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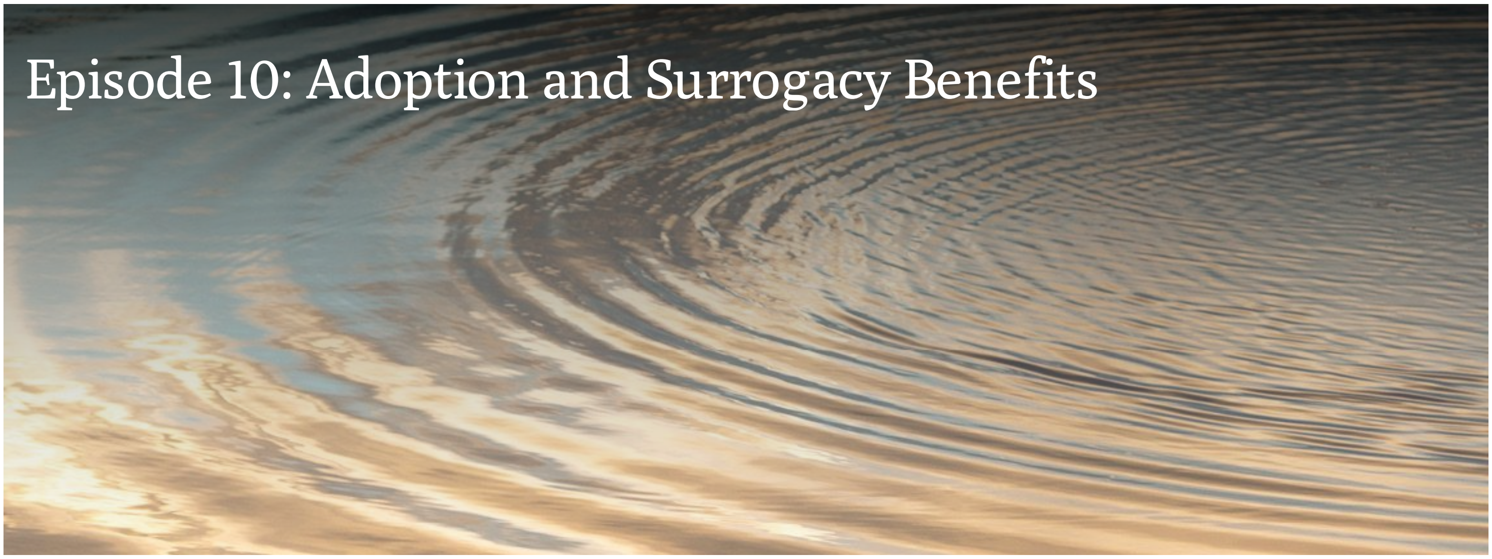
Episode 10: Adoption and Surrogacy Benefits



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Susan Nash: Welcome to Winston's Benefits Blast Podcast, where we explore innovative ideas and trends in employee benefits and executive compensation. I'm Susan Nash and I'm joined today by Jess Diedrich. During this episode, we'll be talking about adoption and surrogacy benefits and how these innovative programs are being offered by employers. It's important to note that the policies and tax rules we're talking about today are with respect to employer-provided benefits. Other rules might apply if you're thinking of adopting or entering into a surrogacy arrangement on your own.

Jess Diedrich: Thanks, Susan. I know a lot of employers these days offer adoption reimbursement programs, and we'll walk through the features of those programs a little bit later. But first, can we talk about surrogacy and why some employers are adding surrogacy reimbursement programs to their benefit offerings?

Susan Nash: Sure, Jess. Surrogacy is where a woman, called the surrogate or the gestational carrier, becomes pregnant and gives birth to a baby in order to give it to someone who cannot have children. There are generally two types of surrogacy, depending on the source of the genetic material. It can either be provided by the surrogate mother herself, called a traditional surrogacy, or the intended parents called a gestational surrogacy. Surrogacy allows the intended parents, who are otherwise incapable of having a child and may wish to, have the genetic linkage that isn't provided when there's an adoption. In most cases, the surrogate is not genetically related to the child, which is known as gestational surrogacy, and that's primarily the one we'll be talking about today.

