, medical testing, the completion of [a] 14-page application, and several interviews with our staff.”).

14. Ali & Kelly, *supra* note 6, at 45. In 2000, the CDC reported 1210 attempted gestational surrogacy arrangements, twice the number attempted just three years earlier. David P. Hamilton, *She’s Having Our Baby: Surrogacy Is on the Rise as In-Vitro Improves*, WALL ST. J., Feb. 4, 2003, at D1. It is estimated that more than 25,000 women have given birth through formal surrogacy arrangements since 1970. Elly Teman, *The Social Construction of Surrogacy Research: An Anthropological Critique of the Psychosocial Scholarship on Surrogate Motherhood*, 67 SOC. SCI. & MED. 1104, 1104 (2008). The overwhelming majority of these arrangements have had happy endings for all involved. Over 99% of surrogates have willingly surrendered the child to the intended parents and less than .01% of surrogacy cases have resulted in court battles between the surrogate and intended parents. *Id.*; see also Judy Keen, *Surrogate Relishes Unique Role*, USA TODAY, Jan. 23, 2007, at D2 (stating that fewer than one-tenth of 1% of surrogacies result in litigation).

15. MUNDY, *supra* note 6, at 129 (“[P]arenting through surrogacy costs between \$100,000 and \$150,000, including payments to a surrogate, an egg donor, one or even two brokering agencies, a fertility clinic, lawyers, and assorted facilitators.”); see also *Anticipated Program Costs for Gestational Surrogacy*, CIRCLE SURROGACY, <http://www.circlesurrogacy.com/index.php/en/costs> (last visited June 2, 2010) (discussing a detailed estimate of total program costs including agency fees, attorney’s fees, screening fees, surrogate fees, and IVF insurance coverage totaling \$80,000 to \$120,000); *Surrogacy*, ADOPTION.COM, <http://adopting.adoption.com/child/surrogacy.html> (last visited June 2, 2010) (estimating the average cost of gestational surrogacy to be between \$75,000 and \$100,000); *Surrogacy and Egg Donation*, NORTHEAST ASSISTED FERTILITY GROUP, <http://www.assistedfertility.com/faqs/fee.shtml> (last visited June 2, 2010) (averaging a total cost for gestational surrogacy to be \$90,000 to \$130,000); Stephanie Saul, *Building a Baby, with Few Ground Rules*, N.Y. TIMES, Dec. 13, 2009, at A1 (explaining that surrogacy arrangements are largely for-profit and can be very lucrative).

16. Melinda M. Hohman & Christine B. Hagan, *Satisfaction with Surrogate Mothering: A Relational Model*, 4 J. HUM. BEHAV. SOC. ENV’T 61, 64 (2001); see also *Surrogacy Agency Comparisons*, GROWING GENERATIONS, <http://www.growinggenerations.com/surrogacy-program/intended-parents/agency-comparisons> (last visited Apr. 14, 2010) (describing the services offered by the agency). Depending upon the skills and experience of the surrogacy agency, it may also

internet for both surrogates and intended parents, screen all the parties involved, and arrange for any necessary medical and psychological testing.¹⁷ Once the surrogate and intended parents are matched, the agency drafts the surrogacy contract and facilitates the various pre-pregnancy medical appointments for any sperm or egg donors, the surrogate, and the intended parents.¹⁸ After a pregnancy is achieved, the agency typically facilitates the payments made from the intended parents to the surrogate and assists with any legal proceedings associated with terminating the surrogate's parental rights and vesting parental rights in the intended parents.¹⁹

B. *Surrogacy Is a Profession*

Along with the agencies, surrogates are vital participants in the surrogacy industry. In fact, similar to the surrogacy agency professionals, surrogates are uniquely qualified and are expected to provide individualized service in a professional manner.

1. *Surrogacy Demands Sacrifice and Skill*

The job of a surrogate is difficult and time-consuming. The would-be surrogate is first screened by the agency.²⁰ If she is approved, she is

oversee all legal matters, including escrow management and the legal determination of parentage after the child is born. Examples of such full-service agencies are ERICKSON LAW, <http://www.ericksonlaw.net>; GROWING GENERATIONS, <http://www.growinggenerations.com>; INT'L ASSISTED REPROD. CENTER, <http://www.fertilityhelp.com>; REPROD. POSSIBILITIES, LLC, <http://www.reproductivepossibilities.com>; and SURROGATE MOTHERS, INC., <http://www.surrogatemothers.com>.

17. See Drabiak et al., *supra* note 6, at 301; Jadva Vasanti et al., *Surrogacy: The Experiences of Surrogate Mothers*, 18 HUM. REPROD. 2196, 2199 (2003) (reporting the results of a survey that asked how women found out about surrogacy: "Twenty-three (68%) of the women had first heard about surrogacy from the media, five (15%) had first heard about it from a family member or a friend, and six (17%) reported a long-term awareness of surrogacy.").

18. See *The Matching Process*, CIRCLE SURROGACY, <http://www.circlesurrogacy.com/index.php/en/become-a-parent/matching-process> (last visited Sept. 22, 2010) (describing the final pre-pregnancy preparations, including finalizing and signing contracts); SURROGACY SPECIALISTS OF AM., <http://www.ssa-agency.com> (last visited Sept. 22, 2010) (discussing the agency's process for supplying attorneys to draft surrogacy contracts).

19. *Questions Frequently Asked by Potential Gestational Carriers*, CIRCLE SURROGACY, <http://www.circlesurrogacy.com/index.php/become-a-surrogate/faqs> (last visited Oct. 23, 2010) (explaining how the surrogacy payments are disbursed and explaining Circle Surrogacy's involvement in facilitating the payments); Saul, *supra* note 15, at A1 (explaining that surrogacy arrangements are largely for-profit and can be very lucrative).

20. See Betsy P. Aigen, *Motivations of Surrogate Mothers: Parenthood, Altruism and Self-Actualization*, AM. SURROGACY CENTER, INC. (1996), <http://www.surrogacy.com/psychres/article/motivat.html> (last visited Oct. 8, 2010) (discussing the surrogate screening process).

placed in the agency's catalog or database to be viewed by intended parents. If she is selected by intended parents she, and possibly her husband or partner, must undergo extensive psychological and medical testing.²¹ After the testing, if all parties agree to work with one another, the would-be surrogate must negotiate the terms of a lengthy contract in which she agrees to carry a child to term, give up the child at birth, and terminate all parental rights to the child.²² In addition, most surrogacy contracts require the surrogate to forgo certain activities before and during the pregnancy. For example, surrogates often agree to forgo sexual intercourse prior to achieving pregnancy and to abstain from drinking alcohol and caffeine, taking medications, and traveling to certain destinations once pregnancy is achieved.²³ In addition, surrogacy

21. The purpose of the medical testing is to ensure that the surrogate is medically able to conceive a child, carry a child to term, and give birth to a child free from diseases. *See, e.g., Sample Gestational Surrogacy Contract*, SURROMOMSONLINE.COM, <http://www.surromomsonline.com/articles/gcontract.html> (last visited Sept. 23, 2010) [hereinafter Surromomsonline GSC] ("The Embryo will have a medical examination, blood and other tests and psychological testing as determined by the genetic Parents and their advisors."); Gary A. Debele, *Gestational Carrier Agreement*, <http://www.wbdlaw.com> (on file with author) [hereinafter Debele GCA] ("[P]rior to the embryo being implanted into [the surrogate's] uterus, all parties shall undergo testing for sexually transmitted diseases (STD's); including but not limited to Hepatitis and Acquired Immune Deficiency Syndrome (AIDS)."). Psychological testing is required for all parties to ensure they fully understand the emotional implications of carrying a child to term and then giving that child to the intended parents. *Gestational Surrogacy Contract*, ALL ABOUT SURROGACY.COM, http://www.allaboutsurgacy.com/sample_contracts/GScontract1.htm (last visited Sept. 23, 2010) [hereinafter Allaboutsurgacy GSC] ("Surrogate, Surrogate's Husband, Genetic Father and Intended Mother shall have psychological testing to the extent their medical advisors determine such testing necessary prior to the transfer and implantation of said embryo(s) to the Surrogate.").

22. *See, e.g., Traditional Surrogacy Contract*, SURROGATE MOTHERS ONLINE, http://www.surromomsonline.com/articles/ts_contract.htm (last visited Oct. 8, 2010) [hereinafter Surromomsonline TSC] ("Surrogate states and declares that she does not desire to have a parental relationship with any child born pursuant to this Agreement. It is her further belief that the child or children . . . conceived pursuant to this Agreement are morally and contractually the Child of the Intended Parents . . ."); Allaboutsurgacy GSC, *supra* note 21 ("The Surrogate and the Surrogate's Husband are a married couple willing to relinquish custody of a child born to the Surrogate for the benefit of and upbringing by the Genetic Father and Intended Mother."); *Gestational Surrogacy Agreement*, AM. SURROGACY CENTER, INC., <http://www.surrogacy.com/legals/gestcontract.html> (last visited Sept. 23, 2010) [hereinafter Surrogacy GSA] ("It is the intent of the parties that neither the Carrier nor her husband shall have any physical or legal custody of or any parental rights or duties with respect to the child born of this gestational surrogacy process and that the Biological Parents shall exclusively have such custody and all parental rights and duties from the moment of the child's birth.").

23. Sharyn L. Roach Anleu, *Reinforcing Gender Norms: Commercial and Altruistic Surrogacy*, 1 ACTA SOCIOLOGICA 63, 65 (1990) ("[C]ontracts often specify what kinds of medical tests or procedures the surrogate will undergo and specify that she will not smoke cigarettes, drink alcohol or use illegal or non-prescription drugs."); *see, e.g., Gestational Surrogacy Contract*, SURROGACY911.COM, <http://www.surrogacy911.com/laws/gestational-contract-sample/> (last visited Oct. 9, 2010) [hereinafter Surrogacy911 GSC] ("The surrogate mother agrees and promises that she

contracts make various demands of the surrogate, such as taking prenatal vitamins, exercising, and allowing the intended parents to attend medical appointments.²⁴

Once the contract is signed, the surrogate must undergo various medical procedures. In the case of a gestational surrogacy using *in-vitro* fertilization (IVF), the surrogate must endure months of hormone injections before having the embryos transferred to her uterus.²⁵ If pregnancy is achieved, the surrogate must carry the pregnancy to term, which includes numerous doctor visits, physical discomfort, weight gain, and significant medical risk.²⁶ Moreover, because of the near impossibility of hiding a pregnancy, the surrogate must share her experience, and often explain and justify her choices, to her family, friends, and coworkers. Despite the demands of this job—or perhaps due to them—surrogacy agencies and intended parents are quite selective as to whom they are willing to hire to be a surrogate.

will not have sexual intercourse with anyone from the first day of her menstrual cycle before the embryo transfer procedure until the date that pregnancy has been confirmed.”); Surromomsonline GSC, *supra* note 21 (“Embryo carrier will not engage in any hazardous or inappropriate activity during the pregnancy.”); Allaboutsurgacy GSC, *supra* note 21 (“The Surrogate agrees not to travel outside of the United States of America after the second trimester of the pregnancy.”).

24. *See, e.g.*, Surromomsonline GSC, *supra* note 21 (“Embryo Carrier will do everything reasonably appropriate for her good health and the good health of the fetus during pregnancy.”); *Sample Gestational Surrogacy Agreement*, ALL ABOUT SURROGACY.COM, http://www.allaboutsurgacy.com/sample_contracts/TScontract2.htm (last visited Oct. 9, 2010) [hereinafter Allaboutsurgacy GSA] (“Surrogate agrees to undergo an amniocentesis or other invasive testing to detect foetal genetic and congenital defects upon the request of Genetic Father”); Debele GCA, *supra* note 21 (“Surrogate agrees that the intended parents shall be allowed to be present, and actively participate . . . in all doctor or hospital examinations” and also agrees to “pump colostrums and provide that to [intended parents] for the benefit of the child.”). The contract may also include language stating the surrogate follow contractual provisions related to sexual intercourse during the pregnancy. *See, e.g.*, Surrogacy911 GSC, *supra* note 23 (“The surrogate mother then agrees that she will not have unprotected intercourse with anyone other than her husband/boyfriend, if there is any, during the term of the pregnancy.”). The intended parents could be excused from taking the child if genetic testing after birth proves the child to be the child of the surrogate’s spouse or partner. KINDREGAN & MCBRIEN, *supra* note 2, at 298.

25. Elizabeth A. Trainor, *Right of Husband, Wife, or Other Party to Custody of Frozen Embryo, Pre-Embryo, or Pre-Zygote in Event of Circumstances*, 87 A.L.R.5th 253, 259 (2004) (“Typically the in vitro fertilization (IVF) procedure begins with hormonal stimulation of a woman’s ovaries to produce multiple eggs.”).

26. Stephanie Smith, *Doubling of Maternal Deaths in U.S. “Scandalous,” Rights Group Says*, CNN.COM (Mar. 12, 2010), <http://www.cnn.com/2010/HEALTH/03/12/maternal.mortality/index.html>.

