THE BODY IN QUESTION: THE INCOME TAX AND HUMAN BODY MATERIALS

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I
INTRODUCTION

The federal income tax treatment of transactions in human body materials—such as eggs, sperm, blood, milk, hair, and kidneys—is a mess. Nothing is firmly settled. Consider, for example, the recent first-impression case of *Perez v. Commissioner*,[1] in which the Tax Court concluded that a paid "donor" of ova had received fully taxable compensation-for-services income (rejecting the taxpayer's claim that the payments qualified under the statutory exclusion from gross income of "damages . . . on account of personal physical injuries"[2]). By contrast, academic commentators writing before *Perez* had thought it fairly obvious that a paid egg donor was the seller of an asset,[3] thus giving rise to at least the possibility of taxation at the favorable rates applicable to long-term capital gain.

Similar confusion reigns in the case of taxpayers who donate their blood to charity. There is support both for the proposition that a blood donor performs a service for the charity[4] (and so is subject to the rule that contributions of services are not deductible[5]), and also for the proposition that a blood donation is a contribution of property (the value of which would be deductible but for the happenstance that blood cells do not live long enough to satisfy the holding period for long-term capital gain).[6] Although the same no-deduction result is

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1. Perez v. Comm'r, 144 T.C. 51 (2015).
2. *Id.* at 58, 63 (quoting I.R.C. § 104(a)(2) (2012)).
3. *See, e.g.*, Bridget J. Crawford, *Our Bodies, Our (Tax) Selves*, 31 VA. TAX REV. 695, 735–41 (2012) (describing analysis of the tax treatment of an egg "donor" on the assumption that the "donation" is a sale of property); Lisa Milot, *What Are We—Laborers, Factories, or Spare Parts? The Tax Treatment of Transfers of Human Body Materials*, 67 WASH. & LEE L. REV. 1053, 1079–80 (2010) (noting that fertility clinics typically claim that they compensate egg donors for their time and effort, not for the eggs themselves, but concluding, "[s]elf-interested statements by the clinics buying the eggs, however, do not change the underlying nature of the transaction for tax purposes"); Jay A. Soled, *The Sale of Donors' Eggs: A Case Study of Why Congress Must Modify the Capital Asset Definition*, 32 U.C. DAVIS L. REV. 919, 923–44 (1999) (viewing the long-term capital gain result as clearly correct under current law, but arguing that the result is inappropriate as a matter of policy and should be changed by legislation).
4. *See, e.g.*, Rev. Rul. 162, 1953-2 C.B. 127.
5. *See, e.g.*, Treas. Reg. § 1.170A-1(g) (as amended in 2008).
6. *See, e.g.*, Lary v. Comm'r, 787 F.2d 1538, 1539–40 (11th Cir. 1986) (questioning the analysis of

reached under either analysis in the case of donated fresh blood—by reason of the § 170(e)(1)(A) denial of a deduction for unrealized appreciation in donated property where the gain upon sale would not have been long-term capital gain—the services-versus-property distinction would be crucial in the case of charitable donations of human body materials (such as hair, a kidney, eggs, or frozen blood) as to which the more-than-one-year holding period requirement is satisfied. Or *is* the holding period requirement satisfied in the case of hair, eggs, and other body materials less ephemeral than blood cells? Just how does one go about determining one's holding period in one's own body materials? There is almost no relevant authority.

And then there is the question—relevant to both sellers and charitable donors of body materials—of a taxpayer's basis in her blood, or eggs, or other body materials. Most commentators conclude that taxpayers have no basis in their body materials,[7] and one court has reached that same conclusion on the facts of a particular case.[8] However, in the rather remarkable case of *United States v. Garber*[9]—an appeal from a criminal conviction of a taxpayer for failing to report large payments received from biopharmaceutical companies for her blood plasma (featuring a rare and valuable antibody)—the Fifth Circuit threw up its collective hands on both the question of whether the defendant had sold her services or her property, and the question of whether her basis in the sold property (if sale of property it was) was zero, the fair market value of the property, or something in between.[10]

The goals of this article are modest. It aims to describe, in some detail, the major controversies concerning the federal income tax consequences of sales and charitable donations of human body materials, and to suggest how those controversies should be resolved by tax administrators and by the courts. The article also touches on issues under the gift, estate, and self-employment taxes, although in much less detail. It makes no claim, however, to having the one true

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Rev. Rul. 162 but concluding that by reason of § 170(e)(1)(A) no deduction would be allowed even if the blood is considered property; the taxpayer had no basis in his blood and had not satisfied the holding period for long-term capital gain); I.R.S. Gen. Couns. Mem. 36,418 (Sept. 15, 1975) [hereinafter GCM 36,418] (criticizing the analysis of Rev. Rul. 162 because it "ignores the fact that today blood is a commodity with a commercial market and value apart from its donor").

7. *See, e.g.*, Note, *Tax Consequences of Transfers of Bodily Parts*, 73 COLUM. L. REV. 842, 855 (1973) (predicting "that the Commissioner and the courts will . . . hold that the entire body has a zero basis"); Note, *The Sale of Human Body Parts*, 72 MICH. L. REV. 1182, 1258 (1974) ("Most likely, the initial cost of a taxpayer's body will be set at zero.").

8. *Lary*, 787 F.2d at 1540 ("Taxpayers have proffered no evidence as to *any* basis in the donated blood. . ."; the court does not, however, rule out the possibility that some other taxpayer might be able to introduce evidence of a basis in blood or other body materials).

9. United States v. Garber, 607 F.2d 92 (5th Cir. 1979).

10. The court concluded that "the tax question was completely novel and unsettled by any clearly relevant precedent," and that a criminal prosecution was "an inappropriate vehicle for pioneering interpretation of tax law." 607 F.2d at 100. Accordingly, the court reversed Ms. Garber's conviction and remanded for a retrial in which Ms. Garber could present evidence of the unsettled state of the law for its bearing on the question of her willfulness. *Id.*

answer to any of the open questions in this area, either in terms of the interpretation of current law or as a matter of legislative reform.

The technical analyses of the various issues arising under the current income tax rules will hopefully be of some interest for their own sakes—both to taxpayers selling or donating body materials and their advisors, as well as to collectors of amusing examples of tax technicalities run amok. In addition, however, the technical discussions set up the question of *why* the application of the income tax to transactions in human body materials is such a morass of uncertainty. At one level, the explanation is fairly obvious. As an early commentator in this area noted more than forty years ago, "[i]nterpretations of any statute to cover unanticipated situations are bound to be a bit strained."[11] As transactions in human body materials become more common we can expect that much of the uncertainty will eventually be resolved either through interpretation—administrative and judicial—or legislation.[12]

More specifically, however, the problem arises because human body transactions expose several of the key structural tensions in the federal income tax. Most significantly, in a number of ways the income tax treats income from property very differently from, and usually more favorably than, income from services. From both technical and policy perspectives, there are few easy answers to questions about whether transactions in human body materials fit better under the property or services rules. Similarly, the favorable rates and charitable deduction rules for long-term capital gains put considerable pressure on determinations of capital asset status and holding period—more pressure than the system can easily cope with, when the question is, say, the capital asset status of ova or the holding period of blood.

Part II of this article provides an overview—accompanied by more than a little authorial commentary—of the development (such as it has been) of the income taxation of transactions in human body materials, from the 1950s to the present. Part III situates the property-versus-services issue with respect to the taxation of body materials in the broader context of the differing income tax treatments of income from property and income from services. After explaining why the tax characterization of body materials resists easy resolution, it concludes that the well-established treatment of taxpayer-created assets as property strongly suggests that body materials should also be treated as property. Part IV explores the questions of capital asset status, holding period, and basis that govern the amount and the character of the gain recognized by a taxpayer on the sale of body materials, on the assumption that the materials are classified as property. Part V considers a miscellany of other issues relating to the income taxation of body materials. Finally, Part VI discusses the possible application of other federal taxes—the gift, estate, and self-employment taxes—to transactions in body materials. Part VII briefly concludes.

11. Note, *Tax Consequences of Transfers of Bodily Parts*, *supra* note 7, at 842.

12. "[I]t is . . . to be expected that as more income is generated by these transactions more attention will be focused on resulting tax consequences." *Id.* at 842.