Susan Nash: In order for a gestational surrogate to carry another person's child, she must undergo in vitro fertilization, which requires multiple hormone injections, eggs derived from the intended mother or donor fertilized outside of the surrogate's body and sperm from the intended father or donor. The embryo is then transferred into the surrogate's uterus. As we know, conventional fertility benefits offered under an employer's medical plan usually covers IVF treatment, including fertility medications and in some cases also egg, freezing and other means of fertility preservation. But currently, there's no benefit for surrogacy under most employer-sponsored plans, and employees may need a surrogate in order to bear a child.

Susan Nash: For example, we see this frequently with same-sex male couples who require a gestational surrogate to have a child, which may be biologically related to one of the partners. We also see this in cases of opposite-sex couples who need a surrogate for a number of different reasons, where it makes it unsafe or impossible for a woman to carry a child.

Jess Diedrich: Can you go through some of the differences between surrogacy and adoption?

Susan Nash: Sure. In adoption, which is more widely available in the United States (and as we'll discuss later, there are tax-favored laws for adoption) the potential parents are called adoptive parents. In surrogacy, the potential parents are called the intended parents. Adoption usually involves bringing a child into your family who's not biologically related to you - not in all cases, but in some cases. Whereas in surrogacy, the woman usually becomes pregnant through IVF using the intended parents' sperm and egg or the sperm and egg of a donor. The intended parents usually have a legally binding contract with the surrogate that they enter into pre-birth, whereas adoptions don't usually become final until sometime after the child is placed with the family. The legal process also varies for surrogacy and adoption. In adoption, the birth parents have to execute a written consent and their legal rights are terminated with respect to the child. Whereas in surrogacy, legal contracts are usually signed ahead of the birth, which sets forth the intended parents as the baby's legal parents. And as we'll discuss later, surrogacy is not legal in all 50 states.

Jess Diedrich: Interesting. Why do you think employers are offering reimbursement for surrogacy and adoption expenses for their employees?

Susan Nash: Well, there's a few different reasons that our clients have been telling us why they're doing this. Historically, surrogacy benefits were pretty rare, but it is becoming more common. According to the Society for Human Resources Management, employer-provided benefits for surrogacy typically take the form of increased paid leave, not reimbursement of expenses. And, only about 5% of employers offer this type of paid leave for intended parents, but it is becoming more common. Also, as I said, surrogacy expense reimbursement programs are also becoming more widely adopted. One of the reasons is we have a very strong competitive labor market right now, and a lot of progressive employer's view this as a way of attracting and retaining their best and brightest employees. They're offering really robust benefit packages with lots of fringe benefits, and one demographic that they want to appeal to are working parents or employees who want to become parents.

Susan Nash: In addition, one big driver in the expansion of surrogacy reimbursement benefits is employers looking at their diversity and inclusion efforts holistically with an eye towards diversity, inclusion, and belonging in all forms of compensation, promotion, leave policies and benefits. So whereas the traditional adoption arrangement may not be the best fit for all employees who want to expand their families, adding the surrogacy expense reimbursement policy can address these other populations. We also see a lot of employers adding benefits such as enhancements to pay leave, backup daycare, egg freezing, and breast milk shipping for traveling moms. We're seeing the surrogacy benefits added to the adoption expense reimbursement policy. Employers just view this as the right thing to do to support their diverse workforce who have a lot of different needs outside of the workplace. We'll talk about the tax issues later and, as you'll see, there are some significant differences between adoption reimbursement and surrogacy reimbursement.

Jess Diedrich: Thanks for providing that background, that's super interesting. How are these benefits typically designed?

Susan Nash: Well, as I mentioned, most employers are adding the surrogacy expense reimbursement to their adoption reimbursement policies. There's usually a cap, either a cap per occurrence or a lifetime dollar limit. One of the first companies to offer surrogacy coverage, for example, was Facebook, which began adding surrogacy benefits in 2014 with a benefit of $20,000. Coverage often includes the cost of the surrogacy, legal fees, and other types of expenses. Other companies have also added this benefit including American Express, AIG, and many universities. We see benefits typically ranging from $10,000 to $35,000. Keep in mind that typical surrogacy costs can range anywhere from $50,000 to $150,000 so this helps a little bit towards that expense. Some of the typical covered expenses that we see in the policies include court costs, legal costs to draft the agreements and attorneys' fees associated with the surrogacy process.