2. *A Good Surrogate Is Hard to Find*

The ideal surrogacy applicant has children of her own, has had easy pregnancies,²⁷ values family deeply,²⁸ and derives so much joy and meaning from her own family that she cannot imagine someone living a life without children.²⁹ In addition, women who are unusually empathetic and who view helping someone have a family as a calling or a vocation are particularly encouraged to apply.³⁰ The women ultimately selected to be surrogates have typically been white, Christian, in their late twenties or early thirties, in stable and committed relationships,³¹ and financially and psychologically stable.³²

27. Brenda M. Baker, *A Case for Permitting Altruistic Surrogacy*, 11 HYPATIA 34, 39 (1996) (“Studies of existing surrogacy programs have found that surrogates are usually women with families of their own who wish to re-experience the joy and ease of being pregnant, but who do not want to raise another child themselves.”).

28. MUNDY, *supra* note 6, at 132.

29. Janice C. Ciccarelli & Linda J. Beckman, *Navigating Rough Waters: An Overview of Psychological Aspects of Surrogacy*, 61 J. SOC. ISSUES 21, 30 (2005); *see also* Linda Kanefield, *The Reparative Motive in Surrogate Mothers*, 2 ADOPTION Q. 5, 12 (1999) (“‘I can’t imagine what it would be like for a woman who wants kids not to be able to have them. I can’t think of anything else I could do for somebody that would mean so much. I feel like it’s something I can do, and if I can do it, I should do it.’”).

30. Surrogates are often strongly motivated by empathy with the infertile couple. Having found the experience of having children to be very important in their own lives, they desire to help another couple share this special experience. Olga van den Akker, *Genetic and Gestational Surrogate Mothers’ Experience of Surrogacy*, 21 J. REPROD. & INFANT PSYCH. 145, 146 (2003).

31. Ciccarelli & Beckman, *supra* note 29, at 31; R.J. Edelman, *Surrogacy: The Psychological Issues*, 22 J. REPROD. & INFANT PSYCH. 123, 130 (2004); *see also* Hohman & Hagan, *supra* note 16, at 63 (stating that most studies found that the majority of surrogate mothers are white, about twenty-seven years old, married, and already mothers of about three children).

32. Kanefield, *supra* note 29, at 5 (explaining that surrogates generally demonstrate a considerable degree of stability, are psychologically stable, suffer from no mental illness, are involved in a supportive relationship, have children of their own, and are financially stable). Although the available research studies on surrogates tend to be small, making the results statistically inconclusive, the findings have been overwhelmingly consistent. In contrast to perceptions and fears commonly voiced in the modern media or in legislative hearings about surrogacy, most surrogates do not come from economically or socially vulnerable groups, do not report feeling exploited by the process, do not claim to be motivated solely by financial gain, and report being very satisfied with the experience—many even choose to be a surrogate for a second or third time. *See* Ciccarelli & Beckman, *supra* note 29, at 31; Edelman, *supra* note 31, at 127; Kanefield, *supra* note 29; *see also* Hohman & Hagan, *supra* note 16, at 63 (stating that studies show that surrogates tend to be from working-class backgrounds, have about one year of college, and work part-time or are full-time homemakers). Although surrogates do tend to be of a lower educational level and a lower social-economic class than the intended parents, “inequity is not an issue for them and, rather than feeling exploited, they firmly believe they are making an informed choice.” van den Akker, *supra* note 30, at 146. According to Ciccarelli and Beckman’s study, most “intended/social parents were married, white, and had incomes over \$80,000 per year.” *Supra* note 29, at 35.

Finally, the most critical requirement of a surrogate is that she be able to give up the child she gestates for nine months.³³ Many people presume this would be incredibly difficult. Research shows, however, that the majority of surrogates experience little difficulty when giving the child to the intended parents and most report not feeling any maternal bond with the child.³⁴ From before the conception occurs, and throughout the pregnancy, a surrogate knows that the child is not hers, and she never intends for the child to be a part of her family.³⁵ If a woman can meet the demanding requirements of being a surrogate, she would do well to apply for the position because studies show that most surrogates report that the experience was “positive and enriching for themselves, their families, and all those involved.”³⁶

C. *Surrogates Enter into Complex Contracts*

As with most business ventures, the overwhelming majority of surrogacy agreements are memorialized in a written contract that outlines the responsibilities and obligations of each party.³⁷ The emotion-laden promises included in a surrogacy agreement, however,

33. See Ciccarelli & Beckman, *supra* note 29, at 34 (explaining that many surrogacy agencies in the United States will contract only with women who have previously given birth and have children of their own because it maximizes the chances of a successful birth and fulfillment of the surrogacy contract).

34. Teman, *supra* note 14, at 1107–08. Teman argues that it is a “cultural myth that ‘normal’ women do not relinquish their children voluntarily” and asserts that studies show that “surrogates are largely classifiable as conservative, moral women who independently make this non-normative decision and that bonding is not a ‘natural’ but a culturally constructed measure which is dependent upon the woman’s own conscious decision and not upon any innate ‘natural’ predisposition.” *Id.*

35. Olga B.A. van den Akker, *Psychosocial Aspects of Surrogate Motherhood*, 12 HUM. REPROD. UPDATE 53, 53 (2007); see Edelman, *supra* note 31, at 130 (explaining that it is common for surrogates to differentiate their surrogacy pregnancy from previous pregnancies because the surrogate knows the baby is not hers and considers it the adoptive couple’s baby from the beginning); Ciccarelli & Beckman, *supra* note 29, at 32 (“Several studies confirm that the surrogate mother generally forms a relationship with the couple rather than the child.”).

36. Teman, *supra* note 14, at 1109 (citing numerous studies with similar results); Vasanti, *supra* note 17, at 2196 (citing studies that show a surrogate’s experience gestating a child for another person or couple is generally positive and that surrogates tend not to experience major difficulties in their relationship with the intended parents or in handing over the baby).

37. Cynthia Fruchtman, *Considerations in Surrogacy Contracts*, 21 WHITTIER L. REV. 429 (1999). The first known surrogacy contract in the United States was executed in 1976. See Keith J. Hey, *Assisted Conception and Surrogacy—Unfinished Business*, 26 J. MARSHALL L. REV. 775, 787 (1993) (referring to the first surrogacy contract executed in Michigan in 1976); Amy M. Larkey, *Redefining Motherhood: Determining Legal Maternity in Gestational Surrogacy Arrangements*, 51 DRAKE L. REV. 605, 608 (2003) (explaining the history and current practices of surrogacy arrangements). The contract that becomes part of the surrogacy arrangement is at times referred to as a “surrogacy contract,” “a gestational agreement,” or a “gestational carrier agreement.”

create a host of unique contractual issues. As a result, surrogacy contracts are meticulously thorough, detailing not only the basic agreement between the parties,³⁸ but also delicate and sensitive matters concerning the surrogate's actions during the pregnancy, as well as her compensation.

The bulk of the provisions in surrogacy contracts deal with who has control of the pregnancy. Provisions such as the specifics of the IVF treatment,³⁹ prenatal care,⁴⁰ and whether the intended parents can attend medical appointments⁴¹ are incorporated into the contract to reinforce that, while the surrogate may be the one carrying the child, it is not her pregnancy. From the parties' perspectives, the pregnancy belongs to the intended parents and the surrogate is hired to provide a valuable service.⁴²

The terms of a surrogacy contract will also specify how the surrogate will be paid for providing that valuable service. Surrogates usually receive reimbursements for expenses⁴³ as well as a base sum for

38. KINDREGAN & MCBRIEN, *supra* note 2, at 296 (“The initial recitals that typically are included in such contracts include the general purpose of the agreement; a definition of each party’s role in the arrangement . . . and a provision regarding anonymity.”).

39. Debele GCA, *supra* note 21 (“[T]he parties agree to attempt the number of IVF cycles recommended by the responsible physician, but agree to discontinue their attempts upon the recommendation of the responsible physician.”); Surrogacy GSA, *supra* note 22 (“The Biological Father and Mother agree and understand that they are entering into this Agreement with the Carrier whereby the Biological Father and Mother agree to the placement of their embryo(s) conceived through IVF into the uterus of the Carrier for the purpose of impregnating the Carrier.”); Allaboutsurgacy GSA, *supra* note 24 (“Genetic Father and Surrogate agree that no more than 2 embryos per cycle may be transferred into her uterus and that remaining embryos, if any, shall be cryopreserved.”).

40. Surromomsonline GSC, *supra* note 21 (“[The surrogate] agrees to follow a transfer and prenatal medical examination schedule set by the attending Physician.”); Allaboutpregnancy GSC, *supra* note 21 (“The Surrogate agrees to follow a prenatal examination schedule . . .”).

41. Debele GCA, *supra* note 21 (Surrogate agrees that the intended parents “shall be allowed to be present, and actively participate . . . in all doctor or hospital examinations”); Surrogacy911 GSC, *supra* note 23 (genetic father and the intended mother are to select a physician and have complete access to all available medical records).

42. Many surrogacy contracts incorporate provisions related to abortion and fetal reduction. The surrogate has a constitutional right to have an abortion; however, in many instances the parties to a surrogacy contract may insert a provision into the contract requiring that the surrogate waive her right to an abortion or stating that an abortion must be performed in certain circumstances. Allaboutsurgacy GSC, *supra* note 21 (“If the fetus(es) has been determined by any designated physician to be physically or psychologically abnormal, the decision to abort the pregnancy or not to abort the pregnancy shall be the sole decision of the Genetic Father and Intended Mother. . . . In the event that the embryo transfer results in three (3) or more fetuses, the Parties to this Agreement may agree to fetal reduction in order to reduce the number of fetuses.”); Surrogacy911 GSC, *supra* note 23 (“The surrogate mother is to agree not to make [sic] an abortion upon her own discretion.”).

43. Actual reimbursement expenses may include reimbursement for such items as medical

gestational services.⁴⁴ Surrogates are often reimbursed specific costs and expenses related to gestating the child such as living expenses,⁴⁵ travel,⁴⁶ maternity clothes,⁴⁷ lost wages,⁴⁸ and child care expenses.⁴⁹ In addition, the surrogate is paid a set amount over and above the expenses for the gestational services.⁵⁰ This base pay⁵¹ ranges from the typical low base pay of \$20,000 to \$120,000 at the extreme high end.⁵² Compensation is often commensurate with prior experience: For example, some agencies

expenses, life insurance premium payments, and parking fees paid by the surrogate. *See, e.g.*, Surrogacy911 GSC, *supra* note 23; Allaboutsurgacy GSC, *supra* note 21.

44. Christine L. Kerian, *Surrogacy: A Last Resort Alternative for Infertile Women or a Commodification of Women's Bodies and Children?*, 12 WIS. WOMEN'S L.J. 113 (1997); *see, e.g.*, Surromomsonline GSC, *supra* note 21 ("Genetic Parents agree to pay Embryo Carrier as compensation for services provided that sum of \$_____"); Debele GSA, *supra* note 21 ("The intended parents agree to pay [surrogate] the sum of \$_____"); Surrogacy GSA, *supra* note 22 ("The biological parents agree to pay the Carrier as compensation for the services provided the sum of \$_____ . . .").

45. *See, e.g.*, Allaboutsurgacy GSC, *supra* note 21 ("Genetic Father and Intended Mother shall pay for certain Living Expenses of the Surrogate subsequent to the confirmation of pregnancy . . .").

46. *See, e.g.*, Allaboutsurgacy GSC, *supra* note 21 ("[The intended parents will reimburse the surrogate] \$0.X per mile for any/all surrogacy related expenses . . ."); Surrogacy GSA, *supra* note 22 ("In addition to the compensation set forth above, the Biological Parents agree to indemnify the Carrier for: (A) all reasonably documented incidental expenses, such as telephone toll charges, travel, [and] parking . . .").

47. *See, e.g.*, Allaboutsurgacy GSC, *supra* note 21 ("[The intended parents will reimburse the surrogate for] maternity clothing."); Surromomsonline GSC, *supra* note 21 (including reimbursement for maternity clothing up to \$500.00).

48. *See, e.g.*, Allaboutsurgacy GSA, *supra* note 24 ("Expenses incurred by Surrogate for travel, lost wages, telephone calls and miscellaneous expenses will be paid directly by the Genetic Father or reimbursed to Surrogate . . ."); Debele GCA, *supra* note 21 (providing for the reimbursement of surrogate's lost wages in the case she is put on bed rest during the pregnancy). In addition, the parties may agree to reimburse the surrogate's spouse for any lost wages incurred during the course of the implantation and pregnancy. *See, e.g.*, Allaboutsurgacy GSC, *supra* note 21 ("In the event the Surrogate's Husband incurs lost wages as a result of the IVF, the total Living Expenses in (i) and (ii) shall be increased prorata at a rate of \$__ per day").

49. *See, e.g.*, Allaboutsurgacy GSC, *supra* note 21 ("Surrogate shall be reimbursed for childcare expenses at a rate of \$7 per hour for medical appointments related to the IVF procedure and any resulting pregnancy").

50. *See, e.g.*, Surromomsonline GSC, *supra* note 21 (Genetic Parents agree to pay Embryo Carrier as compensation for services provided the sum of \$_____); Debele GSA, *supra* note 21 ("The intended parents agree to pay [surrogate] the sum of \$_____"); Surrogacy GSA, *supra* note 22 ("The biological parents agree to pay the Carrier as compensation for the services provided the sum of \$_____ . . .").