II
INCOME TAXATION OF TRANSACTIONS IN HUMAN BODY MATERIALS: A HISTORICAL SURVEY

A. Blood And The Income Tax, 1953–1986

The charitable donation of a taxpayer's own blood was the first transaction in a human body component to have its income tax consequences addressed by a judicial opinion or administrative pronouncement. In 1953 the Internal Revenue Service (IRS) issued Revenue Ruling 162, concluding that no deduction was allowable to a blood donor.[13] At the time of the ruling, in the case of any charitable donation of property, the amount of the deduction was the fair market value of the donated property, but in the case of a contribution of services no deduction was allowed.[14] The fair market value rule for property—which survives to this day, but subject to significant limitations that did not exist in 1953[15]—violates the fundamental rule of tax logic that deductions should be limited to basis; to allow a charitable deduction in excess of basis is to treat a taxpayer as having given away that which the taxpayer was never treated as having.[16] By contrast, the no-deduction-for-services rule was (and is[17]) consistent with tax logic. Reading between the lines of the ruling, one suspects that its authors were well aware of the illogic of the property rule and of its inconsistency with the services rule, and that they were determined to give the property rule the narrowest possible scope. Accordingly, the ruling explained:

> [A]llowable deductions are confined to donations of money and of things which are generally thought of as being comprehended by the term "property" as distinguished from the value of services rendered. It has been a long established policy of the Internal Revenue Service not to allow a deduction for the value of services rendered to charitable institutions. . . .
>
> In view of the foregoing, it is held that furnishing blood for a transfusion or to a blood bank is analogous to the rendering of a personal service by a donor rather than a contribution of "property" and the fair market value . . . is not deductible as a charitable contribution . . . .[18]

Two aspects of the ruling are worth noting. First, the taking of a position on the property-versus-services question was necessary only because of the inconsistent tax treatment of donations of property and donations of services. But for the structural defect in the donation-of-property tax regime, the ruling could have denied any deduction even as it accepted (at least for the sake of argument) the property status of blood. Because the first income tax ruling (or

13. Rev. Rul. 162, 1953-2 C.B. 127.

14. *See* Treas. Reg. 111, § 29.23(o)-1 (1944) (property); O.D. 712, 3 C.B., 188 (1920) (services).

15. I.R.C. § 170(e)(1) (2012) (most significantly, no deduction is allowed for unrealized appreciation in donated property if a sale of the property by the taxpayer would not have given rise to long-term capital gain).

16. *See generally* MARVIN A. CHIRELSTEIN & LAWRENCE ZELENAK, FEDERAL INCOME TAXATION 213 (12th ed. 2012) (making this point).

17. The rule is now contained in Treas. Reg. § 1.170A-1(g) (as amended in 2008).

18. Rev. Rul. 162, 1953-2 C.B. 128.

case) to grapple with the question of body materials as services or property happened to arise in a context in which the interpreters were driven by policy concerns to adopt the services characterization, the otherwise rather implausible services characterization remains influential today.

Of course, the paucity of law on the property-versus-services status of body materials was crucial to the ability of the IRS to take the not-property position in the ruling. If it could plausibly have done so, an IRS sufficiently hostile to the charitable deduction for unrealized appreciation would have taken the position that *no* appreciated assets qualified as property for purposes of the charitable deduction. But that would have been ludicrous, because the property status of, for example, land, art, and corporate stock was so firmly established. Because human body components were, in contrast, so far from fully commodified in 1953 (even farther than they are today), the position that blood was not property, although dubious, was not altogether absurd. In short, tax policy concerns provided the motivation for the ruling, but the very limited commodification of blood as of 1953 made the ruling possible.

The second noteworthy aspect of the ruling is its authors' obvious embarrassment about the ruling's analysis. The ruling does not claim that furnishing blood for transfusion actually is the performance of a service. Apparently concerned that such a claim might not pass the laugh test, the authors assert only that it is "*analogous to* the rendering of a personal service by a donor."[19] It is hard to argue with that limited claim; one could easily make a list of ways in which donating blood to a charity resembles performing services for a charity.[20] In the effort to assert a more defensible foundation for the ruling, however, the authors lengthened the required leap between the foundation and the conclusion. If donating blood to charity actually were the performance of a service, then under settled law no deduction would have been available. But if donating blood is merely *analogous* to performing a service, the implication would seem to be that it is actually a gift of property (because things are not analogous to themselves). And because the then-law of charitable tax deductions depended on the property–services distinction, rather than on analogies, the ruling's no-deduction conclusion does not readily follow from its analogous-to-a-service premise. In fact, the opposite conclusion would have followed much more readily: "Analogous to the rendering of a personal service" implies "but technically property," and from that implication deductibility would have followed.

In 1969 Congress revised the rules governing charitable contributions of property. Of relevance here, it added IRC § 170(e)(1)(A), providing that a deduction for a donation of unrealized appreciation is not allowed unless the gain would have been long-term capital gain if the taxpayer had sold the property for

19. *Id.* (emphasis added).

20. The list might include the common availability of charity-supplied soft drinks and cookies in both cases.

its fair market value instead of donating it.[21] Six years after that, the IRS Chief Counsel's Office issued a General Counsel Memorandum (GCM) commenting on a proposed (but never issued) revenue ruling which relied on Revenue Ruling 162 in concluding that the donation of mother's milk to a charity was the non-deductible rendering of a service.[22] The GCM disagreed with the proposed ruling's analysis: "[M]other's milk is property within the general definition of the term. . . . The milk was tangible and transferable; in fact it was a marketable commodity."[23] But what about Revenue Ruling 162? The GCM expressed "doubt whether the same decision would be made today."[24]

Although the GCM could be clearer on the reasons for that doubt, it suggests two reasons: (1) that the commodification of blood had become more firmly established in the more than two decades since the issuance of the 1953 ruling; and (2) that the no-deduction result indicated by tax logic could now be reached, in the case of both milk and blood, without denying the property status of those bodily fluids, because of the intervening enactment of IRC § 170(e)(1)(A). On the first point, the GCM observed,

> [T]oday blood is a commodity with a commercial market and value apart from its donor. To be consistent with the rationale of Rev. Rul. 162, one would have to say that where a taxpayer wants to donate clothes to the Salvation Army and is required to walk two miles to the depository, the taxpayer is rendering the personal services of delivery and not contributing property.[25]

On the second point, the GCM explained that even if milk is treated as property for tax purposes, its donation would not give rise to a deduction. The taxpayer would have had no basis in her own milk,[26] and although the milk would have been a capital asset[27] the taxpayer would not have held the milk long enough to satisfy the holding period (at the time, more than six months) for long-term capital gains.[28] Thus, IRC § 170(e)(1)(A) would deny the taxpayer any deduction for the donation of milk-as-property. In a footnote, the GCM suggested that IRC § 170(e)(1)(A) would similarly deny a deduction for a blood donation, even if the property status of blood were acknowledged.[29]

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21. Tax Reform Act of 1969, Pub. L. No. 91-172, §201(e)(1), 83 Stat. 487, 555 (current version at I.R.C. § 170(e)(1)(A) (2012)).

22. GCM 36,418, *supra* note 6.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.* ("The taxpayer had a zero basis in her milk unless she showed that she incurred expenses directly attributable to its production.").

27. *Id.* at n.2 ("Since the milk . . . does not seem to fall within any exception [from capital asset status] under Code § 1221, it is a capital asset.").

28. *Id.*

29. *Id.* at n.3 (citing W. M. COPHENHAVER, ET AL., BAILEY'S TEXTBOOK OF HISTOLOGY (16th ed. 1971) on the lifespan of blood components).

Perhaps because GCMs were not available for public inspection in 1975,[30] the GCM was refreshingly candid in its suggestion that the services characterization in the 1953 blood ruling had been adopted in order to reach the no-deduction result desired on policy grounds, and in its suggestion that the implausible characterization of blood-as-services could be abandoned now that the no-deduction result could be reached without it. The GCM did not mention, however, that in some cases the holding period might not be a bar to deductibility. In the case of milk, freezing could be used to satisfy even the more-than-one-year holding period requirement of current law,[31] and the long-term holding period would seem to be naturally satisfied (that is, without the need for freezing or other heroic efforts) in the case of some human body materials such as ova, hair, and kidneys.[32] Limiting its focus to the facts of the blood ruling and the proposed milk ruling, the GCM did not anticipate the possibility that in other situations donated (or sold) human body materials might satisfy the holding period requirement for long-term gains.

Apparently the decisionmakers at the IRS agreed with the GCM's view that the IRS should avoid any further official pronouncements on the property or not-property status of human body materials, as long as the desired no-deduction result could be reached under either characterization. The proposed breast milk revenue ruling was never issued, and the 1953 blood ruling has never been revoked or modified.

The next judicial or administrative development in the income taxation of human body materials was the Fifth Circuit's 1979 en banc decision in the strange case of Dorothy Clark Garber.[33] Ms. Garber's blood contained a rare antibody useful in the production of blood group typing serum. She made a very good living selling her plasma to several producers of typing serum, and failed to report most of the payments received on her federal income tax return. A jury convicted her of willful evasion of income tax, and she appealed on the grounds that she had not been permitted to present expert testimony on the unsettled state of the income tax treatment of transactions in human blood. The Fifth Circuit majority noted the services-or-property dispute. Although the court acknowledged that there was some force to the government's position that Ms. Garber was a provider of services,[34] it seemed to come down on the property side when it observed that "blood plasma, like a chicken's eggs, a sheep's wool, or like any

30. GCMs and other non-published written determinations of the IRS (such as private letter rulings) became publicly available only with the passage of the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1201(a), 90 Stat. 1520, 1660 (codified at I.R.C. § 6110 (2012)).

31. The holding period requirement is contained in I.R.C. § 1222(3) (2012). On freezing milk, see *Healthy Lifestyle: Infant and Toddler Health*, MAYO CLINIC, http://www.mayoclinic.org/healthy-lifestyle/infant-and-toddler-health/in-depth/art-20046350?pg=2 [https://perma.cc/775P-UCLW] ("Freshly expressed breast milk can be stored in the back of a deep freezer for up to 12 months").