Susan Nash: Sometimes there's an agency involved and they will charge fees. There will be travel expenses for intended parents, the donor, or the gestational carrier that are related to the surrogacy process. You might see egg/sperm donation agency fees associated with the process or fees that are charged by agencies to administer surrogacy occurrences. Screening costs for gestational carriers and egg or sperm donors can also be covered by these policies, as well as egg or sperm retrieval fees, IVF, and medical costs associated with the surrogacy process. Note that if you're covering medical expenses under a surrogacy reimbursement policy, it might implicate some other issues, which we're going to talk about in a minute. And then typically non-reimbursable expenses would include things like any charges that are in violation of federal or state law, childcare costs, whether before or after a child is in the home, and any expenses tied to living costs.

Susan Nash: Some policies do exclude compensation to gestational carriers, which as we'll see is not allowed in some states. And sometimes you'll also see exclusion of voluntary or charitable donations or contributions to surrogacy agencies. And then, of course, the costs of personal items, other meals, supplements, and things like that might not be covered as well.

Jess Diedrich: Let's talk a little about medical expenses and taxes. I know that most employer-sponsored plans reimburse for the cost of covered medical expenses for the employee and also their tax dependents such as a spouse, domestic partner, or child. But can they cover the medical expenses of a surrogate?

Susan Nash: That's a really good question and a very complicated one. If the surrogate is not the employee of the employer, the answer is no. The exclusion under the tax code for employer reimbursement of medical expenses only extends to an employee and his or her tax-qualified dependence. So, any expenses of a surrogate mother who is not an employee, if reimbursed by the employer, would not be excludable from the employee's income. Further, there's no federal tax credit for surrogacy like we have for adoption. Some of these fees may be deductible on an individual's tax return, but it varies depending on the expenses. In some cases, if the intended parents act as the egg and or sperm donor and they're incurring medical expenses of their own, those types of expenses might be covered under an employer-sponsored medical plan, or they may be able to deduct those fees on their own tax returns. What's interesting too is that with respect to the medical plan of the employer of the surrogate, many plans exclude coverage for surrogacy expenses or they're silent on the matter altogether.

Susan Nash: And there has been some litigation over ambiguous plan terms as to whether expenses of a surrogate are covered when the surrogate is actually the insured or the employee of the employer. In many cases, an employer might not know that those pregnancy expenses are related to a surrogacy occurrence, but to the extent that it is discovered they may be excluded. And it also raises some complicated issues under the Pregnancy Discrimination Act, which employers will have to take a look at. I've even seen some insurance policies that attempt to put a lien on any amounts that are paid by an insurance company for medical expenses for a surrogacy occurrence if it turns out later that the surrogate receives compensation for medical expenses reimbursed from another source. So kind of like a third-party reimbursement or subrogation provision.

Jess Diedrich: Interesting. You said earlier that typical surrogacy reimbursement programs exclude the reimbursement of expenses that are not legal under state or federal law. Can you talk a little bit more about that?

Susan Nash: Sure. It's really interesting because there are no federal laws governing surrogacy right now, which means the states have the opportunity to step in and make their own rules. And the surrogacy laws vary from state to state, presenting a really complicated array of different rules and regulations. Surrogacy is not legal in all 50 states as I mentioned earlier, and there's a spectrum of how friendly the states are to surrogacy. For example, California law is very friendly towards surrogacy and there's a whole industry that has developed around surrogacy supporting those services, but it is not legal in the state of New York to compensate someone for being a surrogate. This past summer there was a New York bill that was introduced to legalize paid surrogacy. It passed in the New York Senate, but then it didn't make its way through the Assembly and did not make its way into current law.

Susan Nash: Currently under New York law, paid surrogacy is punishable by a fine and unpaid surrogacy agreements would not be enforceable. There are about 47 states where gestational surrogacy is permitted or the law is silent. But in some cases, as I mentioned, surrogacy is permitted just because there's no prohibition. In other states, surrogacy contracts may not be enforceable unless there's a pre-birth order for the intended parents or other hoops that you have to jump through, such as in Illinois. Only a handful of states, though, permit traditional surrogacy where the surrogate uses her own egg. And, the reason for this is that there can be complications with respect to who's the legal parent in those cases. Employers will have to carefully evaluate the laws in the states where their employees live in order to make sure that they're not reimbursing illegal expenses under their programs.

Jess Diedrich: That seems pretty complicated. Are there any other things that employers should be watching out for?