51. This Article uses the term "base pay" to distinguish the payment for gestational services from reimbursed expenses.

52. SPAR, *supra* note 6, at 92. Reports vary, but the average surrogate appears to be paid between \$13,000 and \$25,000. MUNDY, *supra* note 6, at 133 ("[S]urrogates get about \$20,000, egg donors anywhere from \$5,000 to \$50,000."); Drabiak et al., *supra* note 6, at 303.

report that first time surrogates receive base pay of approximately \$22,000, second time surrogates receive \$25,000, and third-time surrogates receive \$30,000.⁵³ These payments, considered in combination with the government estimate of 1000 births from surrogacy every year, result in surrogates being paid in excess of \$22 million each year.⁵⁴

II. WHEN YOUR BODY IS YOUR BUSINESS, YOU HAVE TAXABLE INCOME

Surrogacy is a multi-million dollar a year industry in which agencies and intended parents pay surrogates upwards of \$22 million a year.⁵⁵ Despite these significant payments, there is evidence that many surrogates are not reporting surrogacy payments as income.⁵⁶ Under the Internal Revenue Code (“the Code”), however, the payments are income. Federal income taxation applies broadly. The Code specifically defines gross income as “all income from whatever source derived.”⁵⁷ This definition is incredibly broad. The Supreme Court has held that almost any time a taxpayer has an economic gain over which he or she has complete control, the taxpayer has income.⁵⁸ Surrogates receive payments with no restrictions on the use of the money. The payments, therefore, fall squarely within the definition of income.⁵⁹

53. See, e.g., *Surrogate Fee Information*, GROWING GENERATIONS, <http://www.growinggenerations.com/surrogacy-program/surrogates/financial-information> (last visited Sept. 23, 2010).

54. MUNDY, *supra* note 6, at 130. Debra Spar calculated that U.S. surrogates received over \$27 million in compensation in 2004. SPAR, *supra* note 6, at 3.

55. SPAR, *supra* note 6, at 3.

56. See, e.g., *Surrogacy Taxes*, INFORMATION ON SURROGACY, <http://www.information-on-surrogacy.com/surrogacy-taxes.html> (last visited Oct. 9, 2010) (“Most contracts have . . . wordings that usually circumvent the need for taxes to be paid on compensation.”). Part of the rationale for the omission could be that surrogates are not properly advised of their tax obligations. See KINDREGAN & MCBRIEN, *supra* note 2, at 302–03 (noting the uncertainty surrounding the characterization of compensation to surrogates and providing a “drafting tip” that contracts “should contain a clause regarding taxes, noting that the parties are not being advised as to taxation and that it is their responsibility to report payments received in connection with services rendered under the contract if they deem it necessary under applicable tax law”).

57. I.R.C. § 61 (2006). This is in contrast to, for example, gifts, which are not taxed at all to the recipient. I.R.C. § 102(a).

58. *Comm’r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (defining income as an accession to wealth that is clearly realized, over which the taxpayer has complete dominion). We say “almost” because some transfers will fit the *Glenshaw Glass* definition of “income” but are specifically excluded through some other Code provision.

59. We are not the first academics to recognize this reality. See, e.g., Natalie Loder Clark, *New Wine in Old Skins: Using Paternity-Suit Settlements to Facilitate Surrogate Motherhood*, 25 J. FAM. L. 483, 514 (1986–87) (“One must also note that child support payments made to mother [sic] are

Many possible reasons explain the failure to account properly for surrogacy payments. One might be fear of reporting such income because in a handful of states, surrogacy is illegal.⁶⁰ But even in states in which surrogacy is illegal, the payment is nonetheless taxable because, under the Code, even illegal income must be reported.⁶¹ A more likely explanation for the omission, given the language in surrogacy contracts, is that surrogates and agencies are attempting to fit surrogacy payments within an exception to the income rule. Although many surrogacy contracts include clauses stating that the parties are not receiving tax advice,⁶² the contracts seem to be written with an eye to the Code. For example, some contracts suggest that the payment is a gift,⁶³ others describe the payment as compensation for pain and suffering,⁶⁴ some even refer to the amounts paid as pre-birth child support,⁶⁵ and some

not taxable income to her, while contractual payments to her for the services of pregnancy and birth presumably are.”); Crawford, *Taxing Surrogacy*, *supra* note 10; Crawford, *Taxation, Pregnancy and Privacy*, *supra* note 10.

60. See, e.g., MICH. COMP. LAWS ANN. §§ 722.851–.863 (2002 and Supp. 2010). It is a felony in Michigan to arrange or assist in the formation of a contract for surrogacy and is punishable by fine of no more than \$50,000. See *id.* § 722.857. “A surrogate parentage contract is void and unenforceable as contrary to public policy.” *Id.* § 722.855.

61. *James v. United States*, 366 U.S. 213, 219 (1961) (holding that illegal income is taxable).

62. KINDREGAN & MCBRIEN, *supra* note 2, at 302–03. See, e.g., Surromomsonline GSC, *supra* note 22 (“This Agreement does not instruct the Parties on immigration and taxation. It is the responsibility of the Party receiving payments or any other benefits pursuant to this Agreement to seek independent legal advice regarding the tax consequences of said payments, benefits and/or immigration laws.”); *Surrogate Services Agreement*, REPROD. ASSISTANCE, INC., <http://www.reproassistinc.com/SurrogateAgreement8-1-2007.pdf> (last visited Oct. 9, 2010) [hereinafter *Reproassistinc SSA*] (“The monetary compensation received may or may not be tax deductible. Surrogate should seek tax advice from an accountant.”).

63. Jennifer L. Watson, *Growing a Baby For Sale or Merely Renting a Womb: Should Surrogate Mothers Be Compensated for Their Services?*, 6 WHITTIER J. CHILD & FAM. ADVOC. 529, 552 (2007) (suggesting gift treatment for surrogacy payments); see *Question re: Income and How It Affects My Taxes*, SURROGATE MOTHER, <http://www.surrogatemother.com/forum/topics/question-re-income-and-how-it> (last visited Oct. 9, 2010) (commenting on a discussion board that many experienced surrogates felt they did not need to report their payments as income); see also *Taxes*, SURROGATE MOTHER, <http://www.surrogatemother.com/forum/topics/taxes-1> (last visited Oct. 9, 2010).

64. See, e.g., Debele GCA, *supra* note 21; Surromomsonline TSC, *supra* note 22 (“In consideration of . . . pain and suffering . . . incurred by Surrogate in performance of all the terms and obligations set forth in this Agreement, Intended Parents shall pay or cause to be paid the amounts specified below.”).

65. *Surrogacy Taxes*, INFORMATION ON SURROGACY, <http://www.information-on-surrogacy.com/surrogacy-taxes.html> (last visited Oct. 30, 2010) (“[A]nother commonly untaxed exclusion is that of pre-birth child support. The intended parents are paying for the prenatal care of their unborn child, and are compensating the surrogate mother with her expenses while pregnant.”); see also, e.g., Allaboutsurgacy GSA, *supra* note 24 (“In recognition of the Genetic Father’s obligation to support his child being carried by the Surrogate and for the cost of the Surrogate to care for the

recite that some or all payments are reimbursement for expenses.⁶⁶ As described below, these attempts to take advantage of the exceptions to the income rule are unjustifiable, and surrogacy payments are taxable income.

A. *Surrogacy Payments Are Not Gifts*

Some surrogates do not report the base pay they receive from intended parents because they consider that money to be a gift.⁶⁷ These surrogates assert that their motives are altruistic and that the payments from the intended parents are merely tokens of the intended parents' gratitude. However, even where surrogates are amazingly altruistic, and the intended parents incredibly grateful, the payments are income, at least as far as the IRS is concerned.

Surrogates are part of a profit-making industry in which they are paid service providers. As such, under the Code, surrogates must be either employees or independent contractors.⁶⁸ If the surrogate is an employee, the analysis is straightforward: gifts made in the employment setting are almost always income. The Code declares that transfers "by or for an employer to, or for the benefit of, an employee" shall not be excluded from income under the "gift" rule.⁶⁹ Given the size of the ART industry,

child. Genetic Father shall pay the total sum of [amount].").

66. KINDREGAN & MCBRIEN, *supra* note 2, at 301–02 (noting that in some cases reimbursement fees can seem excessive, suggesting that compensation is in fact involved); *see, e.g.*, Surrogacy911 GSC, *supra* note 23 (providing only for payment of expenses); Allaboutsurgacy GSC, *supra* note 21 (same).

67. *See Taxes*, SURROGATE MOTHER, *supra* note 63; *see also* George Saenz, *Tax Talk*, BANKRATE.COM, http://www.bankrate.com/brm/itax/tax_adviser/20050524a1.asp (last visited Oct. 10, 2010) (answering a question posed by a surrogate on whether her services were a gift: "[A]lthough your generosity allowed a couple to have a child, I can't see how that would change the fact that you were compensated for your services. In fact, the payment would not be considered a gift, as it was not made with gratuitous intent.").

68. *See infra* Part III.A.

69. I.R.C. § 102(c)(1) (2006) (providing that the gift exclusion "shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee."). IRS regulations provide that "extraordinary transfers to the natural objects of an employer's bounty" are exempt from Section 102(c). Treas. Reg. § 1.102-1(f)(2) (1989). Therefore, Section 102(c) would not prevent gift treatment if a mother transferred a car to her son, who was also her employee, so long as the transfer "can be substantially attributed to the familial relationship." *See id.* In rare circumstances there is room to argue for gift status in the employment setting. Specifically, the Tax Court has observed that "payment from an employer to an employee *solely for personal reasons* can still be a gift if the payment is completely unrelated to the employment relationship and reflects no expectation of a business benefit." *Larsen v. Comm'r*, 95 T.C.M. (CCH) 1273, 1275 (2008) (quoting *Williams v. Comm'r*, 85 T.C.M. (CCH) 1113 (2003)) (emphasis added). A gestational surrogate would be very hard pressed to fall within this exception. Few gestational surrogates have preexisting relationships with the intended parents with whom they work.

§ 102(c) undermines the argument that a surrogate's compensation ought to be a gift.⁷⁰

If the surrogate is an independent contractor, the common-law "gift" analysis applies. The common law analysis examines the motives underlying the transfer. In *Commissioner v. Duberstein*,⁷¹ the Supreme Court interpreted the term "gift" for income tax purposes. "A gift in the statutory sense," the Court held, "proceeds from a 'detached and disinterested generosity,' 'out of affection, respect, admiration, charity or like impulses.'"⁷² The Court reasoned that it is the intent of the transferor, according to the totality of the circumstances, which controls.⁷³

In the context of surrogacy there is no objective evidence that the intended parents intend to give surrogates a gift when the parents sign lengthy contracts that commit them to substantial financial obligations. The mere recitation that the payment is a "gift" is insufficient to establish that the payment is not income.⁷⁴ To be sure, intended parents regularly give smaller, non-monetary gifts to the surrogate and even the surrogate's children during the pregnancy.⁷⁵ These gifts have become so customary that surrogacy agencies even encourage intended parents to participate actively in this gift giving.⁷⁶ These gifts, however, are voluntary on the part of the intended parents and tend to be small tokens of kindness, in contrast to the five-figure payments the surrogate will

70. See *supra* note 4 and accompanying text, noting the total revenue figures for the ART industry.

71. 363 U.S. 278 (1960).

72. *Id.* at 285 (citations omitted). The Court noted that "a voluntarily executed transfer of . . . property by one to another, without any consideration or compensation" is not necessarily a "gift" within the meaning of the income tax statute. *Id.* Similarly, the mere absence of legal duty does not establish a "gift." *Id.*

73. *Id.* at 289 (stating that the decision rests "ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case").

74. In *Duberstein*, the Court warned that "the donor's characterization of his action is not determinative" and dictated that "there must be an objective inquiry into whether what is called a gift amounts to it in reality." 363 U.S. at 286; see also, e.g., *Dexter v. United States*, 306 F. Supp. 415, 426 (N.D. Miss. 1969) (rejecting taxpayer's claim that the property deeded to her by her father via his will was a gift for federal income tax purposes, and noting that "the Court cannot accept or consider as conclusive the language used in the deed and will, indicating the transfer to be a gift" because the father's "intention must be determined by a consideration of all evidence in the case").

75. Hohman & Hagan, *supra* note 16, at 63 ("Ragone . . . found that the surrogates and parents were encouraged to be close and have frequent contacts These relationships usually became quite intense, whereby the parents would go to the doctor with the surrogates, take her out to lunch, speak to her on the phone frequently, give her presents, etc.").

76. *Id.*

receive for gestating the child. For intended parents, the surrogacy is a business relationship, albeit one with a hugely personal component.

Some surrogates argue that the payment they receive is a gift because their motivations are altruistic. It is true that few surrogates report financial gain as their sole motivation.⁷⁷ Instead, the overwhelming majority of surrogates report that they are motivated by a combination of factors, including altruism.⁷⁸ Surrogates describe the experience of carrying a child for another family as a “gift of life.”⁷⁹ Some surrogates explicitly state that being a surrogate is not a job, but is borne out of “compassion.”⁸⁰ In fact, many surrogates report thinking so highly of what they are doing that they consider it beyond monetary compensation.⁸¹

We readily recognize the profound altruism driving many surrogates even though they accept money for their services. As far as tax is concerned, however, the surrogate’s motivations are merely a factor in determining the intended parents’ intent. Considering all the facts and circumstances—as the *Duberstein* Court instructs—will most often lead to the conclusion that the base pay that passes from intended parents to surrogates is not a gift.⁸² Surrogates and intended parents are in a business relationship. Despite the surrogate’s altruism, the intended parents lack the requisite gift-giving mental state—that of “detached and

77. Teman, *supra* note 14, at 1110 (“The most popular motivations found among surrogates across studies have been an enjoyment of being pregnant, a feeling of sympathy for childless couples, a desire to earn money as stay-at-home moms, and a desire to do something ‘special.’”); *see also* van den Akker, *supra* note 35, at 56 (“Few surrogates explicitly stated that money was one reason for becoming a surrogate, and the majority said they did it for altruistic reasons. Most surrogates enjoyed pregnancy and childbirth, and many surrogates said surrogacy fulfilled or added something to their lives (increased feelings of self-worth and self-confidence, and the development of intense and unusual friendships with the commissioning parents, particularly the commissioning mothers.”); van den Akker, *supra* note 30, at 156 (“The present study and previous research have found no evidence . . . that most surrogates’ primary motives for participating in these arrangement is first and foremost for financial gain.”).