32. For much more on the holding periods of various human body materials, see *infra* text accompanying notes 125–54.

33. United States v. Garber, 607 F.2d 92 (5th Cir. 1979).

34. "In some ways, Garber's activity does resemble work . . . ." *Id.* at 97.

salable part of the human body, is tangible property."[35] The court also noted, however, that the property characterization would lead to a no-income conclusion only if Ms. Garber had no gain on her sales, because her cost basis in her blood equaled (or exceeded) the sales proceeds.[36] But perhaps she did have just such a basis:

> The cost of Garber's blood plasma, containing its rare antibody, cannot be mathematically computed by aggregating the market cost of its components such as salt and water. That would be equivalent to calculating the basis in a master artist's portrait by costing the canvas and paints. . . .
>
> In such a situation it may well be that its value should be deemed equal to the price a willing buyer would pay a willing seller on the open market. If this were the proper basis, the exchange would be a wash resulting in no tax consequences.[37]

This passage reflects a stunning—for even one federal appellate judge, let alone the nine judges signing on to the majority opinion—misunderstanding of the nature and function of basis in the income tax. By equating basis with value, the passage implies that a taxpayer never realizes a gain on the sale of any asset unless she somehow manages to sell it for more than it is worth (in other words, to sell it to a sucker). But the majority somehow considered this analysis plausible enough ("it may well be") that Ms. Garber's proffered expert testimony should have been admitted for the light it might have shed on the question of her willfulness; accordingly, the court reversed the conviction and remanded for a new trial.[38]

Despite the indefensibility of the Fifth Circuit's analysis of the basis issue, the court was correct in its claim that the "tax treatment of earnings from the sale of blood plasma or other parts of the human body [was] an uncharted area in tax law,"[39] and at least arguably correct that a "criminal proceeding . . . is an inappropriate vehicle for pioneering interpretations of tax law."[40]

Coincidentally, the first civil tax case involving the sale of blood plasma arrived less than a year after the *Garber* decision. Margaret Cramer Green also had rare blood plasma of interest to a biopharmaceutical company, and also received substantial payments for her plasma.[41] The Commissioner and Ms. Green agreed that Ms. Green had realized ordinary income upon the sale of her plasma; Ms. Green made neither the basis-equals-value argument of Ms. Garber nor the damages-on-account-of-personal-injuries argument later made by Nichelle Perez in her egg-donation case.[42] The only issues in *Green* related to the several business expense deductions claimed by Ms. Green. Because the court's

35. *Id.*
36. *Id.*
37. *Id.* (citations omitted).
38. *Id.* at 100.
39. *Id.* at 99.
40. *Id.* at 100.
41. Green v. Comm'r, 74 T.C. 1229 (1980).
42. Perez v. Comm'r, 144 T.C. 51 (2015). For a detailed discussion of *Perez*, see *infra* text accompanying notes 56–87.

analysis of the business expense deductions would depend in part on whether the business was the performance of a service or the selling of a product, the court addressed the services-versus-property question. It easily concluded that Ms. Green was involved in the sale of a tangible product:

> Except for the unusual nature of the product involved, the contact [sic] between the petitioner and the lab was the usual sale of a product by a manufacturer to a distributor . . . . A tangible product changed hands at a price, paid by the pint. . . . Although we recognize the traditional sanctity of the human body, we can find no reason to legally distinguish the sale of [hen's eggs, bee's honey, cow's milk, and sheep's wool] from the sale of petitioner's blood plasma.[43]

The Tax Court made no mention of the IRS's contrary conclusion in the charitable donation context in Rev. Rul. 162.

The Tax Court also made quick work of the issue of capital asset status. Although the court said nothing to suggest that blood was inherently excluded from capital asset status, it concluded that Ms. Green's regular sales of her plasma meant that her plasma was "property held for sale to customers in the ordinary course of business," and thus excluded from capital asset status by IRC § 1221(a)(1).[44]

As for the claimed business expense deductions, the court allowed deductions for the extra cost of a required high-protein diet, and a deduction for the cost of transportation to and from the laboratory, but disallowed a claimed percentage depletion deduction.[45] The court's determination that Ms. Green's plasma was a product was crucial to the deductibility of her transportation expenses; the court reasoned that the expenses were allowable costs of transporting merchandise to market, rather than nondeductible costs of commuting to perform services.[46]

The IRS did not appeal its loss on the transportation expense issue. In recommending acquiescence in the Tax Court's decision in *Green*, the Chief Counsel's Office asserted that "Rev. Rul. 162, . . . which held that the donation of blood constituted the provision of a service, no longer represents the respondent's position."[47] Despite this public—but non-binding—renunciation of the 1953 ruling, the IRS has never formally revoked or modified the ruling.[48]

Another chapter in the blood-and-tax saga (and the final one to date) appeared in the form of the Eleventh Circuit's 1986 opinion in *Lary v. United*

43. *Green*, 74 T.C. at 1234.

44. *Id.* at 1233–34.

45. *Id.* at 1236–38.

46. *Id.* at 1237–38. Apparently the applicability of the self-employment tax (IRC § 1401) was not at issue in the case. The Tax Court's opinion makes no mention of the self-employment tax, despite the fact that it would seem to apply to Ms. Green's situation as analyzed by the court. Although it would not be, strictly speaking, an *income* tax issue, the question of blood as property or services could arise in the context of the self-employment tax. The tax would apply to the net earnings from an activity classified as the performance of services, and it would also apply to the net earnings from a business of selling property, but it would not apply to gain from casual (that is, nonbusiness) sales of property. I.R.C. § 1402(e) (2012). For a fuller discussion of this issue, see *infra* text accompanying notes 239–46.

47. Green v. Comm'r, 74 T.C. 1229 (1980), *action on dec.*, 1981-128 (Apr. 23, 1981).

48. Milot, *supra* note 3, at 1078.

States.[49] Dr. John Lary claimed a charitable deduction for the value of one pint of blood he donated to the Red Cross. In an opinion primarily concerned with other, bigger-dollar tax issues, the district court had disposed of this issue in a single paragraph.[50] Basing its decision entirely on the precedent of Rev. Rul. 162—and presumably doing so at the government's urging, despite the fact that the IRS had informally renounced the ruling following its loss in *Green*—the district court concluded that Dr. Lary had performed a nondeductible service for the Red Cross.[51]

On appeal the Eleventh Circuit noted the conflict between Rev. Rul. 162 (blood as services) and *Green* (blood as property), but concluded there was no need to decide between the competing views because no deduction was allowable under either view.[52] Even under the view of blood as property, and even assuming the blood qualified as a capital asset, Dr. Lary had not proven he had any basis in his blood, nor that any gain on a hypothetical sale of the blood would have been long-term gain.[53] Thus, under IRC § 170(e)(1)(A), his deductible amount would have been zero, even under the taxpayer-favorable assumption that the blood was a capital asset. The court's conclusion that Dr. Lary had not held his blood for long enough to satisfy the holding period for long-term capital gains (then more than six months, now more than one year) was buttressed by the court's citation to *Encyclopaedia Britannica*, noting that the lifespan of a red blood cell is about four months, and that of a platelet only about two days.[54] The court expressed no concern about the absurdity of income tax consequences turning on the lifespans of blood cells, nor did it consider the possibility that a person's blood should be viewed as a single renewable asset held by the person since, and even before, birth.[55]

B. *Perez*: Egg "Donors" And The Income Tax, 2015

After *Lary,* all was quiet—at least in terms of cases, rulings, and legislation—on the frontier where the income tax meets the human body, until the Tax Court's 2015 decision in the *Perez* egg donation case.[56] On two occasions Nichelle Perez received payments—$10,000 each time—from a for-profit egg donation agency (the Donor Source) for consenting to undergo the prolonged and painful process of retrieving some of her unfertilized eggs for use by infertile couples wanting to conceive.[57] The contracts between Ms. Perez and Donor Source stated that her

49. Lary v. United States, 787 F.2d 1538 (11th Cir. 1986).

50. Lary v. United States, 608 F. Supp. 258, 263 (N.D. Ala. 1985), *aff'd*, 787 F.2d 1538 (11th Cir. 1986).

51. *Id.* at 263.

52. *Lary*, 787 F.2d at 1539–40.

53. *Id.* at 1540.

54. *Id.* at 1540 n.3.

55. For a detailed consideration of taxpayers' holding periods in various sorts of human body materials, including blood, see *infra* text accompanying notes 125–54.

56. Perez v. Comm'r, 144 T.C. 51 (2015).

57. *Id*. at 52–56.

fee "is for Donor's good faith and full compliance with the donor egg procedure, not in exchange for or purchase of eggs and the quantity or quality of eggs retrieved will not affect the Donor Fee."[58] The contract further stated that "[t]he Parties acknowledge and agree that the funds provided to the Donor shall not in any way constitute payment to Donor for her eggs."[59] There was also a second contract, between Ms. Perez and the would-be parents, which the court described as "in all ways consistent with the contract [of Ms. Perez] with the Donor Source."[60] Despite the repeated contractual insistence that there is no sale of eggs going on here, the Tax Court opinion describes (without quoting the relevant language) the contract between Ms. Perez and the intended parents as providing that "[o]nce the eggs are removed, they immediately become the *property* of the intended parents."[61]

Before the Tax Court, both Ms. Perez and the Commissioner took the position that the payments received by Ms. Perez were not for the sale of her eggs.[62] Although the court does not comment on the parties' litigation strategies, the reasons for the parties' agreement on the no-sale characterization are clear enough. The IRS's goal was to have the payments taxed as ordinary income; if the IRS could convince the court to adopt the not-a-sale characterization, it would avoid the risk that the payments would be taxed only as long-term capital gain.[63] The taxpayer's goal was to have the payments excluded from gross income as "damages . . . received . . . on account of personal physical injuries or physical sickness,"[64] and gain on the sale of tangible property is clearly not within the scope of the damages exclusion.[65] In short, the parties—each hoping for a complete victory—had their separate strategic reasons for rejecting the sale-of-eggs characterization of the transaction.