Susan Nash: Yes. One issue that I always raise with clients is whether the reimbursement of medical expenses under the surrogacy benefit creates an ERISA plan. The reason is that some of these surrogacy policies do reimburse expenses of the employee or the spouse that are not covered under a medical plan. If that is the case, that benefit may become a group health plan subject to ERISA. And if that's offered outside of the medical plan to all employees, it may be treated as a separate ERISA plan, which if not integrated with another type of a medical plan would not comply with requirements of the Affordable Care Act that apply to group health plans. Also, sometimes reimbursement of these expenses outside of the medical plan can cause employees to lose eligibility for making contributions to a Health Savings Account. As you know, under those rules, individuals aren't eligible to contribute to an HSA if they are covered under other disqualifying coverage that would reimburse under the deductible of their high deductible health plan. Fertility related benefits probably wouldn't meet this exception, so it's also advisable to look into the structure of the benefit from that angle as well.

Jess Diedrich: Let's switch gears for a moment and talk about adoption benefits. What are some of the tax benefits of adoption?

Susan Nash: Sure. This actually is an area where there is a tax benefit, as you mentioned, and it's been in the code for quite some time. Tax benefits for adoption include both the tax credit for qualified adoption expenses that are paid to adopt an eligible child that someone can take on their own individual tax return, as well as an exclusion from income for employer-provided adoption assistance. The credit is non-refundable, which means it's limited to your tax liability for the year, but any credit in excess of your tax liability can be carried forward up to five years. In 2019, the maximum amount of credit or employer reimbursement is $14,080 per child, so it's a pretty significant benefit. Employer-provided adoption assistance is excluded from income tax as long as it's provided through a qualified adoption assistance program up to the IRS limits that we just talked about. But, it is not excludable from employment taxes such as Medicare, Social Security and FUTA. So employers have some special reporting requirements with respect to adoption assistance programs.

Jess Diedrich: What are the requirements to be a qualified adoption assistance program?

Susan Nash: Well, first of all, these plans have to be in writing and they have to meet specific requirements under the tax code. They also can't discriminate in favor of highly compensated employees and they have to be written in such a way as to notify employees, who's eligible, what's going to be reimbursed, and what's not going to be reimbursed. And while the surrogacy benefits don't have a defined code section that would provide for their exclusion, a lot of times those expenses will be added to an adoption expense reimbursement policy as a taxable benefit. With respect to qualified adoption expenses for both the credit and the exclusion, those would be things such as reasonable and necessary adoption fees, court costs and attorney's fees, traveling expenses, and other expenses directly related to the adoption.

Susan Nash: Any expense can be qualified, even if it's paid before the child has been adopted. The child does have to be under the age of 18 or mentally or physically incapable of caring for themselves. One thing to note is that qualified adoption expenses don't include expenses that a taxpayer would pay to adopt a child of the taxpayer's spouse. So, you're out on that one. In addition, employer adoption assistance benefits can't be used if the same expenses were claimed as a deduction or a credit on your tax return, so no double-dipping.

Jess Diedrich: Certainly sounds like an employer has a lot of legal and administrative issues to address when looking at adding adoption or surrogacy reimbursement as an employee benefit. Let's talk about our Winston

Takeaways.

Susan Nash: Yes, we've covered a lot of different territory on this short podcast, but certainly, adding adoption and surrogacy benefits is an excellent way for an employer to demonstrate a commitment to diversity and inclusion, and also offering a variety of options to its workforce to address family needs. We didn't talk about pet insurance, but that's another one where you can expand your family as well! It's a highly valued benefit for those employees who need it. And you know, as with any employee benefit plan or policy, the details matter. It's really important for employers to carefully develop their policies with clear guidelines on the amount that's reimbursable, which expenses are reimbursable, which are excluded and then, of course, the complicated tax issues that we've been discussing.

Jess Diedrich: Agreed. I think the second takeaway would be for employers to consider how offering adoption and surrogacy benefits impacts the other benefits being offered. For example, if the surrogacy program reimburses medical expenses, you may need to make sure that the benefit offering is compatible with the Health Savings Account so that you don't inadvertently disqualify employees from making those contributions. It's also important to address the tax and ERISA issues here. And finally, make sure that you align your paid leave policies with any adoption or surrogacy policies that you may implement or adopt.

Susan Nash: Thanks, Jess. Those are really excellent points and thanks to everyone for listening to another edition of Winston's Benefits Blast Podcast. Make sure to stay tuned for future episodes for more insights on the latest legislative, regulatory, and practical developments concerning employee benefits and executive compensation. Also, remember to subscribe to our blog on our website at Winston.com for updates on the latest legal developments in the employee benefits area.

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