78. Drabiak et. al., *supra* note 6, at 304.

79. Heléna Ragoné, *The Gift of Life: Surrogate Motherhood, Gamete Donation, and Constructions of Altruism* in TRANSFORMATIVE MOTHERHOOD 65, 66 (Linda L. Layne, ed., 1999); Kanefield, *supra* note 29, at 9 (“I think of it as a gift I’m carrying. I won’t get attached and want to keep it.”).

80. Kanefield, *supra* note 29, at 10.

81. Ragoné, *supra* note 79, at 68 (“When questioned about remuneration, surrogates consistently protest that no one would become a surrogate for the money alone because, they reason, it simply ‘isn’t enough.’”).

82. We say “most often” because in some instances, a woman will serve as a surrogate for a close friend or family member. In those situations, the gift argument is more likely to prevail.

disinterested generosity.”⁸³ Instead of springing from “affection, respect, admiration, charity or like impulses,”⁸⁴ the money that flows from intended parents to surrogates is simply, and almost certainly, compensation for services and taxable income.⁸⁵

B. *Surrogacy Payments Are Not for Pain and Suffering*

Many involved in the surrogacy industry contend that payments to surrogates are nontaxable because the payments are “compensation for pain and suffering.”⁸⁶ This nomenclature appears to be an attempt to exclude the payments from income under § 104(a)(2), the statutory exception for damages received on account of physical injury. Section 104(a)(2) permits the victim of a tort, such as a battery, to exclude the damages received as settlement of the claim.⁸⁷ The section provides that gross income does not include “the amount of any damages . . . received (whether by suit or agreement . . .) on account of personal physical injuries or physical sickness.”⁸⁸ No doubt gestating a fetus to term—not to mention delivering a baby—involves pain and suffering,⁸⁹ but this statutory exclusion does not apply to surrogates.

83. *Comm’r v. Duberstein*, 363 U.S. 278, 285 (1960).

84. *Id.*

85. In addition, similar arguments made by other service providers have failed. Waitresses and casino dealers have argued that the gratuities they receive from patrons are more akin to gifts than to wages, and should be excluded from income. Nonetheless, it is established that tips and tokens are not gifts, but income to the recipient. *Roberts v. Comm’r*, 176 F.2d 221, 225 (9th Cir. 1949) (holding that tips are income); *Olk v. United States*, 536 F.2d 876, 879 (9th Cir. 1976) (holding that tokens are income). Tokens are gratuities given to gambling dealers, usually when a gambling patron wins a hand. *See, e.g., Olk*, 536 F.2d at 877. A news report of a \$10,000 tip has raised questions about the steadfastness of this rule. *See Bartender Gets \$10,000 Tip on \$26 Tab*, MSNBC (Aug. 31, 2006, 11:15 AM), <http://www.msnbc.msn.com/id/14598504>. Nonetheless, in the ordinary case, tips are not gifts, but income.

86. *See, e.g.,* INFORMATION ON SURROGACY, *supra* note 65 (noting “[m]ost contracts have one of two different wordings that usually circumvent the need for taxes to be paid on compensation” and characterizing payments to surrogates as for pain and suffering or as pre-birth child support); SURROGATE MOTHER, *supra* note 63. Numerous visitors on the site have commented that surrogacy payments qualify as “pain and suffering” payments.

87. For example, in Revenue Ruling 85-97, a taxpayer, who was seriously injured when struck by a bus, was permitted to exclude the entire settlement amount because it represented compensation for the taxpayer’s injuries. Rev. Rul. 85-97, 1985-2 C.B. 50.

88. I.R.C. § 104(a)(2) (2006).

89. Common complaints during pregnancy include headaches, morning sickness, constipation, hemorrhoids, back pain, and ankle swelling. *See, e.g., Healthy Pregnancy*, MAYO CLINIC, <http://www.mayoclinic.com/health/pregnancy-week-by-week/MY00331> (last visited Oct. 1, 2009). More serious conditions, such as gestational diabetes and pre-eclampsia can also develop. *Id.* Women report varying levels of physical pain during labor, and although some pain can be avoided or mitigated through proper anesthesia, not all laboring women choose anesthesia. *See, e.g., Labor and*

Critical to qualifying for this exception are the requirements that the payment be “damages” and that the payment be premised on a tort or tort-like claim. These requirements make plain that not every payment that is intended to compensate for pain and suffering will be excluded under the Code.⁹⁰ In an example analogous to surrogacy, in *United States v. Garber*,⁹¹ a taxpayer attempted to use § 104(a)(2) to exclude from her income payments received for donating plasma.⁹² The court held that because there was no tort—the plasma donation was voluntary—the taxpayer was not permitted to exclude the income.⁹³ Similarly, professional football players must include all of their wages in income, despite the pain and suffering that most football players (at least the linemen) endure.⁹⁴ As such, the tort requirement will also undermine a surrogate’s effort to exclude her base pay under the statutory exception. Surrogacy, like plasma donation and professional football, is not a tort and the payments received are not damages. As such, despite the pain and suffering endured, the statutory requirements to exclude income are not met.

Delivery, Postpartum Care, MAYO CLINIC, <http://www.mayoclinic.com/health/labor-and-delivery/PR00105> (last visited Oct. 1, 2009). Also, for various reasons, not all anesthesia options are available to all women. See, e.g., *Epidural Anesthesia*, AM. PREGNANCY ASS’N, <http://www.americanpregnancy.org/labornbirth/epidural.html> (last visited Oct. 1, 2009) (noting that epidurals cannot be given to women on blood thinners or with low platelet counts).

90. Recent proposed regulations contemplate an elimination of the tort requirement, and could complicate the above analysis. See Prop. Treas. Reg. § 1.104-1, 74 Fed. Reg. 47152 (Sept. 15, 2009). This proposed change does not contemplate a radical revision of the Section 104(a)(2), but the elimination of the tort requirement could make it easier for surrogates (and others) to argue that any compensation for pain and suffering ought to be excluded from income. Such an argument would ultimately fail, because the statutory language itself requires that the amount excluded be “damages.” Although not as clear as a tort-requirement, the use of the term “damages” prevents an overly broad reading of this exception because “damages” implies, and indeed might require, a non-consensual event. *Id.* § 1.104-1(c) (defining “damages” as “an amount received (other than workers’ compensation) through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution”); see also BLACK’S LAW DICTIONARY 445 (9th ed. 2009) (defining “damage” as “of or relating to monetary compensation for loss or injury to a person or property”).

91. 589 F.2d 843 (1979).

92. *Id.*; accord *Green v. Comm’r*, 74 T.C. 1229, 1230 (1980) (holding that proceeds from sale of plasma must be included in income).

93. 589 F.2d at 847 (noting that “[i]n applying section 104(a)(2) courts have uniformly assumed that the exclusion applies only to payments resulting from the prosecution or settlement of a tort claim” and holding that because there was no “suggestion that the payments to [the taxpayer] were in settlement of a possible tort liability, these payments could not as a matter of law fall within the exclusion of section 104(a)(2)”).

94. See, e.g., David Gelman, *The Most Dangerous Game*, NEWSWEEK, Dec. 14, 1992, at 66.

C. *Surrogacy Payments Are Not Pre-Birth Child Support*

Some surrogacy advisers suggest describing surrogacy payments as “pre-birth child support.”⁹⁵ In other words, rather than the surrogacy payments being compensation, they are merely “pre-birth child support” paid by the intended parents to the surrogate during the pregnancy. This appears to be a tax-driven contractual term, designed to exclude the payments from income. Again, the effort, while based in the Code, will fail. While it is true that child support payments are not included in the income of the recipient (the custodial parent),⁹⁶ simply calling the payment to surrogates “child support,” does not make it so.⁹⁷

Child support payments are excluded from income because the payments are received not for the economic benefit of the recipient, but in a “quasi-agency capacity” and are “to be used for the designated purpose of supporting dependent children.”⁹⁸ This rationale does not apply with full force to surrogates. Unlike a custodial parent, the surrogate is not accepting payment (at least the majority of her payment) in a quasi-agency role on behalf of the fetus. Instead, surrogates report intending to use the money for down payments on homes, to pay off debt, and for other non-gestational related expenses.⁹⁹

Further, it is unusual for courts to order pre-birth child support.¹⁰⁰ Where a request for child support has been brought before the birth of a

95. INFORMATION ON SURROGACY, *supra* note 65 (“[A]nother commonly untaxed exclusion is that of pre-birth child support. The intended parents are paying for the prenatal care of their unborn child, and are compensating the surrogate mother with her expenses while pregnant.”); *see also*, e.g., Allaboutsurgacy GSA, *supra* note 24 (“In recognition of the Genetic Father’s obligation to support his child being carried by the Surrogate and for the cost of the Surrogate to care for the child. Genetic Father shall pay the total sum of [amount].”).

96. I.R.C. § 71(b)–(c) (2006) (noting that alimony is included in the income of the payee; child support is not alimony). The corollary is that child support payments are not deductible by the payor (the non-custodial parent); *see also* I.R.C. § 215(a) (2006) (classifying alimony as deductible to the payor).

97. *Hayutin v. Comm’r*, 508 F.2d 462, 468 (10th Cir. 1974) (noting that the characterization placed by state court upon transfer of property from husband to wife in a property settlement is not controlling for tax purposes); Deborah A. Geier, *Simplifying and Rationalizing the Federal Income Tax Law Applicable to Transfers in Divorce*, 55 TAX LAW. 363, 364 (2002) (explaining that “[p]ayments that would be characterized as ‘alimony’ for tax purposes may constitute ‘child support’ or a ‘property settlement’ under state law, and vice versa.”).

98. Marci Kelly, *Calling a Spade a Spade: The Failure of Matrimonial Tax Reform*, 44 TAX LAW. 787, 795 (1991).

99. Kanefield, *supra* note 29, at 9 (1999) (noting that some surrogates “look toward the additional income as a down payment on a house, or a car, a way to get out of debt, an investment for their children’s education”).

100. *See, e.g.*, MINN. STAT. §§ 257.66, .75 (2008) for an example of paternity being established by court order or by the parents voluntarily executing a document called the Recognition of

child, most courts make clear that the required payments begin with the birth of a living child.¹⁰¹ Although some states permit reimbursement of pregnancy-related expenses in subsequent child support orders,¹⁰² such reimbursement is limited to pregnancy and childbirth costs,¹⁰³ and in the surrogacy context, those costs usually are already borne by the intended parents.¹⁰⁴

Finally, child support is awarded on the basis of custody or parentage.¹⁰⁵ Neither the surrogate nor the intended parents are likely to ask a court to make a determination that the gestational carrier is the custodial parent—even for the limited duration of the pregnancy. Indeed, surrogacy agencies and intended parents make every effort to minimize the surrogate's potential claim of parenthood.¹⁰⁶ Surrogates are also not motivated to claim custody because surrogates report that they do not consider themselves “parents” of the fetus.¹⁰⁷ Instead, surrogates report feeling more like caretakers, or at most, foster parents.¹⁰⁸

Parentage. In most cases, establishing paternity is relatively simple, but if it is contested or there are multiple possible fathers, a court may order an alleged father to pay temporary child support. *E.g.*, *id.* § 257.62, subdiv. 5.

101. *E.g.*, *In re Marriage of Godwin*, 567 P.2d 144, 145 (Or. Ct. App. 1977); *Edwards v. Sandusky*, 448 N.E.2d 506, 510 (Ohio Ct. App. 1982).

102. *See, e.g.*, MINN. STAT. § 257.66 (2008). The Minnesota statute is based on section 15(c) of the 1973 Uniform Parentage Act. *See* UNIF. PARENTAGE ACT § 15(c), 9B U.L.A. 465 (1973). The 1973 version of the Uniform Parentage Act has been adopted (possibly with revisions) by Alabama, California, Colorado, Delaware, Hawaii, Illinois, Kansas, Minnesota, Missouri, Montana, Nevada, New Jersey, New Mexico, North Dakota, Ohio, Rhode Island, Washington, and Wyoming. 9B U.L.A. 377.

103. *See* *Bunge v. Zachman*, 578 N.W.2d 387, 389–90 (Minn. Ct. App. 1998); *In re Paternity of W.L.*, 855 P.2d 521, 523–24 (Mont. 1993); *Jelen v. Price*, 458 N.E.2d 1267, 1270 (Ohio Ct. App. 1983).

104. John Dwight Ingram, *Surrogate Gestator: A New and Honorable Profession*, 76 MARQ. L. REV. 675, 689–91 (1993) (discussing surrogate compensation).