Of course, a court does not have to accept a conclusion merely because the parties agree on it; there are notable instances in the annals of tax litigation in which courts have questioned legal conclusions agreed to by both parties, sometimes by appointing an *amicus curiae* to argue the position contrary to that taken by both parties.[66] But the judicial path of least resistance is to accept the

58. *Id.* at 54.

59. *Id.*

60. *Id.*

61. *Id.* (emphasis added).

62. *Id.* at 56.

63. *Id.* (the court notes that, because of the not-a-sale characterization, the case "does not require us to decide whether human eggs are capital assets").

64. I.R.C. § 104(a)(2) (2012).

65. The closest thing to a relevant exclusion applicable to gain on the sale of property is the I.R.C. § 1033 exclusion for gains on involuntary (forced) sales where the taxpayer reinvests the sales proceeds in property "similar or related in service or use" to the property sold. Viewing the transaction as a sale of eggs, Ms. Perez would have satisfied neither the involuntariness requirement nor the reinvestment requirement of § 1033.

66. *See, e.g.*, Warren v. Comm'r, 282 F.3d 1119 (9th Cir. 2002) (appointing constitutional law professor Erwin Chemerinsky to brief the issue as an *amicus curiae* although both parties agreed on the constitutionality of the parsonage allowance exclusion of I.R.C. § 107), *appeal dismissed per stipulation*,

agreement of the parties, and that is what Tax Court Judge Holmes did in *Perez*. With the parties in agreement, Judge Holmes disposed of the sale-versus-services issue in one short paragraph:

> Both of Perez's 2009 contracts with the Donor Source specify that her compensation is in exchange for her "good faith and compliance with the donor egg procedure." . . . Perez's compensation depended on neither the quantity nor the quality of the eggs retrieved, but solely on how far into the egg-retrieval process she went. On this key point the testimony of both parties to the contracts agrees with the contract language. We have to find that Perez was compensated for services rendered and not for the sale of property.[67]

The court did not deny the possibility of a transaction in human eggs that would be taxed as a sale of property. It distinguished the Tax Court's earlier conclusion in *Green* that a taxpayer paid for her blood plasma was a seller of tangible personal property, on the grounds that Ms. Green, unlike Ms. Perez, was "paid by the quantity and the quality of plasma produced."[68]

The court's services conclusion was the result of three factors: (1) the agreement on the issue between the taxpayer and the Commissioner; (2) the insistence on the services label in the governing contracts; and (3) the contractual allocation to the Donor Source, rather than to Ms. Perez, of the risk that no eggs, or only unusable eggs, could be extracted. Neither independently nor in combination, however, do these three factors justify the court's conclusion.

First, the fact that the parties agreed on a particular issue should not have been conclusive—or even relevant, apart from the merits of the parties' legal analyses—to the court's resolution of the issue.

Second, few principles are more firmly established in the income tax than that taxpayers cannot change the tax treatment of a transaction by the simple expedient of labeling it as something it really is not.[69] If the substance of the transaction was a sale of eggs, it should be taxed as such—regardless of how many times the contract between Ms. Perez and the Donor Source insists that it is not a sale. True, there is a strong—but not absolute—tendency of the IRS and the courts to hold taxpayers to the forms and labels they have chosen,[70] even if those forms and labels do not comport with economic reality. But this non-disavowal doctrine does not come into play where the IRS—or, as it might have done in *Perez*, the court itself—challenges the taxpayer's forms and labels.

302 F.3d 1012 (9th Cir. 2002); Bob Jones Univ. v. United States, 456 U.S. 922 (1982) (inviting attorney William T. Coleman, Jr., to defend the government's original position as an *amicus curiae* after the government changed its position in a case involving the tax-exempt status of Bob Jones University).

67. *Perez*, 144 T.C. at 57.

68. *Id.*

69. For a discussion, see BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 1.03[3] (3d ed. 2002). The Supreme Court enunciated the income tax's substance-over-form doctrine as early as 1921: "We recognize the importance of regarding matters of substance and disregarding forms in applying the provisions of the Sixteenth Amendment and income tax laws enacted thereunder." United States v. Phellis, 257 U.S. 156, 168 (1921).

70. For an excellent description and analysis of the law on this issue, see Emily Cauble, Reforming the Non-Disavowal Doctrine (unpublished manuscript) (on file with author).

Third, the fact that the contract between the parties allocated the risk of loss in a manner highly favorable to Ms. Perez does not—contrary to the court's assertion—negate characterization of the transaction as a sale. The terms of the contract are fully amenable to analysis as a sale under Article 2 of the Uniform Commercial Code (UCC), which applies to "transactions in goods."[71] Section 2-105 of the UCC defines "goods" as "all things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities [], and things in action."[72] Human eggs fit comfortably within that capacious definition. Section 2-613 of the UCC ("Casualty to Identified Goods") addresses the situation contemplated by the contract terms concerning the possible failure by Ms. Perez to produce usable eggs: "Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without the fault of either party before the risk of loss passes to the buyer, . . . then . . . if the loss is total the contract is avoided."[73] The implication is that the contract is *not* avoided—and thus the seller is entitled to be paid—if the goods "suffer casualty without the fault of either party" *after* the risk of loss has passed to the buyer. So when does the risk of loss pass to the buyer? The default rule in a case such as this, expressed in UCC § 2-509(3) (governing "Risk of Loss in the Absence of Breach"), is that the risk of loss does not pass to the buyer until "tender of delivery."[74] It may be debatable when "tender of delivery" occurs in the sale of human eggs, but that does not matter here, because UCC § 2-509(4) permits the parties to deviate from the default rule by "contrary agreement," and the parties here did so by agreeing that the risk of loss (from "Casualty to Identified Goods") was allocated to Donor Source from the instant the contracts were signed.[75] In short, the contract terms providing for payment to Ms. Perez even in the case of her inability to produce usable eggs are fully consistent with the characterization of the contracts as for the sale of goods—contracts in which the parties agreed to risk-of-loss terms different from the default rules of Article 2.[76]

Having concluded—quickly and incorrectly—that the contracts did not involve sales of property, the Tax Court turned to Ms. Perez's argument that her

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71. U.C.C. § 2-102 (AM. LAW INST. & UNIF. LAW COMM'N 2014).

72. *Id.* at § 2-105.

73. *Id.* at § 2-613.

74. *Id.* at § 2-509(3).

75. *Id.* at § 2-509(4).

76. Writing years before *Perez*, Jay Soled also looked to Article 2 in reaching the conclusion that an egg "donation" contract would be a contract for the sale of property even if it contained a provision along the lines of the provision in the *Perez* contract requiring payment even if no usable eggs are extracted. Soled, *supra* note 3, at 931. Soled analyzed the contract as providing for a sale of goods, but with all warranties expressly excluded (as permitted by UCC § 2-316). This is also a plausible analysis, although the *Perez* contract fits more easily under UCC § 2-613 (implying that a contract can be for the sale of goods even if the contract contemplates the possibility that the seller will be entitled to payment despite the failure of the goods to change hands) than under UCC § 2-316 (recognizing that a contract can be for the sale of goods where the goods do change hands, but the goods are deficient in some important respect).

payments were excluded from gross income by IRC § 104(a)(2) as damages on account of personal physical injuries. The government's position was that although the payments received by Ms. Perez might have been, at least in part, "on account of personal physical injuries," the fact that Ms. Perez had consented to the injuries in advance meant that they were not "damages," as required by the statute.[77] Contractual payments for an injury consented to before the fact did not fit the regulatory definition of damages as "an amount received . . . through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution."[78]

The most striking aspect of the § 104(a)(2) issue in *Perez* was that, although § 104(a)(2) (or its predecessor) had been on the books throughout the entire period that the IRS, courts, and commentators had struggled with the taxation of transaction in human body materials, before *Perez* no one had ever taken the issue seriously. In both *Garber* and *Green*, the court did not think the issue even worthy of textual discussion, and disposed of the issue in a footnote.[79] Commentators on the income taxation of transactions in body materials either considered the question only briefly before concluding that § 104(a)(2) did not apply,[80] or did not even discuss the issue.[81] The tendency of courts and commentators not to take seriously the possible application of § 104(a)(2) was justified; there were several judicial opinions on the books considering the question of whether § 104(a)(2) could apply to payments for injuries consented to in advance (although none of the cases involved transactions in human body materials), and the opinions all agreed that such payments were not "damages" and that the statutory exclusion therefore did not apply.[82]

So why did Ms. Perez and her attorney push the issue so hard, and why did Judge Holmes feel the need to discuss the issue at considerable length before ruling against Ms. Perez? Until 2012, the relevant regulation stated that to qualify as "damages," amounts had to be received on account of "tort or tort-type rights."[83] In 2012, however, Treasury amended the regulation to remove the "tort or tort-type" requirement.[84] Ms. Perez argued that, as a result of the 2012 amendment, her contract-based payments now qualified for the exclusion from gross income. Rejecting her claim, Judge Holmes explained that the sole purpose of the 2012 amendment was to provide that amounts received under no-fault

77. Perez v. Comm'r, 144 T.C. 51, 62 (2015).

78. Treas. Reg. § 1.104-1(c) (as amended in 2012).

79. United States v. Garber, 607 F.2d 92, 95 n.2 (5th Cir. 1979); Green v. Comm'r, 74 T.C. 1229, 1233 n.5 (1980).

80. Note, *Tax Consequences of Transfers of Bodily Parts*, *supra* note 7, at 850–51.

81. Crawford, *supra* note 3, at 736 n.268 (mentioning the issue only in a footnote citing examples of "misleading tax information" to be found on the Internet, including the claim that payments to egg donors "could fall under compensatory damages that one receives for physical damage or illness and therefore be non-taxable income"); Milot, *supra* note 3; Soled, *supra* note 3.

82. *See, e.g.*, Starrels v. Comm'r, 304 F.2d 574, 576 (9th Cir. 1962), *aff'g* 35 T.C. 646 (1961); Roosevelt v. Comm'r, 43 T.C. 77, 88–89 (1964).

83. Treas. Reg. § 1.104-1(c) (2010).

84. T.D. 9573, 2012-12 I.R.B. 498.

statutes were eligible for exclusion as damages, even if the no-fault liability standard meant that the taxpayer did not have a tort-type claim.[85] "This small change," wrote Judge Holmes, "just helped tax regulation keep up with a bit of a shift in American law toward administrative or statutory remedies and away from common-law tort for some kinds of personal injuries. . . . [I]t . . . doesn't help Perez."[86]

Judge Holmes concluded his opinion by noting that a decision in favor of Ms. Perez would have had far-ranging effects—effects which would have been contrary to firmly settled understandings of the scope of the income tax. Under the taxpayer's argument, not only egg donors would be eligible for the exclusion for physical injury damages. Anyone with a physically demanding or dangerous job—Judge Holmes mentioned professional boxers, football and hockey players, and "working men and women on farms and ranches, in mines, or on fishing boats"—could exclude at least some of his or her compensation under § 104(a)(2).[87]

Two final points are worth noting about the argument rejected by the Tax Court in *Perez*. First, as indicated by Judge Holmes' parade of horribles, the argument was only incidentally about transactions in human body materials. If the argument had prevailed, its logic would have required the exclusion of vast amounts of income from services, in most cases involving nothing that could reasonably be classified as a transaction in human body materials. Second, Judge Holmes' analysis of the taxpayer's argument utterly demolishes the argument. As the rest of this article demonstrates at considerable length, there is not a great deal that can be said with certainty about the income taxation of transactions in human body materials. One thing, however, is certain: the exclusion of § 104(a)(2) does not apply to payments received by taxpayers who voluntarily transfer any of their body materials.

III
PROPERTY VERSUS SERVICES IN THE INCOME TAX: WHY IS THIS SO DIFFICULT?

Despite the fact that IRC § 61(a) includes in gross income "all income from whatever source derived," in the details of its operation the Code is much more serious about taxing income from services than it is about taxing income from property.[88] Special low rates apply to two important categories of income from property—long-term capital gains and dividends on corporate stock[89]—whereas labor income is taxed at "ordinary" income rates. A great deal of investment gain permanently escapes income taxation—first through the deferral of gain on

85. Perez v. Comm'r, 144 T.C. 51, 61–63 (2015).
86. *Id.* at 62.
87. *Id.* at 63.
88. I.R.C. § 61(a) (2012).
89. I.R.C. §§ 1(h)(1) (long-term capital gains), 1(h)(11) (dividends).

unrealized appreciation,[90] and later through the tax-free step-up in basis at death.[91] No analogous benefits are available for labor income. A number of "basketing" rules protect the system's ability to tax labor income by providing that certain deductions are allowable only against specified types of income from property, and may not be used to shelter labor income from tax.[92] The tax liability on income from property may be transferred to a lower-bracket taxpayer by making a gift of the income-producing property,[93] but in the case of labor income the "fruits" may not be "attributed to a different tree from that on which they grew."[94]

To a considerable extent, the half-heartedness of the taxation of income from property reflects an ambivalence about (or a compromise concerning) whether the major federal revenue source should be a tax on income or a tax on consumption. A standard critique of income taxation is that imposing tax both on income when it is saved, and on the investment return on the saved income, constitutes a sort of double taxation of savers, and thereby favors grasshopper behavior (current consumption) over ant behavior (saving for future consumption).[95] The various forms of income tax favoritism for property income over investment income can be understood as responses—albeit incomplete responses—to the pro-consumption-tax argument.

In a nutshell, the federal income tax has so much trouble with transactions (sales and donations) in human body materials because (1) the distinction between labor income and property income is crucial under the income tax rules; and (2) there is no intuitive answer to the question of whether the transfer of one's own blood, for example, should be thought of as the performance of a service or as a property transaction. The degree of personal participation—in both the self-creation and the extraction of one's blood—suggests the performance of a service; however, the undeniable thingness of the resulting pint of blood, and its ready alienability and transferability, point in the direction of property.

The most closely analogous areas of the income tax in which the law is well-developed are the treatments of self-created property under the assignment-of-income doctrine and under the capital gains rules. Take the assignment-of-income analogy first. If a taxpayer creates an asset by her own efforts—say, a painting or a copyright in a novel—and then makes a gift of the asset, is taxation of the income from the asset (either the gain from the sale of the asset or the

90. I.R.C. § 1001(a) (implying that increases in value of property are not subject to tax prior to the "sale or other disposition" of the property).

91. I.R.C. § 1014.

92. *See, e.g.*, I.R.C. §§ 163(d) (investment interest), 469 (passive activity losses), 1211 (capital losses).

93. This is true both with respect to unrealized appreciation in the gifted property (I.R.C. § 1015) and future income streams from income-producing gifted property. *See, e.g.*, Blair v. Comm'r, 300 U.S. 5, 14 (1937).

94. Lucas v. Earl, 281 U.S. 111, 115 (1930).

95. CHIRELSTEIN & ZELENAK, *supra* note 16, at 486–91 (describing, but not endorsing, the critique).

income stream produced by the asset) governed by the rule that labor income cannot be assigned for tax purposes, or by the rule that income from property can be assigned? The capital gains question is similar: If a taxpayer sells a self-created asset at a gain, is the profit taxable at the higher rates applying to ordinary income like labor income, or at the lower rates applying to long-term capital gains?

For the first question, the answer is that self-created assets are subject to the taxpayer-favorable assignment-of-income rules applicable to property, rather than to the unfavorable rules governing services.[96] Although this treatment of self-created assets as property may have resulted from a rather mindless syllogistic application of legal categories—"income from property can be assigned by making a gift of the property, self-created property is property, therefore income from self-created property may be assigned by gift"—the result is nevertheless defensible in terms of the policy justification for having different assignment-of-income rules for property than for services.[97]

The capital gains rules are less favorable to self-created property than are the assignment-of-income rules. As is described in detail in the next part of this article,[98] many—but by no means all—self-created assets do not qualify as capital assets in the hands of their creators, by reason of either the inventory exception to capital asset status,[99] or the exception for "a copyright, a literary, musical, or artistic composition, . . . or similar property, held by . . . a taxpayer whose personal efforts created such property" or by a person who received the property as a gift from its creator.[100]

Two points are worth noting here. First, the well-developed state of the law concerning the tax treatment of the usual sorts of self-created property contrasts sharply with the muddled state of the law concerning the taxation of transactions in human body materials. The obvious explanation is that self-created property tax issues have long been common, and the dollar amounts involved can be large, so it is not surprising that the tax law has responded by developing clear rules for common and economically significant transactions. Although recent developments—especially the emergence of the *Perez* case—suggest that things are beginning to change, the law has not been subject to similar pressures to develop clear rules for transactions in body materials, because the issues have been of more limited economic significance.

96. BITTKER, MCMAHON, JR., & ZELENAK, *supra* note 69, ¶ 34.02[6] (noting, however, that "lawyers and doctors [cannot] treat wills or prescriptions as literary compositions that can be donated to members of their families and sold by the donees to the client or patient").

97. Consistent application of the principle that income from property should be taxed to the person with the strongest ongoing connection to the income-producing property results in tax-effective assignments of income from property (because income-producing property can be alienated), but not of income from services (because a taxpayer cannot alienate herself from her own human capital). CHIRELSTEIN & ZELENAK, *supra* note 16, at 270. Once human capital has been transformed into a taxpayer-created asset alienability is possible, and thus a tax-effective assignment of income is possible.

98. *See infra* text accompanying notes 107–124.