105. JANET LEACH RICHARDS, *MASTERING FAMILY LAW* 145 (2009).

106. *See, e.g.*, Jami L. Zehr, *Using Gestational Surrogacy and Pre-Implantation Genetic Diagnosis: Are Intended Parents Now Manufacturing the Idyllic Infant?*, 20 LOY. CONSUMER L. REV. 294, 301 (2008).

107. Ingram, *supra* note 104, at 687–88 (noting the very low risk of unyielding “maternal bonding” on the part of the gestational surrogate).

108. *Cf. id.* at 687 (likening the relationship between gestational surrogate and fetus to that between a nanny or housekeeper and her charge). Although we have not seen attempts to do so, payments to surrogates would not qualify as “foster care” payments for federal tax purposes. Although foster care payments typically are not included in income, such payments must come from a state or political subdivision, and must be made on behalf of a “qualified foster individual.” IRC § 131(a)–(b) (2006). The statute does not address unborn children. *See id.*

D. Only Some Surrogacy Payments Are Nontaxable Reimbursements

Most surrogacy contracts recite that in addition to the surrogate's base pay, certain out-of-pocket surrogacy-related expenses that the surrogate incurs will be reimbursed.¹⁰⁹ For example, a surrogate might incur out-of-pocket expenses for medical co-pays, surrogacy-related travel, or maternity clothes. Similar expenses are commonly reimbursed in many employment settings, and in most cases the reimbursement need not be reported as taxable income.¹¹⁰ In particular, reimbursements need not be reported as income if the employer has an "accountable plan" and if the reimbursement is for an expense that the taxpayer could otherwise deduct.¹¹¹ Technically, the reimbursement is income, but because it is also deductible, the IRS permits taxpayers to treat the transaction as a wash.¹¹² As such, many of a surrogate's properly reimbursed expenses need not be included in taxable income.

Other contracts, though, go much further. Those contracts do not provide for a base payment at all, and instead characterize all of the money to be paid to the surrogate as reimbursement.¹¹³ For example,

109. KINDREGAN & MCBRIEN, *supra* note 2, at 302–03 (advising that contract include explicit language on reimbursement).

110. See generally John A. Miller & Robert Pikowsky, *Taxation and the Sabbatical: Doctrine, Planning and Policy*, 63 TAX LAW. 375, 384 (2010) (describing how, in the proper circumstances, professors on sabbatical need not report reimbursed expenses).

111. Treas. Reg. § 1.62-2(c)(4)–(5) (2003); see also Rev. Proc. 2008-59, 2008-41 I.R.B. 858. Technical requirements must be met for the reimbursement to qualify as an above-the-line wash. See 34 AM. JUR. 2D *Federal Taxation* § 17801; Temp. Treas. Reg. § 1.274-5T(f)(2) (2010). A plan satisfies the requirements of an "accountable plan" if the employees are required to make an "adequate accounting" to the employer for their expenses. The regulations define adequate accounting as a submission to the employer of the documentary evidence required to substantiate travel and entertainment expenses. *Id.*; *Employee Reimbursement Plans*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/govt/fslg/article/0,,id=164471,00.html> (last visited Oct. 10, 2010). If the plan does not meet the requirements, all payments under the arrangement are treated as made under a nonaccountable plan—in other words, the payments are income and must be reported. The employee can then take a deduction if appropriate. Treas. Reg. 1.62-2(c)(5) (2003). See also INTERNAL REVENUE SERV., MISCELLANEOUS DEDUCTIONS 3 (2009), available at <http://www.irs.gov/pub/irs-pdf/p529.pdf>. In some circumstances, similar expenses paid on behalf of independent contractors, rather than employees, can qualify for similar treatment. *United States v. Gotcher*, 401 F.2d 118 (5th Cir. 1968).

112. See Miller & Pikowsky, *supra* note 110, at 384 (explaining the impact of employee reimbursements: "How then should a reimbursement of an otherwise deductible expense be treated? In the first place, it should be understood that the reimbursement is itself income. But since it is offset by an expense, the net tax effect should be zero.")

113. KINDREGAN & MCBRIEN, *supra* note 2, at 301–02 (noting that in some cases "reimbursement fees can appear excessive, suggesting that compensation is in fact involved"). See, e.g., *Surrogacy911 GSC*, *supra* note 23 (providing only for payment of expenses); *Allaboutsurrogacy GSC*, *supra* note 21 (same). In some states, this tax incentive is coupled with

suppose a surrogate has \$5000 in surrogacy-related expenses, and the intended parents have also agreed that the surrogate will be paid an additional \$20,000. It is not difficult for the surrogate to provide the intended parents or agency with \$25,000 in receipts, especially when contracts are written to allow the surrogate to be reimbursed for food, childcare, and even housing in the form of mortgage payments. From a tax perspective, the implication is that if a surrogate does not receive a base payment, and is merely reimbursed for her expenses, she does not have any taxable income.¹¹⁴ Here again, merely terming a payment “reimbursement” rather than taxable income will not make it so: only those expenses that are otherwise deductible as business expenses are properly excluded under the “reimbursement” rationale. Consequently, housing expenses will not be deductible as reimbursement, because housing (unless the taxpayer is away from home) is a personal, not a business, expense.¹¹⁵ On the other hand, other expenses, such as parking and travel expenses related to the surrogacy, could properly be excluded as reimbursements, so long as those expenses otherwise qualify under § 162.

Under the broad definition of income in the Code, surrogacy payments are taxable. Although there are exceptions to this rule, none apply to surrogates. Payments to surrogates are not gifts, they are not compensation for pain and suffering, and they are not excludable as pre-birth child support. Although some reimbursements might be excludable, the majority of the surrogate’s compensation will be income. As a result, surrogates must report the payments they receive. Of course, when businesses professionals report income, they also look for possible deductions.

another equally powerful incentive to creatively characterize payments. In particular, in states that prohibit surrogacy compensation, parties attempt to circumvent the statute by providing that all compensation is reimbursement, even when the parties have agreed to an “over and above expenses” amount. Whether this duplicity suffices to circumvent the prohibition on paying surrogates is beyond the scope of this Article. However, it is clear that it will not suffice to avoid income and the concomitant taxes.

114. Surrogacy attorneys we have spoken with believe that this phenomenon is a trend in surrogacy. They suggest that the surrogacy industry has borrowed this practice from the adoption context. In that context, birth mothers cannot be paid in exchange for giving up babies, as that would amount to prohibited baby selling, but birth mothers can be reimbursed for expenses. Several states permit reimbursement to birth mothers not just for out-of-pocket expenses, but also for living expenses. Because living expenses is a vague term, the reimbursement can become significant. *See generally* Andrea B. Carroll, *Re-Regulating the Baby Market: A Call for a Ban on Payment of Birth Mother Living Expenses*, 59 KAN. L. REV. (forthcoming 2010) (criticizing the permissive nature of state regulation and likening the payment of living expenses to baby selling).

115. Miller & Pikowsky, *supra* note 110, at 381–84 (explaining the concept of “tax home” and describing that taxpayers may deduct the cost of housing only when away from that “tax home”).

III. PAYING TAXES WHEN YOUR BODY IS YOUR BUSINESS

Surrogates, as paid professionals in the ART industry, are responsible for reporting their income and fulfilling any payment obligations. The amount of tax due, and who is responsible for paying that tax, depends on several additional fundamental tax concepts. First, whether the surrogate, intended parents, or surrogacy agency is obligated to remit and report will depend on whether the surrogate is an employee or an independent contractor. Second, a surrogate may qualify for significant tax benefits under the Code. Some surrogates may qualify for the Earned Income Tax Credit. Moreover, because surrogates are business professionals, they will be able to deduct many surrogacy-related outlays as business expenses.

A. *Surrogates Have Tax Responsibilities as Employees or Independent Contractors*

Individuals who provide services for money, such as surrogates, are classified for tax purposes as either employees or independent contractors.¹¹⁶ Both employees and independent contractors have reportable income, but the rules differ as to who is responsible for reporting that income. If surrogates are independent contractors, the surrogates themselves bear the burden of numerous reporting and remitting obligations.¹¹⁷ If surrogates are employees, these obligations

116. Although at first blush, it may seem that surrogates are neither employees nor independent contractors; for tax purposes, surrogates must be one or the other. If a surrogate is not an employee, she is, by default, an independent contractor. See Louis Lyons, *Congressional Campaign Workers: Independent Contractors or Employees? Politics, Taxes, and the Limits of the Internal Revenue Service's Authority over Employment Classification*, 8 ADMIN. L.J. AM. U. 371, 371 n.3 (1994) (“[T]ax law requires that a worker be classified either as an independent contractor or an employee.” (citing L.A. Cnty. Bar Ass’n Section of Taxation, *Legislative Proposal on Classification of Workers as Employees or Independent Contractors*, 55 TAX NOTES 821, 822 (1992))).

117. I.R.C. §§ 1401–1402 (2006) (imposing obligations on self-employed individuals similar to the FICA tax). Independent contractors, like all self-employed workers, must pay self-employment taxes, which they must calculate, report, and remit. These taxes are similar to the social security and Medicare taxes withheld from the pay of most wage earners. They must file a Schedule C or C-EZ in addition to their 1040 forms. If classified as an independent contractor, the surrogate might receive a 1099 from an agency. Some online discussion among surrogates focuses on which agencies issue 1099 forms. *What Agency or Attorney Gives Out 1099's?*, SURROGATE MOTHERS ONLINE, <http://www.surromomsonline.com/support/showthread.php?p=1604396> (last visited Oct. 8, 2010) (providing a “sticky note” listing surrogate agencies that issue 1099 forms and those that do not). Some sperm banks and egg donation agencies make a practice of issuing the form. See *California Cryobank Sperm Donor Compensation*, SPERMBANK.COM, <http://www.spermbank.com/newdonors/index.cfm?ID=4> (last visited Oct. 8, 2010) (“In 1995, the IRS instructed California Cryobank to issue 1099’s to all sperm donors earning \$600 or more in any calendar year.”);

are transferred to the intended parents or surrogacy agency, who must withhold income and employment taxes from employee wages and pay them to the IRS.¹¹⁸ Another significant difference between employees and independent contractors under the Code is the differing treatment of deductions. If surrogates are independent contractors, then their surrogacy-related expenses receive the most favored deduction status: they are deductible above the line, under § 162.¹¹⁹ On the other hand, if the surrogate is an employee, any unreimbursed expenses are classified as miscellaneous itemized deductions.¹²⁰

The distinction between employee and independent contractor is not always intuitive and depends not only on the service provided,¹²¹ but on the nuances of the relationship between the parties.¹²² For tax purposes, an employer-employee relationship will exist where the person requesting the work to be performed maintains the right to control¹²³ and directs the individual hired, not only as to the result, but also as to the means by which the service must be accomplished.¹²⁴ The requisite

Frequently Asked Questions, EGG DONOR SELECT, <http://www.eggdonorselect.com/donor/faq.aspx> (last visited Oct. 8, 2010) (“[Egg] [d]onors will receive a Form 1099 from Egg Donor Select.”).

118. Federal Insurance Contributions Act, I.R.C. §§ 3101–3128 (2006); *see also* Robert W. Wood, *Independent Contractor vs. Employee and Blackwater*, 70 MONT. L. REV. 95, 97 (2009). These burdens, coupled with the significant financial stakes involved, and increasing Congressional concern about the loss of tax revenue due to misclassification, have combined to bring recent attention to the self-employment/employee classification issue.

119. Above the line deductions are those taken from gross income to arrive at adjusted gross income. See generally I.R.C. § 62 (defining adjusted gross income), DANIEL Q. POSIN & DONALD T. TOBIN, *PRINCIPLES OF FEDERAL INCOME TAXATION 2* (7th ed. 2005) (discussing relationship between adjusted gross income and above the line deductions).

120. Jeffrey H. Kahn, *Beyond the Little Dutch Boy: An Argument for Structural Change in Tax Deduction Classification*, 80 WASH. L. REV. 1, 20–21 (2005) (discussing the differing tax treatment for the same expense when a taxpayer is an independent contractor instead of an employee). Adding insult to injury, these deductions can be lost altogether if the taxpayer is subject to the Alternative Minimum Tax. *Id.*

121. For example, nurses have been held to be employees in some circumstances, but independent contractors in others. *Compare* Rev. Rul. 57-300, 1957-2 C.B. 632 (holding nurses were employees for federal income tax purposes), *with* Rev. Rul. 61-196, 1961-2 C.B. 155 (holding nurses were not employees, but independent contractors).

122. Wood, *supra* note 118, at 96–97 (noting that “[t]he distinction between independent contractors and employees may seem self-evident” but that “the line between employee and independent contractor is . . . subtle” and “[d]isputes over classification are common”).

123. The IRS has made it clear that it is not necessary for the purported employer to actually direct or control the manner in which the services are to be performed, but rather that the purported employer has the right to do so. In addition, “if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor.” Treas. Reg. § 31.3121(d)–1(c)(2) (1980).

124. Rev. Rul. 87-41, 1987-1 C.B. 298.

control boils down to three basic areas of inquiry: control over behavior; control over finances; and the relationship of the parties.¹²⁵ Within these three areas, the IRS looks at the totality of the circumstances to determine whether an employer-employee relationship exists.¹²⁶ If an employer-employee relationship does not exist, then the service provider is an independent contractor.