99. I.R.C. § 1221(a)(1) (2012).

100. I.R.C. § 1221(a)(3). *But see* I.R.C. § 1221(b)(3) (allowing taxpayers to elect capital asset status for self-created "musical compositions or copyrights in musical works").

Second, the analogy between the usual sorts of self-created property and body materials is strong enough—indeed, body materials could be conceptualized as merely a subset of self-created property—for the tax treatment of self-created property to serve as the template for the fuller development of the income taxation of transactions in body materials. At first glance, however, it may seem that the assignment-of-income rules for self-created property and the capital gains rules for self-created property point in opposite directions with respect to the property–services distinction. Self-created assets are treated as property for assignment-of-income purposes, but often are not treated as capital assets. Note, however, that only the assignment-of-income result depends on the property-versus-services distinction. A non-capital-asset result, in contrast, does not involve denial of the property status of self-created assets; it merely consigns self-created assets to the category of ordinary-income property.[101]

In short, the analogy to self-created property—the closest analogue for which the income tax rules for distinguishing services from property are well-developed—supports the tax treatment of body materials as property; the assignment-of-income doctrine points toward property status for body materials, and the capital asset rules do not address the property-versus-services distinction.

IV
CAPITAL GAIN ISSUES

If a transaction, whether sale or donation, in human body material is treated as a transfer of property rather than as the performance of a service, the next question is whether the body material qualifies as long-term capital gain property. If so, the taxpayer's gain in the case of sale will be taxed at the favorable rates applicable to long-term capital gains,[102] and the deduction in the case of a charitable contribution will be for the fair market value of the material (rather than for only its low or zero basis).[103] In order to reach these attractive tax results, a taxpayer must establish both that his sold or donated body material qualifies as a capital asset, and that before the sale or donation he had held the material for more than one year. Both issues are examined here.

A. Capital Asset Status

1. The Inventory Exception

Given that capital gains are generally considered exceptions to the norm of ordinary income, IRC § 1221(a) takes a strangely backward approach to the definition of a capital asset.[104] Under that provision, an asset is a capital asset

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101. *See* I.R.C. § 1221(a) (listing eight types of non-capital assets).

102. I.R.C. § 1(h) (in most cases the rate will be either 15% or 20%, compared with ordinary income rates of as high as 39.6% (I.R.C. § 1(a)).

103. I.R.C. § 170(e)(1)(A) (amount of charitable deduction). The determination of a taxpayer's basis in human body materials is discussed *infra* text accompanying notes 155–70.

104. I.R.C. § 1221(a).

unless it fits within one of the eight statutory exceptions.[105] Only two of the exceptions are of potential relevance to human body materials. The § 1221(a)(1) inventory exception is considered first, and the § 1221(a)(3) exception for certain taxpayer-created assets is considered thereafter.

Section 1221(a)(1) excludes from capital asset status "inventory . . . or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."[106] In *Green* the Tax Court held that Ms. Green—a regular seller of her unusually valuable blood plasma—held her plasma for sale to customers in the ordinary course of her business, and it was therefore not a capital asset.[107] Perhaps because Ms. Green did not contest the non-capital-asset status of her plasma, the court simply stated its conclusion on the issue without discussion.

Although the court's conclusion is plausible, the issue is trickier than the opinion suggests. Considering Ms. Green's blood in its entirety (rather than pint-by-pint), she held her blood for more than one purpose—as a source of plasma to sell to laboratories, but also (and much more importantly) as a fluid to deliver oxygen to every part of her body and to perform the other life-essential functions of blood. Section 1221(a)(1) denies capital asset status only if either (1) the property is "of a kind which would properly be included in inventory of the taxpayer if on hand at the close of the taxable year," or (2) the property is "held by the taxpayer *primarily* for sale to customers."[108] No one—not even a regular plasma seller—is required to include in inventory blood "on hand" (that is, in body) at the close of a taxable year. And no one—again, not even a regular seller of plasma—holds her blood primarily for sale to customers. In the well-known case of *Malat v. Riddell*,[109] the Supreme Court considered the application of the inventory exception to a taxpayer who held a parcel of land for dual purposes—sale or development as rental property—but who eventually sold the land undeveloped. The IRS claimed that a "substantial" sale-to-customers purpose would be enough to remove the land from capital asset status, even if that purpose was less important than the development-for-rental alternative.[110] In its brief opinion, the Supreme Court ruled against the government on the grounds that the statute meant what it said: "A literal reading of the statute is consistent with [the] legislative purpose. We hold that, as used in [§ 1221(a)(1)], 'primarily' means 'of first importance' or principally."[111]

In light of *Malat*, it seems that the Tax Court was wrong on this issue in *Green.* But could the result in *Green* be saved by a pint-by-pint analysis of Ms. Green's

105. *Id.* ("[T]he term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include" the eight exceptions.).

106. I.R.C § 1221(a)(1).

107. Green v. Comm'r, 74 T.C. 1229 (1980) (discussed *supra* text accompanying notes 41–48).

108. I.R.C. § 1221(a)(1) (emphasis added).

109. Malat v. Riddell, 383 U.S. 569 (1966).

110. *Id.* at 571.

111. *Id.* at 572.

blood, under which she held the bulk of her blood exclusively for the purpose of keeping herself alive, but at the same time she held primarily for sale the small portion of her blood that she actually sold? That argument should fail because of the identification problem. As her blood coursed through her arteries, veins, and capillaries, there was no way of telling which units of blood would be extracted for sale and which would not. For any given pint or cell, the chances of being sold must have been quite small. As a result, even under a pint-by-pint or cell-by-cell analysis, Ms. Green did not hold any of her blood primarily for sale.

Lisa Milot, however, has suggested an analysis that could lead to a different result.[112] In her view, material removed from the human body and transferred in a commercial context should be treated as property for tax purposes, but materials within the human body—and also materials transferred gratuitously—should not.[113] Under this view, the purpose for which a taxpayer held her blood while it was inside her body would be irrelevant to the § 1221(a)(1) analysis, because the blood was not property at that time; only the taxpayer's post-extraction purpose for holding the blood would be taken into account.[114]

This analysis would not result in all human body materials falling within the inventory exception, but it would eliminate the easy route for avoiding § 1221(a)(1) based on the "primarily" requirement as interpreted by *Malat.* A single isolated sale of body material—for example, of a kidney—would not be a sale of an inventory-type asset even disregarding the taxpayer's in-body purpose for "holding" his kidney,[115] but under Milot's analysis the plasma of a regular seller of plasma would probably be classified as inventory, and thus as a non-capital asset.

Milot's analysis is intriguing and original. Its originality may be a point against it, however, in terms of the likelihood that it will be adopted by the IRS or the courts. In all the discussions of the taxation of human body materials in the cases,

112. Milot, *supra* note 3, at 1090–1108.

113. *Id.* at 1093. Consider a continuum of (1) body material inside the body, (2) body material removed for gratuitous transfer to a relative or friend, (3) body material removed for donation to charity, and (4) body material removed for sale. Milot would draw the property line between (3) and (4), with the result (among other things) that donations to charity would be nondeductible donations of services. Treas. Reg. § 1.170A-1(g) (as amended in 2008). Even if one accepts Milot's basic approach, there is a strong argument that the line should be drawn between transactions outside the formal economy and transactions within the formal economy. In that case, the line would go between (2) and (3); blood donated to the Red Cross is just as much in the formal economy as blood sold to a plasma center. If the line is drawn between (2) and (3), then a charitable donation would be allowed for the value of donated body material if the gain on the sale of the material would have been long-term capital gain. I.R.C. § 170(e)(1)(A). Under Milot's view that the holding period begins only when the material is removed from the body, Milot, *supra* note 3, at 1101, it would be difficult for the donating taxpayer to satisfy the holding period requirement for long-term capital gain, but it could be done in some cases (especially where freezing is feasible). Holding period issues are considered *infra* text accompanying notes 125–54.

114. *Id.* at 1100.

115. *Id.* at 1102 (suggesting that most human body materials would avoid the inventory exception, and would qualify as capital assets, even disregarding the taxpayer's pre-removal purpose for holding the materials). However, under Milot's analysis the holding period would not start until the removal of the material from the taxpayer's body, so the gain would be short-term capital gain. *Id.* at 1101. This aspect of Milot's analysis is discussed *infra* text accompanying note 128.

rulings, and commentaries before Milot, no one had suggested that tangible physical material undergoes a tax transmogrification—unrelated to any change in the actual physical attributes of the material—when it is removed or severed from the human body. The idea that property is *created* when blood is drawn—or, for that matter by a process as simple and undramatic as a haircut—is not particularly intuitive and is not supported by anything in the existing law. Milot's analysis does succeed, however, in adding yet another uncertainty to the long list of uncertainties in the income taxation of transactions in human body materials. The remainder of this discussion of the inventory exception will assume that Milot's analysis is not adopted.

Results under § 1221(a)(1) depend on close examination of the facts of a particular case, so the blood-and-plasma-specific conclusion offered above does not necessarily extend to all human body materials. Unlike blood, ova are not necessary to the health of the woman whose body produces them. It is possible to imagine a taxpayer determined never to have children of her own (in a social, as opposed to biological, sense), who would hold her eggs primarily—perhaps even exclusively—for sale to customers. In the case of most egg donors, however, the potential personal use of ova probably looms larger than their potential sale; in those cases the "primarily" standard, as interpreted by *Malat*, should prevent the eggs from being classified as § 1221(a)(1) property.