The more control the employer has, the more likely the surrogate will be deemed an employee.¹²⁷ Given the incredible detail provided in many surrogacy contracts, the control the intended parents exercise over the surrogate's behavior suggests that the surrogate is an employee.¹²⁸ For example, contracts specify what foods a surrogate can eat (or must forgo),¹²⁹ and require particular medical visits with specialized physicians on a determined schedule.¹³⁰ Similarly, services that must be performed primarily by the person hired suggest a high degree of control and, therefore, an employee-employer relationship.¹³¹ Intended parents are quite particular as to who they hire to be a surrogate, and expect that woman to gestate their child. Surrogacy is intimate and intensely personal, and it goes without saying that the surrogate could not subcontract the work. In addition, intended parents have control over finances. Although surrogates typically are not paid on an hourly basis, but in a lump sum or in several installments (cutting for independent contractor status),¹³² almost all expenses are reimbursed (cutting toward employee status).¹³³

125. The three areas of inquiry stem from twenty common law factors, the importance of which depends on the facts of the particular case. *See* *United States v. Silk*, 331 U.S. 704, 714 n.8 (1947) (listing factors); *id.* at 720 (Rutledge, J., concurring) (describing the “common law control test”); *Independent Contractor*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/businesses/small/article/0,,id=179115,00.html> (last updated May 19, 2010) (noting the three basic areas of inquiry).

126. *Avis Rent a Car System, Inc. v. United States*, 503 F.2d 423, 430 (2d Cir. 1974); Treas. Reg. § 31.3121(d)-1(c)(3) (“Whether the relationship of employer and employee exists under the usual common law rules will in doubtful cases be determined upon an examination of the particular facts of each case.”).

127. *Leavell v. Comm’r*, 104 T.C. 140, 149 (1995) (noting the importance of the right to control).

128. *E.g.*, *Hodgkinson v. Comm’r*, 27 T.C.M. (CCH) 865, 866 (1968) (holding that babysitter was employee where parents provided specific instructions for the care of the children).

129. *See, e.g.*, *Allaboutsurgacy GSA*, *supra* note 24 (“Surrogate agrees to refrain from: . . . [i]ngesting medicinal herbs, saccharine or other artificial sweeteners.”).

130. *E.g.*, *Debele GCA*, *supra* note 39.

131. *United States v. Porter*, 569 F. Supp. 2d 862, 869–70 (S.D. Iowa 2008) (“If the Services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results.”) (quoting Rev. Rul. 87-41, 1987-1 C.B. 296).

132. *See, e.g.*, *Surromomsonline GSC*, *supra* note 21 (“Genetic Parents agree to pay Embryo

The final area of inquiry in determining whether a surrogate is an employee is the relationship between the surrogate and the intended parents. According to the IRS, this inquiry considers whether there are written contracts or employee-type benefits—such as insurance or vacation pay—as well as the duration of the relationship.¹³⁴ The relationship between surrogate and intended parents is highly formalized in most instances, which suggests an employment relationship.¹³⁵ Although there is no vacation or sick time, surrogacy contracts often do provide for health insurance to be paid by the intended parents, and the intended parents often provide term life insurance for the surrogate.¹³⁶ These are factors that favor employee status. On the other hand, few surrogates have ongoing relationships with intended parents. That is, once the surrogacy is complete, the relationship terminates. The finite nature of the relationship favors independent contractor status.¹³⁷

Ultimately, whether a surrogate is an employee or independent contractor is a question of fact that will be determined on a case-by-case basis.¹³⁸ Although some surrogacy contracts explicitly refer to the surrogate as an “independent contractor,”¹³⁹ other contracts are silent about the surrogate’s status, and no contract we have reviewed refers to a surrogate as an employee. Although intuitively, as pointed out in the preceding paragraph, surrogates might seem more like independent

Carrier as compensation for services provided the sum of \$ _____. The compensation shall be paid in 10 equal monthly installments, the first being paid after the pregnancy is confirmed.”); Debele GCA, *supra* note 21 (“The [intended parents] agree to pay [surrogate] the sum of \$ _____ as and for the risks she is undertaking by becoming the gestational carrier to a child for [intended parents]. This sum shall be paid in the following installments . . .”).

133. *See, e.g.*, Surrogacy911 GSC, *supra* note 23; Allaboutsurgacy GSC, *supra* note 21; *see also Porter*, 569 F. Supp. 2d at 874 (explaining that reimbursement of expenses favors a finding of employee status).

134. *Independent Contractor (Self-Employed) or Employee?*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html> (last visited Oct. 30, 2010).

135. *Id.* (noting more formal relationship leans toward employee status).

136. Allaboutsurgacy GSA, *supra* note 21. (“Genetic father shall pay the cost of a term life insurance policy on Surrogate’s life payable to a beneficiary named by Surrogate . . .”).

137. INTERNAL REVENUE SERVICE, *supra* note 125.

138. *Azad v. United States*, 388 F.2d 74, 76 (8th Cir. 1968); *Matthews v. Comm’r*, 92 T.C. 351, 360 (1989); *see also Wood*, *supra* note 118, at 97 (“The process of attempting to classify a worker involves few bright-line tests. In large part, determining whether a worker is an employee or an independent contractor involves a subjective analysis, even though the criteria may appear objective.”).

139. *See Reproassistinc SSA*, *supra* note 62 (“Surrogate specifically states that she has been engaged as an independent contractor of [Reproductive Assistance Inc.]; and that at no time shall she be treated or considered as one of RAI’s employees.”).

contractors than employees,¹⁴⁰ based on the contracts we have reviewed, several factors favor employee status. In any case, simply terming the surrogate an independent contractor in the contract will not settle the question.¹⁴¹ Instead, due to the factually intensive analysis required under the Code, it is impossible to predict definitively whether the IRS will consider a surrogate to be an independent contractor or employee. Some surrogates might qualify as employees, and some as independent contractors, but the determination cannot be made without intimate knowledge of the relationship between intended parents and surrogates. This determination is imperative to make clear who is responsible for the payment of employment taxes. Failure to do so not only risks penalties, but an unpleasant (and expensive) run-in with the IRS.¹⁴²

B. As Professionals, Surrogates Should Consider a Variety of Tax Benefits

In addition to making sure that surrogacy payments are reported as income, surrogates, intended parents, and agencies would be wise to consider credits and deductions that can reduce their combined tax obligations, such as the Earned Income Tax Credit and deductions for ordinary and necessary business expenses.

140. Lisa Milot, *What Are We—Laborers, Factories or Spare Parts? The Tax Treatment of the Transfer of Human Body Materials* 33 (University of Georgia School of Law Legal Research Paper Series, Paper No. 09-015, 2009), available at <http://ssrn.com/abstract=1480355> (“[I]n at least most instances the surrogate mother will not be an employee of the clinic or individual employing her . . .”).

141. See, e.g., *Vizcaino v. Microsoft*, 120 F.3d 1006, 1012 (9th Cir. 1997) (concerning a group of workers Microsoft classified contractually as “independent contractors” who sued to gain access to Microsoft’s savings and stock purchase plans; in previous years, the IRS had reclassified such workers as employees, and Microsoft was required to pay withholding taxes and the employer’s portion of FICA); Rev. Rul. 56-440, 1982-2 C.B. 685; see also Wood, *supra* note 118, at 117–18 (“Some employers are startled to learn that a written contract with an independent contractor that clearly identifies the worker as an ‘independent contractor’ may not be respected by the courts.”).

142. The failure to report income also leaves the surrogate without “credit” for her contributions, which can result in detrimental economic consequences when the surrogate wants to retire. See, e.g., Mary E. Becker, *Obscuring the Struggle: Sex Discrimination, Social Security, and Stone, Seidman, Sunstein & Tushnet’s Constitutional Law*, 89 COLUM. L. REV. 264, 277 (1989) (noting that because women live longer than men, and because “public and private income-support systems for the elderly afford much better protection for men than for women[,] . . . social security is especially important for women”).

1. *Some Surrogates Are Eligible for the Earned Income Tax Credit*

Lower income surrogates could qualify for the Earned Income Tax Credit (EITC).¹⁴³ The EITC is a refundable credit for taxpayers who work and have low wages.¹⁴⁴ A “refundable” credit means that the government actually pays money to those taxpayers qualifying for the credit if those taxpayers do not have positive tax liability.¹⁴⁵ The amount can be significant—up to almost \$5000. To qualify, however, the surrogate must have “earned income”¹⁴⁶ and report that income to the IRS. Surrogacy payments would qualify as earned income, if reported. Therefore, the EITC provides an incentive for some surrogates to report surrogacy payments.

It is also the case that the receipt of the additional taxable income could phase some surrogates out of eligibility for the credit.¹⁴⁷ It is imperative that surrogates understand the full import of the receipt of the taxable income from surrogacy services when negotiating their contracts. Surrogates whose EITC eligibility will phase out might negotiate additional compensation to make up for that decreased eligibility.

2. *Surrogates Are Professionals Who May Deduct Business Expenses Under Various Code Provisions*

Taxpayers can also reduce their tax obligations¹⁴⁸ through deductions.¹⁴⁹ Deductions for business expenses are more valuable than

143. I.R.C. § 32 (2006).

144. See *Earned Income Tax Credit (EITC) Questions and Answers*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/individuals/article/0,,id=96466,00.html> (last updated Mar. 15, 2010). The credit is available to taxpayers whose AGI and earned income are under certain thresholds. For example, for taxpayers with two qualifying children, the threshold is \$40,363 (or \$45,373 for married couples filing jointly) in 2010. Rev. Proc. 2009-50 § 3.06, 2009-45 I.R.B. 617, 622. Taxpayers must also have investment income of \$3100 or less for the year. *Id.*

145. WEST’S TAX LAW DICTIONARY § 867 (2008).

146. Taxable earned income includes wages, salaries, and tips, as well as net earnings from self-employment. See *What Is Earned Income*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/individuals/article/0,,id=176508,00.html> (last updated Mar. 23, 2010). Not included in “earned income” are interest and dividends; pensions; social security; unemployment benefits; and alimony. *Id.*

147. Dorothy A. Brown, *The Tax Treatment of Children: Separate but Unequal*, 54 EMORY L.J. 755, 836 (2005) (“The phase-out range is where the taxpayer’s earned income increases and the taxpayer’s EITC begins to decrease and is eventually reduced to zero.”).

148. Tax liability is determined as a percentage of “taxable income,” which in turn is determined via “adjusted gross income.” Deductions reduce adjusted gross income, and therefore reduce tax liability. See generally I.R.C. §§ 1, 62, 63, 67 (2006).

deductions for personal expenses,¹⁵⁰ which, as a rule, are not deductible.¹⁵¹ As such, a savvy surrogate—one who recognizes that she is a professional in a for-profit industry—should consider closely which of the expenses she incurs as part of her surrogacy can be deducted as business expenses.

The majority of business expenses are deducted under two key Code provisions. Section 162 permits taxpayers to deduct “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.”¹⁵² Similarly, § 212 permits a deduction for those same sorts of expenses when they are incurred for the production of income, as opposed to in an active trade or business.¹⁵³ This statutory language imposes two specific requirements relevant to surrogates. For a surrogate to take a business deduction, she must show that: (1) her expenses are incurred for the production of income or in conducting a trade or business and (2) the expenses are ordinary and necessary. We argue that a surrogate will be able to meet both of these requirements.¹⁵⁴ In addition to the statutory requirements, personal expenses are not deductible. However, as discussed below, in the case of surrogacy expenses that look quintessentially personal, such as medical expenses, will be deductible as business expenses.

149. Unlike income, which is broadly construed, deductions are construed narrowly, and the burden of establishing a deduction is on the taxpayer. *E.g.*, *INDOPCO, Inc. v. Comm’r*, 503 U.S. 79, 84 (1992) (noting the “‘familiar rule’ that ‘an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer.’”) (quoting *Interstate Transit Lines v. Comm’r*, 319 U.S. 590, 593 (1943)); *accord* *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) (noting that deductions “depend[] upon legislative grace” and are allowed “only as there is clear provision therefor”).

150. This is because deductions for business expenses are “above the line,” while deductions for personal expenses are “below the line.” *See* I.R.C. § 62. Many deductions for personal expenses are subject to other limitations. *E.g.*, *id.* § 213 (limiting deductions for medical expenses to those expenses exceeding 7.5% of AGI). Furthermore, expenses for earning income, so-called “business deductions” are generously allowed. MARVIN A. CHIRELSTEIN, *FEDERAL INCOME TAXATION* 104 (11th ed. 2009) (noting the “breadth and generality” of § 162(a)).

151. I.R.C. § 262 (disallowing any deduction for “personal, living, or family expenses”). That rule, however, is one that is proven in spades by its exceptions. Congress has frequently chosen to cross the “business/personal line” by expressly authorizing deductions for expenses that appear purely personal. *See, e.g.*, I.R.C. § 170(a)(1) (permitting charitable deductions); §163(h)(2)(D) (permitting deductions on home mortgage interest); §213(a) (permitting deductions for medical expenses).

152. I.R.C. § 162.

153. *Id.* § 212.

154. To claim a deduction, a taxpayer must also show that his or her expense is not capital in nature, that it is paid or incurred in the taxable year, and that the taxpayer is “carrying on” the trade or business. Those requirements are easily satisfied, and not at issue here.

a. *Surrogacy Is a “Trade or Business” Under the Code*

To deduct business expenses under § 162, the taxpayer must be engaged in a “trade or business.” ART is big business, and there is little doubt that the physicians and attorneys involved in the ART industry are engaged in a “trade or business.” On the other hand, pregnancy and child bearing are traditionally viewed as inherently and pervasively personal. Despite this history, when the pregnancy and child bearing occurs in the context of surrogacy, pregnancy is not personal. Instead, surrogates are in the ART business just like the physicians and attorneys in the industry.¹⁵⁵ Surrogacy is a tedious, potentially dangerous profession, requiring daily attention and effort. Surrogates, no less than the other service professionals with whom intended parents work, provide a critical service.¹⁵⁶ Because surrogates are members of the team of ART professionals who help couples create families, the IRS should classify them as in the “trade or business” of providing services to intended parents.

The IRS will determine whether surrogates are engaged in a “trade or business” by applying the “trade or business” test articulated by the Supreme Court.¹⁵⁷ The Court instructs that we look to the totality of the circumstances to determine whether an income-producing activity is a trade or business.¹⁵⁸ If the activity is carried on “full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby” the activity will be a “trade or business.”¹⁵⁹ Because the inquiry is one that looks to all the circumstances, other factors are sometimes considered, such as whether the activity requires extensive

155. This is so regardless of the outcome of the independent contractor/employee inquiry discussed *supra* notes 116–142 and accompanying text, because taxpayers can be in the trade or business of being employees. *Primuth v. Comm’r*, 54 T.C. 374, 377 (1970) (employees are in the trade or business of being employees). Note, however, that employees may deduct unreimbursed trade or business expenses only as miscellaneous itemized expenses. Therefore, expenses may be deducted only to the extent they exceed 2% of the taxpayer’s AGI, and taxpayers who do not itemize are denied the benefit of the deduction. I.R.C. § 67.

156. Indeed, there are many ART physicians, but gestational surrogates are fewer and farther between.

157. *Comm’r v. Groetzinger*, 480 U.S. 23, 27 (1987). Although the Court has articulated factors, Congress has never defined “trade or business.” *Id.* (lamenting that “the Code has never contained a definition of the words ‘trade or business’ for general application, and no regulation has been issued expounding its meaning for all purposes”).

158. *Id.* at 36 (noting that resolution of the “trade or business” inquiry “requires an examination of the facts in each case”) (citing *Higgins v. Comm’r*, 312 U.S. 212, 217 (1941)).

159. *Id.* (holding that taxpayer who wagered on dog racing was involved in a trade or business, not a mere hobby).

activity over a substantial period of time, and whether the activity has components of personal pleasure or recreation.¹⁶⁰

Application of these factors leads to the conclusion that surrogates are in a “trade or business” for tax purposes. The business of gestating is a full time activity—surrogacy requires daily attention to overall health, including diet; most surrogates must self-administer daily hormone injections prior to implantation; and all surrogates attend frequent medical visits both prior to pregnancy, and once pregnancy is achieved.¹⁶¹ It cannot be fairly called a hobby,¹⁶² and the monetary transfer from intended parents to the surrogate evidences a good faith intention of making a profit. Furthermore, it is inconsequential whether the surrogate has a “day job” because individuals may be involved in more than one trade or business.¹⁶³

Unlike in the gift analysis, however, surrogates’ attitudes toward their roles complicate the “trade or business” analysis. A critical factor in the “trade or business” determination is the taxpayer’s motivation—that is, to be in a trade or business, the taxpayer’s primary motivation must be to make a profit.¹⁶⁴ The test focuses on the subjective intent of the taxpayer, but objective facts matter more than a “mere statement” of taxpayer intent.¹⁶⁵ Surrogates almost universally claim that money is not their prime motivation and suggest that they feel guilty about accepting payment.¹⁶⁶ These statements are ubiquitous, and at first glance, undermine a trade or business determination.

160. *Id.* at 30.

161. *Green v. Comm’r*, 74 T.C. 1229, 1235 (1980) (holding taxpayer to be in the trade or business of selling plasma, and reasoning that her “daily attention to her special diet” and frequent trips to the extracting laboratory supported that finding).

162. *Nickerson v. Comm’r*, 700 F.2d 402, 407 (7th Cir. 1983) (noting that taxpayer’s primary goal in owning dairy farm was profit, and reasoning that “petitioner may have chosen farming over some other career because of fond memories of his youth does not preclude a bona fide profit motive”). Much of the skepticism of business expenses stems from individuals attempting to subsidize sporting or recreational activities by disingenuously claiming the expenses as business expenses. *See, e.g., Imbesi v. Comm’r*, 361 F.2d 640, 645 (3d Cir. 1966) (“Where the activity is . . . of a sporting or recreational nature, then indeed, if he incurs losses in it, the question of motive becomes acute. The taxpayer is required to demonstrate that the appearance of a pleasure-seeking motive is misleading and that instead the motive for the activity was profit making.”).

163. *Snyder v. United States*, 674 F.2d 1359, 1363 (10th Cir. 1982) (citing *Wiles v. United States*, 312 F.2d 574, 576 (10th Cir. 1962)).

164. *See Comm’r v. Groetzing*, 480 U.S. 23, 35–36 (1987); *see also Snyder*, 674 F.2d at 1364–65 (remanding for additional fact-finding on taxpayer’s primary motivation).

165. *Wesley v. Comm’r*, 93 T.C.M. (CCH) 1062, 1063 (2007) (citations omitted).

166. *Ciccarelli & Beckman*, *supra* note 29, at 30; *Edelmann*, *supra* note 31, at 128; *Kanefield*, *supra* note 29, at 10. Though surrogates also note that they plan to “put the money to good use.” *Id.*

Despite their pervasiveness, however, such statements do not tell the whole story. Researchers persuasively contend that surrogates' tendency to report altruistic motivations reflects society's unease with paying surrogates more than it reflects the surrogates' reality.¹⁶⁷ In fact, open disclosure of a financial motive can preclude a woman from being accepted as a surrogate in the first place.¹⁶⁸ It is reasonable to consider the impact of societal skepticism of surrogacy on how surrogates characterize their work, because the "trade or business" determination is a broad inquiry that takes into account all the facts and circumstances.¹⁶⁹ The gift rhetoric is overcome by the reality of the transaction the surrogate enters. Specifically, almost every surrogate accepts payment, and concedes that in addition to her altruistic motivations, there are also financial incentives.¹⁷⁰ Indeed, altruism and profit seeking are not mutually exclusive.¹⁷¹ Surrogates can, and in fact many do, view surrogacy as both a job and a gift. This phenomenon is not unique to surrogates. Clergy, social workers, and legal aid attorneys are just a sampling of other professionals who are readily accepted as engaging in a trade or business, but who view their jobs as callings that have a strong gift component.

Even if a court determined that a surrogate was not in a "trade or business," she would still be able to deduct her expenses pursuant to § 212, because the expenses are incurred for the production of income.¹⁷² Section 212 permits taxpayers to deduct the ordinary and necessary

167. Hal V. Levine, *Gestational Surrogacy: Nature and Culture in Kinship*, 42 *ETHNOLOGY* 173, 181–82 (2003) ("The emphasis on the gift of life allows surrogates to transcend the base notion that they are prostituting their maternity.").

168. Drabiak et al., *supra* note 17, at 305 ("Unlike other circumstances of professional recognition where value of the profession is measured by currency and regulated by market functions, categorization of surrogacy as altruistic . . . may reduce surrogates' ability to negotiate their terms, since open disclosure of financial motivations may be viewed as socially unacceptable.").

169. *Groetzing*, 480 U.S. at 36.

170. Drabiak et al., *supra* note 5, at 303–04 ("Despite the fact that nearly all commercial surrogacy arrangements involved compensation, studies in which surrogates have been asked about their motivations find that most reject money as motivation for their participation. Even if financial motivation is a factor, only a handful of women mention money as their primary motivation for entering into an agreement." (internal citations omitted)).

171. Kanefield, *supra* note 29. When agencies have attempted to recruit unpaid surrogates, they have failed. Noel Keane was reportedly the first person to offer payment for gestational surrogacy. Keane, a Michigan attorney, learned that state law prohibited baby selling. Keane stopped offering payment "offering potential surrogates the chance to give the gift of life without any financial compensation." Under this business model, Keane was unable to attract enough surrogates to meet the demand. Keane moved his business to Florida. SPAR, *supra* note 52, at 75–76.

172. I.R.C. § 212 (2006).

expenses paid or incurred during the taxable year when those expenses are incurred for the production or collection of income.¹⁷³ Section 212 imposes the exact requirements as § 162, except the “production or collection of income” standard is substituted for the “trade or business” requirement.¹⁷⁴ Despite the similarity, deductions under § 212 are less preferable, because § 212 deductions are below the line; that is, they are deductible only as itemized expenses and only to the extent that those expenses, in the aggregate, exceed 2% of the taxpayer’s adjusted gross income.¹⁷⁵ As already discussed, in addition to the surrogate’s altruistic motivations, she is also in the surrogacy business to make money; therefore she could deduct her expenses under § 212.¹⁷⁶

b. Surrogates’ Expenses Are “Ordinary and Necessary”

In addition to satisfying the “trade or business” requirement, a surrogate’s expenses must also be “ordinary and necessary” to be deductible under §§ 162 or 212.¹⁷⁷ Typically, this requirement is relatively easy to satisfy, and courts and the IRS tend to defer to taxpayers’ business judgment.¹⁷⁸ Often, businesses establish that a particular expense is “ordinary and necessary” simply by pointing out

173. *Id.*

174. In *Higgins v. Commissioner*, 312 U.S. 212 (1941), the Supreme Court held that salaries and other expenses incident to looking after one’s own investments in bonds and stocks were not deductible as expenses paid or incurred in carrying on a trade or business. Congress responded to *Higgins* by adding Section 212, which permits deductions for the ordinary and necessary expenses paid or incurred for the production or collection of income. 68A Stat. 69 (codified as amended at I.R.C. § 212 (2006)). *E.g.*, *Cameron v. Comm’r*, 94 T.C.M. (CCH) 245, 247 (2007) (noting that for a “taxpayer to be a trader, the trading activity must be substantial, which means frequent, regular, and continuous enough to constitute a trade or business as opposed to sporadic trading”) (internal citations omitted).

175. I.R.C. §§ 62 (providing that only trade or business expenses are above the line), 67 (imposing 2% limit).

176. This distinction between sections 162 and 212 has been criticized as largely a historical anomaly that produces illogical results. *See* F. Ladson Boyle, *What Is a Trade or Business?*, 39 TAX LAW. 737, 739 (1986) (noting “illogical results” and providing examples of inconsistencies, such as a consultant “who actually performs no services has been held to be in a trade or business [but] a nonprofessional fiduciary has been held not to be engaged in a trade or business” and “a passive real estate owner is generally in a trade or business, but not a securities investor who has extensive holdings that require full-time attention, including offices and staff”) (internal citations omitted).

177. I.R.C. §§ 162, 212.

178. Robert B. Lachenauer, Note, *Campbell v. Commissioner: The Availability of Business Expense or Loss Deductions for Insured Contingencies*, 30 WM. & MARY L. REV. 433, 450 (1989) (“Deference to business judgment is one of the policies underlying section 162.” (citing *Welch v. Helvering*, 290 U.S. 111, 113 (1933))).

that the expense is customary in their line of business.¹⁷⁹ Surrogates, however, like other businesspeople in novel trades, may have a hard time pointing to what is “customary” in their business.¹⁸⁰ Luckily for surrogates, although the business of pregnancy is unique, the experience of pregnancy is not, and expenses associated with pregnancy are well established. For example, it is well accepted, probably even by Tax Court judges, that maternity clothes are an established and ordinary expense relating to pregnancy, even if those expenses are normally undertaken in the personal rather than the business context.¹⁸¹ As such, most of a surrogate’s pregnancy-related expenses will meet the “ordinary and necessary” requirement.

c. In Surrogacy, Personal Expenses Are Often Business Expenses

After a surrogate clears the trade or business hurdle and establishes that her expenses are ordinary and necessary, the surrogate must establish that the expense is a business, rather than a personal expense. If the expense is for business, it is deductible under § 162. If the expense is personal, it is not deductible, except under narrow provisions as explicitly authorized in the Code.¹⁸² Section 213, which permits the

179. *Deputy v. DuPont*, 308 U.S. 488, 495 (1940) (“Ordinary has the connotation of normal, usual, or customary.”).

180. Commentators have criticized the potential problems of focusing too narrowly on the frequency of a particular expense in a particular industry. Such an approach has potential to stifle business creativity. BORIS I. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS* ¶ 20.3.2, at 20–47 (1981) (“There is no sound reason to deny a deduction merely because the taxpayer is unusually imaginative or innovative . . .”).

181. The “ordinary” requirement is also used to deny deductions for expenditures that must be capitalized. As a rule, expenditures that provide a benefit beyond the current taxable year must be capitalized, rather than deducted currently. *See* I.R.C. § 263; Gregg D. Polsky & Brant J. Hellwig, *A Tax Question Teed Up by Tiger*, 126 *TAX NOTES* 863, 865 (2010) (noting that there is no universally accepted understanding of the “ordinary” condition, but the “best interpretation . . . found that the purpose of the term ‘ordinary’ is to distinguish between payments that give rise to an immediate deduction and payments that constitute capital expenditures”) (internal citation omitted). Presumably, some maternity clothing might last beyond one year, and might be subject to capitalization. The IRS, however, does not seem to require capitalization in those instances when work-related clothing has been addressed, regardless of whether the clothing item would last longer than a year. *See, e.g.*, A.J. Cook, *Clothes Can Be Tax-Deductible, but at the Discretion of the IRS*, *MEMPHIS BUS. J.*, Nov. 19, 2004, <http://www.bizjournals.com/memphis/stories/2004/11/22/smallb3.html> (discussing permitted current deductions for clothing such as nurses’ uniforms). A highly conservative approach might be to provide in the surrogacy contract that the intended parents will reimburse the surrogate for up to a set dollar amount of maternity clothing, which would then be delivered to the parents after the pregnancy.