The analysis for hair is similar to that for ova. Although one can imagine a person who grows his hair long only for the purpose of eventual sale, and would actually prefer shorter hair apart from the prospect of financial gain, in most hair cases the "primarily" for sale requirement will not be satisfied and § 1221(a)(1) will not apply.

What about an (illegally) sold kidney? Kidneys are like blood, and unlike ova and hair, in being crucial to the health of their possessors. Even if a taxpayer had been thinking for years that he would eventually sell a kidney, it would be a stretch to conclude that the purpose of holding for sale dominated the health-related purpose of having a spare kidney.[116] It is left to the interested reader to work out on her or his own the parallel analyses for breast milk, sperm, and any other marketable human body materials.

Before leaving § 1221(a)(1), it is worth considering how it should apply in the case of a charitable donation of body materials. According to § 170(e)(1)(A), no deduction is allowed for unrealized appreciation in donated property to the extent the gain "would not have been long-term capital gain . . . if the property had been sold by the taxpayer at its fair market value" instead of donated to charity.[117] Imagine a charitable donation of human body material which is treated as a donation of property (rather than of services); the taxpayer has held the

116. Moreover, as noted above in connection with the discussion of Milot's analysis (*supra* text accompanying notes 112–15), even if the health-related reasons for "holding" one's kidney are disregarded, that should not be enough to transform a one-time sale into a "sale to customers in the ordinary course of [the taxpayer's] trade or business."

117. I.R.C. § 170(e)(1)(A).

donated material for more than one year, and the taxpayer regularly donates but never sells such material.[118] Also suppose that, if the taxpayer sold the material as regularly as she donates it, it would be disqualified from capital asset status by § 1221(a)(1).

The question then would be whether § 170(e)(1)(A) requires imagining just a single hypothetical sale of the body material that was the subject of a particular donation, or whether it requires placing each donation in the context of all other similar donations by the same taxpayer, with each donation transformed into a hypothetical sale. A conclusion that the material was disqualified from capital asset status by § 1221(a)(1)—thus denying the taxpayer a deduction for the excess of value over basis—would be much more likely if the hypothetical sale were placed in the context of many other similar hypothetical sales than if it were viewed as a single, isolated sale. The statutory language—which says nothing about placing any particular donation in the context of other related donations—seems more consistent with the taxpayer-favorable single-hypothetical-sale approach, but the language is open to interpretation and plausible policy arguments could be made for either approach.

As fascinating as it would be to see a court wrestle with this issue, under the approach to § 1221(a)(1) suggested here in the case of actual sales, the issue would seldom arise. Even if a hypothetical sale is considered in the context of other hypothetical sales, the taxpayer's primary purpose for holding the material will almost always be a personal purpose, rather than sale to customers—real or hypothetical.

This question in the interpretation of § 170(e)(1)(A) is not unique to donations of human body materials. The same issue could arise, for example, if a taxpayer regularly donates art to museums, at a rate which would turn the donated art into inventory if each donation were considered in the context of all the other donations transformed into hypothetical sales, but not if each donation were considered in isolation. The absence of any reported cases on this issue suggests that the IRS does not pursue the issue in the art donation context. It would probably also not pursue the issue in the context of donations of body materials.

2. The Personal Efforts Exception

Section 1221(a)(3)(A) denies capital asset status to "a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by . . . a taxpayer whose personal efforts created such property."[119] Might human body materials fall within the scope of that exclusion, pursuant to an expansive reading of "similar property"? The language of the statute does not rule out that reading. An author's copyright in her own work and a person's own

118. Blood would be the obvious example, but for the more-than-one-year holding period requirement. On the possibility of satisfying the holding period requirement with respect to blood, see *infra* text accompanying notes 133–36.

119. I.R.C. § 1221(a)(3)(A).

blood are similar in that both are self-created property (albeit created with greater conscious effort in the former case), and in that the taxpayer-creator would typically have little or no basis in both cases. The legislative history of the provision, however, furnishes no support for so broad an interpretation of "similar property." The provision originated in the Revenue Act of 1950.[120] The Senate Finance Committee Report offered only "a radio program . . . created by the personal efforts of the taxpayer" as an example of "similar property," and indicated that "inventions, patents and designs" were not "similar property."[121] In keeping with the legislative history, the relevant regulation provides,

> [S]imilar property includes for example, such property as a theatrical production, a radio program, a newspaper cartoon strip, or any other property eligible for copyright protection . . . , but does not include a patent or an invention, or a design which may be protected only under the patent law and not under the copyright law.[122]

This is more than sufficient to rule out an interpretation of "similar property" broad enough to cover self-created human body materials, but Congress made the broad interpretation even more untenable in 1969, when it amended the self-created-property exclusion to cover a "letter or memorandum" created by or for a taxpayer.[123] A "letter or memorandum" is surely more similar to a "copyright, a literary, musical, or artistic composition" than is any human body material. If Congress considered a statutory amendment necessary to bring letters and memoranda within the scope of § 1221(a)(3), it could not have considered "similar property" to be broad enough to encompass, for example, blood and ova.[124]

B. Holding Periods Of Body Materials (More Than You Ever Wanted To Know)

Even if human body materials are classified as capital assets, rather than as either services or non-capital assets, favorable tax results will follow only if the materials satisfy the more-than-one-year holding period for long-term capital gain.[125] This is true whether the taxpayer sells the material (so that the issue is the availability of favorable long-term capital gains rates[126]), or donates the material to charity (so that the issue is the deductibility of the excess of value over basis[127]).

Consistent with her view that body materials are not property until they are

120. Revenue Act of 1950, Pub. L. No. 81-814, § 210(a), 64 Stat. 906, 932-33 (1950) (codified as amended at I.R.C. § 1221 (2012)).

121. S. REP. NO. 81-2375, at 84 (1950).

122. Treas. Reg. § 1.1221-1(c)(1) (1960).

123. Tax Reform Act of 1969, Pub. L. No. 91-172, § 514, 83 Stat. 487, 643 (1969) (codified as amended at I.R.C § 1221(a)(3)).

124. The legislative history indicates that Congress viewed letters and memoranda as indisputably outside the scope of § 1221(a)(3) prior to the 1969 amendment; this was not a case of legislation intended to resolve an ambiguity in the existing statute. *See* H.R. REP. NO. 91-782, at 318 (1969) (Conf. Rep.) (describing the change in the law without any suggestion that it is merely a clarification).

125. I.R.C. § 1222(3).

126. I.R.C. § 1(h).

127. I.R.C. § 170(e)(1)(A).

severed from the body that produced them, Milot takes the position that the holding period does not begin until material is removed from the body for the purpose of sale.[128] Under this view, long-term gain in body materials would be very unusual, although not impossible in the case of hair, or materials compatible with long-term freezing. Under the more plausible view—that holding period includes the time material is held within the body—a highly fact-intensive analysis is required for each type of body material. The discussion here will be limited to blood, sperm, eggs, milk, kidneys, and hair.

Before delving into the material-specific analyses, two preliminary points should be noted. First, the reader may detect a certain air of absurdity to much of what follows. This is not an attempt at humor; to the contrary, this is a best attempt to offer technically accurate analyses of the various holding period issues. Rather, the hint of absurdity results from the need to apply the holding period rules to asset types so different from those on which Congress was focusing when it enacted the holding period provisions. The income tax is not well-prepared to deal with the increasing commodification of the human body. The sense of absurdity is enhanced by: (1) the need to analyze separately each type of body material, with the resulting possibility that sales or donations of different materials will be taxed differently despite the lack of any policy rationale for the differing treatments; (2) the tax incentive, in some cases, for long-term freezing of body materials prior to their sale or donation;[129] and (3) the possible application of "tacked" holding periods in situations so different from those in which tacked holding periods ordinarily apply.

The second preliminary observation is that Treasury apparently has the power, for all types of body materials, to promulgate regulations treating the materials as "collectibles" eligible for only the not-all-that-favorable long-term capital gains rate of 28%,[130] instead of the 15% and 20% rates applicable to most long-term capital gains.[131] Collectibles gain is defined as the gain on the sale or exchange of a capital asset if the asset is a work of art, rug or antique, metal or gem, stamp or coin, alcoholic beverage, or "any other tangible personal property specified by the Secretary."[132] There is nothing in the statute to prevent Treasury from issuing a regulation relegating some or all types of body materials to the collectibles category. But such a regulation does not currently exist, and in its absence body materials do not even arguably fit within any of the statutorily-specified categories of collectibles.

128. Milot, *supra* note 3, at 1101.

129. This strange incentive would be even more significant under the Milot analysis than under a more conventional analysis, because under the Milot analysis the long-term holding period could be satisfied *only* by the taxpayer's continuing to hold the material after it had been removed from his or her body.