182. I.R.C. § 262 (disallowing deduction of personal expenses). *But see, e.g.*, I.R.C. §§ 213 (medical expenses), 163(h) (home mortgage interest).

deduction of medical expenses, is one such narrow provision.¹⁸³ We assert that the majority of a surrogate's expenses are properly deducted as a business expense under § 162. This includes medical expenses, which for other taxpayers might be deductible only under § 213.

In determining whether a particular expense incurred by a surrogate is business or personal, courts likely will apply the "primary purpose" test¹⁸⁴ in which courts "focus on taxpayers' 'real' motivation"¹⁸⁵ for a particular expense. Only if the motivation is primarily business is the expense allowed. Applying the primary purpose test to standard surrogacy expenses results in the deductibility of expenses that for other taxpayers might be quite personal. For example, for most people expenses for travel to medical appointments are non-deductible personal expenses. When the business is the intensely personal one of gestating an infant, however, such expenses that look very personal are actually business expenses.

Two examples of expenses typically considered to be personal are birthing classes and maternity clothing. Under the Code, clothing is usually a nondeductible personal expense, despite the fact that most of us must wear clothing to work.¹⁸⁶ Clothing is a deductible business

183. I.R.C. § 213(a), (d) (permitting a deduction for expenses paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body"). The deduction provided in § 213 is sometimes referred to as a deduction for "extraordinary" medical expenses, because only those expenses that exceed 7.5% of the taxpayer's adjusted gross income are permitted to be deducted. For example, if a taxpayer's adjusted gross income is \$100,000, and the taxpayer has \$15,000 in unreimbursed medical expenses, the taxpayer may deduct only \$7500, which is the amount her medical expenses exceeded 7.5% of her AGI (here, 7.5% of \$100,000 is \$7500).

184. The primary purpose test, first articulated in *Rassenfoss v. Commissioner*, 158 F.2d 764, 767 (7th Cir. 1946), is one of four tests used in the business/personal distinction. See BITTKER & LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶20.2.1 (1999 & Supp. 2010) (noting that "the IRS, the courts, and Congress have vacillated between four main approaches" in "deciding whether to allow expenses along the business-personal borderline"). Another approach is simply to label a particular expense "inherently personal" and disallow the deduction. Yet another approach is illustrated by the historical treatment of the cost of meals and lodging incurred by taxpayers on business trips; it is to permit the deduction of the expenses, but only "if, and to the extent that the expense was increased by the exigencies of the taxpayer's business." *Id.* The allocation approach is used, for example, in permitting deductions for home offices, and for certain "listed property." I.R.C. §§ 280A, 280F.

185. Tsilly Dagan, *Commuting*, 26 VA. TAX REV. 185, 188 (2006) (criticizing the current business/personal analysis generally and in particular the federal income tax treatment of commuting expenses).

186. *E.g.*, *Pevsner v. Comm'r*, 628 F.2d 467, 469 (5th Cir. 1980) (denying deduction for Yves St. Laurent-brand merchandise to manager of an elegant women's clothing store and noting "[t]he generally accepted rule governing the deductibility of clothing expenses is that the cost of clothing is deductible as a business expense only if: (1) the clothing is of a type specifically required as a condition of employment, (2) it is not adaptable to general usage as ordinary clothing, and (3) it is

expense when it is worn exclusively for work-related purposes and is not suitable for everyday wear.¹⁸⁷ For example, military service members are permitted to deduct the cost of their uniforms, so long as they are worn exclusively while on duty.¹⁸⁸ Even though a surrogate's maternity clothes are suitable for daily wear, the unique nature of the surrogate's job requires them to be "on duty" for nine continuous months, and makes strict application of the standard rule onerous. Similarly, a birthing class would almost always be considered a personal expense and not deductible. For a surrogate, however, the sole purpose of attending such a class would be to more readily perform her job-related duties as a surrogate. To a surrogate, the expenses of birthing classes have no element of personal consumption and are readily classified as deductible just as an attorney's continuing legal education expenses are deductible.

Perhaps the most significant business expense surrogates incur that looks personal is the cost of medical care leading up to pregnancy.¹⁸⁹ Achieving pregnancy through IVF, as occurs in gestational surrogacy, is a sizeable medical expense.¹⁹⁰ Infertile couples using IVF outside the surrogacy context may deduct those expenses under § 213,¹⁹¹ and some infertile couples have been permitted to deduct expenses such as agency fees and medical and psychological testing of potential egg donors.¹⁹²

not so worn." (citing *Donnelly v. Comm'r*, 262 F.2d 411, 412 (2d Cir. 1959)).

187. *Id.*

188. *E.g.*, Vance M. Forrester, *Deducting Employee Business Expenses*, 132 MIL. L. REV. 289, 303-04 (1991) (explaining when military service members can deduct the costs of uniforms; in particular, "[a]ctive duty members may deduct the cost and maintenance of military fatigue uniforms if the uniform is required to be worn as part of military duties, and if military regulations prohibit the wearing of the fatigue uniform except while on duty or while traveling to and from work").

189. We limit this discussion to the costs of care leading up to pregnancy, because once pregnancy is achieved, insurance almost always covers medical expenses.

190. Assuming an average of three IVF cycles per successful implantation, pre-pregnancy medical expenses can top \$50,000 because the costs include not just the IVF, but also hormone injections for the surrogate. Jim Hawkins, *Financing Fertility*, 47 HARV. J. ON LEGIS. 115, 115-16 (2010) (noting a single round of IVF costs over \$12,000).

191. There is no binding guidance, but the IRS considers the costs of "Fertility Enhancement" deductible. *See* INTERNAL REVENUE SERV., PUB. 502, MEDICAL AND DENTAL EXPENSES 6 (2009) (providing that taxpayers may include in "medical expenses" "the cost of the following procedures to overcome an inability to have children," including "[p]rocedures such as *in vitro* fertilization (including temporary storage of eggs or sperm)").

192. I.R.S. Priv. Ltr. Rul. 2003-18017 (allowing deduction of numerous expenses incurred by an infertile couple using an egg donor). Recently, another taxpayer was unsuccessful in deducting surrogacy related expenses. *Magdalin v. Comm'r*, 96 T.C.M. (CCH) 491, 493 (2008) (disallowing deduction of surrogacy related expenses to a single, gay male taxpayer because none of the expenses were incurred due to a "medical condition or defect . . . that required treatment or

These expenses are also incurred by couples using gestational surrogates. The deduction, however, is more properly taken by the surrogate pursuant to § 162. When your body is your business, surrogacy-related medical expenses are deductible under § 162 as ordinary and necessary business expenses.¹⁹³ Although § 213 governs medical expenses specifically, while § 162 speaks more generally of business expenses, there is no indication that the more specific provision should forbid application of § 162 in the context of surrogacy.¹⁹⁴ Specifically, there is no indication that § 213, which provides an exception to the provision disallowing deductions for personal or living expenses,¹⁹⁵ was enacted to prevent abuse of § 162 by limiting its application to a particular category of expenses. In fact, when Congress attempts to limit the application of § 162, it does so clearly, as when it imposed limits on business-related entertainment deductions.¹⁹⁶

Furthermore, the origin of the claim doctrine supports deducting IVF expenses pursuant to § 162. The origin of the claim doctrine “holds that a claim’s personal or business character is to be determined by its origin rather than its effects.”¹⁹⁷ In the surrogacy context, there is no pregnancy without IVF, and if there is no pregnancy, there is no business. The source of IVF expenses is doubtless the surrogate’s business, not the surrogate’s personal consumption. This origin of the claim analysis finds its genesis in tax cases in which the disputed expense has both personal and business elements.¹⁹⁸ In the case of surrogacy, application of the

mitigation through IVF procedures”).

193. This proper treatment of the medical expenses yields a tax advantage, because the 7.5% threshold does not apply to § 162 deductions.

194. A standard canon of construction is that the specific trumps the general. *Varity Corp. v. Howe*, 516 U.S. 489, 511 (1996) (acknowledging the canon that “the specific governs over the general” but warning that “[t]o apply a canon properly one must understand its rationale”).

195. There is scant evidence as to congressional intent for the medical expense deduction. *See, e.g., James W. Colliton, The Medical Expense Deduction*, 34 WAYNE L. REV. 1307, 1307 (1988) (noting that “confusion surrounds the nature of the deduction and its basic purposes”).

196. I.R.C. § 274 (imposing additional requirements on the basic requirements of § 162 for travel and entertainment expenses such as limiting the otherwise allowable deduction for meals and entertainment to 50% of the cost).

197. Richard C.E. Beck, *Deductibility of Treble Damages Paid for Breach of National Health Service Corps Scholarship Contracts: The Misuse of IRC 265(a)(1) in Stroud v. United States and of the Origin of the Claim Test in Keane v. Commissioner*, 1 CHARLESTON L. REV. 1, 24 (2006).

198. The Supreme Court applied the test, for example, when the owner of a General Motors dealership unsuccessfully attempted to deduct part of the cost of his divorce by arguing that if he had lost the divorce, he would have lost his dealership. *United States v. Gilmore*, 372 U.S. 39, 44 (1963) (discussing the “origin of the claim” test: “Congress has seen fit to regard an individual as having two personalities [for income tax purposes]: ‘one is [as] a seeker after profit who can deduct the expenses incurred in that search; the other is [as] a creature satisfying his needs as a human and

origin or source of the claim test leads to the deductibility of the expense, but might not even be necessary because the IVF procedure does not have any personal benefit to the surrogate.

Attempting to shoehorn the surrogate's ordinary and necessary business expenses into the § 213 medical expenses deductions is not only unnecessary, but also unwise because of its collateral consequences. In particular, it imposes limits on the deductions a person in the trade or business of surrogacy can take, while not imposing those same limits on individuals choosing other trades or businesses. In other business situations expenses that are sometimes deductible as personal itemized deductions are deductible above the line through § 162 when those same expenses are incurred in connection with a business. For example, property taxes incurred in connection with a trade or business are deductible under § 162, without resort to the specific provision permitting deductions for property taxes provided in § 164.¹⁹⁹

Just as ART physicians and surrogacy attorneys are professionals, the surrogates themselves are professionals in the ART industry. As professionals, surrogates must report their income and pay their taxes. Furthermore, if surrogates are independent contractors, they will have additional remitting and reporting obligations. The news is not all bad, though, as surrogates may qualify for significant tax benefits under the Code such as the Earned Income Tax Credit and almost all surrogates will have significant surrogacy-related business expenses that should be deductible under § 162.

CONCLUSION

Choosing to be a surrogate is a deeply personal decision. This fact, however, does not preclude surrogacy from being a business or surrogates from being business professionals who must pay taxes. Surrogacy is a highly specialized industry in which women are carefully screened and selected to be surrogates. Once chosen, these women enter into lengthy, complex contracts in which they agree in intricate and intimate detail how they will provide their service. In addition,

those of his family but who cannot deduct such consumption and related expenditures.” (quoting SURREY & WARREN, CASES ON FEDERAL INCOME TAXATION 272 (1960)).

199. Keith E. Engel, *Deducting Interest on Federal Income Tax Underpayments: A Roadmap Through a 50-Year Quagmire*, 16 VA. TAX REV. 237, 276 (1996) (noting that the Tax Court recognizes the deductibility of state income taxes under Section 162). This rule is long-standing. See Note, *Accrual of Tax Deficiencies and Recoveries*, 58 COLUM. L. REV. 372, 372 n.7 (1958) (noting that taxpayers may deduct real estate and other taxes under § 162 to the extent that they are trade or business expenses, or may use § 212 if the expenses are incurred in the production of income).

surrogates negotiate significant compensation, ranging from \$20,000 to over \$120,000 for their personal services.

Unfortunately, society, surrogacy agencies, and even surrogates themselves fail to recognize the true import and value of their services. Despite the fact that the multi-million dollar surrogacy industry would screech to a halt if not for the surrogates, surrogates are rarely seen as legitimate professionals in the industry. Surrogacy contracts, along with information available to surrogates on the internet, attempt to exclude from income the compensation surrogates receive for their services. A surrogate's base pay, however, is almost certainly income under the Internal Revenue Code.²⁰⁰ It is not a gift, is not excluded from income meant to compensate for "pain and suffering," and is not excludable as "pre-birth child support" or as reimbursement for expenses. Instead, surrogates are engaged in the trade or business of surrogacy and must report their income.

By recognizing surrogates as professionals, surrogates are able to deduct any ordinary and necessary business expenses associated with surrogacy as business expenses. This includes such typically personal expenses as maternity clothes and medical expenses related to the surrogacy. Moreover, surrogates, agencies, and intended parents must conclusively determine whether an individual surrogate is an employee or independent contractor so that they know exactly who is responsible for reporting the income and paying the taxes. Only then will society, the surrogacy industry, and surrogates themselves fully recognize that, for surrogates, their body is their business.

200. Each surrogate has a unique relationship with the intended parent. For this reason, in some instances the surrogate will not have income if, for example, the surrogate is the relative or close friend of the intended parents.