130. I.R.C. §§ 1(h)(1)(F), 1(h)(4).

131. I.R.C. §§ 1(h)(1)(C), (D).

132. I.R.C. § 408(m)(2), made applicable in this context by I.R.C. § 1(h)(5)(A).

1. Blood

Blood is the one body material for which there is judicial precedent on the holding period question. The Eleventh Circuit in *Lary* concluded that no charitable deduction was allowable for donated blood, even assuming the blood qualified as a capital asset, because Dr. Lary had no basis in his blood and because individual red blood cells live for only four months—and only ten days in the case of platelets.[133]

But this is too simple an explanation, for several reasons. First, the *Lary* court's analysis does not consider the possibility—although not a possibility at issue on the facts of *Lary*—that a taxpayer could have his blood extracted and frozen, retaining ownership of the frozen blood long enough to satisfy the holding period for long-term gain, and only then donating or selling it. Long-term freezing of blood is not a common practice, but it is technically feasible. It is used to preserve rare blood types that might otherwise be unavailable for emergency transfusion, and to preserve autologous blood units when surgery is delayed.[134] With the use of a cryoprotectant chemical, frozen blood can be stored for up to ten years.[135] It is uncertain whether a taxpayer wanting to freeze his blood for tax-strategic reasons could find a cooperative blood-freezing organization, and whether the costs of freezing—which would be among the more peculiar examples of deadweight loss caused by the federal income tax—would be low enough relative to the tax savings to make the game worth playing.[136]

Even without using the freezing strategy, a taxpayer selling or donating his blood could argue that *Lary* is wrong on the holding period issue. Perhaps instead of thinking about blood cell-by-cell in the manner of the *Lary* court, a person's blood should be thought of as a single unitary asset, held by the taxpayer for his entire life. Beyond the commonsense appeal of unitary asset treatment, there is also a technical argument that arrives at the same bottom line via a different route.

As individual red blood cells and platelets expire at the ends of their all-too-brief existences, the body replaces them with new blood cells and platelets. It is not generally supposed that the process of blood regeneration requires an income tax analysis, but perhaps for holding-period purposes it does. According to IRC § 1033(a)(1), if property is "involuntarily converted [i]nto property similar or related in service or use to the property so converted," "as a result of its destruction in whole or in part," then a taxpayer recognizes no gain upon the conversion.[137] Although the point has previously gone unmentioned in the tax law

133. Lary v. United States, 787 F.2d 1538, 1540 n.3 (11th Cir. 1986).

134. *Frozen Blood Program*, BLOOD CONNECTION, http://thebloodconnection.org/products-services/laboratory-services/frozen-blood-program/ [https://perma.cc/3X9L-QE8F] (last visited Nov. 1, 2016).

135. *Id.*

136. The freezing strategy is just as viable under the Milot view of the holding period as beginning on the date of extraction as it is under the more conventional view that the holding period includes time inside the body.

137. I.R.C. § 1033(a)(1).

literature, the process of blood regeneration satisfies all the technical requirements of § 1033(a)(1). Old blood cells are destroyed and replaced by ("converted into," in the words of the statute) new blood cells, all without any voluntary action on the part of the blood-possessing taxpayer. The taxpayer is not unhappy about this involuntary conversion, but nothing in § 1033 or the regulations thereunder conditions the application of the provision on the taxpayer's unhappiness with the conversion. This is an atypical involuntary conversion in that there is no second party to the conversion, but again nothing in § 1033 or its regulations conditions the provision's application on the existence of a second party. In short, there is no obvious technical reason why the blood regeneration process does not qualify for tax purposes as an involuntary conversion.

The result under § 1033—no income tax imposed on the blood regeneration process—is the same result reached by the standard approach of assuming, sensibly enough, that the income tax has no application to the everyday inner workings of the human body. But § 1033 arguably matters here, because it brings into play the "tacked" holding period rules of IRC § 1223. According to § 1223(1)(A), the holding period of an asset received in an involuntary conversion includes the holding period of the asset surrendered or destroyed in the conversion, with no limit on the number of involuntary conversions over which the holding period can be tacked.[138] Thus, even under the cell-by-cell tax view of blood, the holding period for each blood cell is the taxpayer's entire life, by reason of the combined application of § 1033 and § 1223.

If all this seems more than a touch hypertechnical, recall that it is needed only because of the *Lary* court's conclusion—hypertechnical in its own right—that the tax analysis of blood should proceed cell-by-cell. The law could reach the same result much more simply by forgetting all about individual blood cells, § 1033, and § 1223, and simply treating a person's blood as a single asset held for the person's entire life.

2. Sperm

Although the fact has somehow escaped mention in any reported tax case or revenue ruling, a human sperm cell is typically about seventy-four days old at the time of ejaculation.[139] Fortunately for the sperm seller (or charitable donor, if such exists), freezing sperm for up to ten years is routine, and frozen preservation for up to fifty-five years is possible.[140]

For a taxpayer who wants a long-term holding period without having to go to the trouble of having his sperm frozen, the same two arguments discussed in connection with blood are available here. One can argue either that one's supply

138. I.R.C. §1223(1)(A).

139. *Infertility in Men In-Depth Report*, N.Y. TIMES, http://www.nytimes.com/health/guides/disease/infertility-in-men/print.html [https://perma.cc/758N-DAM2].

140. *Freezing and Storing Sperm*, HUMAN FERTILISATION & EMBRYOLOGY AUTH. (U.K.), http://www.hfea.gov.uk/74.html [https://perma.cc/3SSX-QA6A] (last visited Nov. 1, 2016).

of sperm is a single unitary asset held since puberty, or that the process of sperm regeneration—in which old sperm that is either ejaculated or reabsorbed into the body is replaced with new sperm—qualifies as an involuntary conversion resulting in a tacked holding period.[141]

3. Eggs

All the egg cells a woman will ever produce are present—albeit in an undeveloped form—in her ovaries when she is born.[142] Accordingly, the case for a long-term holding period is more straightforward for eggs than for either blood or sperm. It is not necessary to view all of a woman's eggs as a single asset; even under an egg-by-egg analysis the long-term holding period is satisfied. An argument to the contrary, however, could be made. During each menstrual cycle, one egg is transformed into a ready-to-be-fertilized mature egg.[143] It might be argued that the transformation creates a tax discontinuity; the mature egg is a different thing from its previous self, and so the taxpayer's holding period dates only from the date of the transformation. Even if the discontinuity is conceded, however, the transformation should qualify under § 1033 as an involuntary conversion. The transformation at issue here differs from the replacements involved in the cases of blood and sperm, but the language of § 1033(a)—"destruction in whole or in part"—is broad enough to cover both situations. The blood and sperm processes are instances of "destruction in whole" followed by replacement; the egg process is an instance of "destruction in part" of the original version of the egg, followed by its transformation. Assuming § 1033 applies, the tacked holding period of § 1223(1) automatically follows.

Although the long-term result is reasonably clear here under either the same-egg view or the transformed-egg view, an egg seller or charitable donor who wanted to be absolutely certain of a long-term holding period could have her eggs frozen.[144] Eggs can be frozen safely for several years prior to fertilization.[145]

3. Milk

Neither the unitary asset theory nor the involuntary-conversion-plus-tacked-holding-period theory would reliably produce a long-term holding period for

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141. Because most (although certainly not all) ejaculations are intentionally achieved, it might be argued that the involuntariness standard of § 1033 is not satisfied. However, the old sperm must be replaced with new sperm whether or not the old sperm is ejaculated, which should be enough to satisfy the requirements of § 1033.

142. *Egg Cell Production*, PENN MED., https://web.archive.org/web/20131109024406/http:/www.pennmedicine.org/encyclopedia/em_DisplayAnimation.aspx?gcid=000045&ptid=17 [https://perma.cc/U6NS-9QTT].

143. *Id.*

144. Freezing could also be used to ensure a long-term holding period in the somewhat unlikely event that the IRS or the courts were to adopt Milot's view that the holding period begins only upon the removal of the egg from the taxpayer's body.

145. *Egg Freezing FAQs*, U.S.C. FERTILITY CLINIC, http://uscfertility.org/egg-freezing-faqs/ [https://perma.cc/9FTA-G768] (reporting an instance of an egg being used after having been frozen for ten years).

fresh breast milk. Under either theory the holding period would begin neither at birth nor at puberty, but only at the beginning of a period of lactation. There would be no argument, then, for a long-term holding period for milk produced during the first year after childbirth. However, breast milk can be safely stored in a deep freezer for up to twelve months.[146] And unlike blood, sperm, and eggs, milk can be frozen on a do-it-yourself basis; there is no need to find an accommodating specialized facility in order to carry out one's tax strategy. But the simultaneous satisfaction of the health and tax criteria may require precision timing; if the taxpayer is relying solely on the period of freezing to satisfy the holding period requirement, the milk must be sold or donated within a few days of the anniversary of its freezing.

4. Kidneys

Selling a kidney is illegal under federal law,[147] but that illegality should have no effect on the income tax treatment of a kidney seller. Illegal income is taxable,[148] and there is no statutory provision denying favorable long-term capital gains rates to an otherwise-qualifying sale on the grounds that the sale is illegal. And, of course, donation of a kidney is not illegal, so illegality is not a concern with respect to a deduction for the unrealized appreciation in a donated kidney.[149] Because one has possessed one's kidneys continuously since one's days as an embryo, it is reasonably clear that the gain qualifies as long-term—except under the Milot view that the holding period begins only when the kidney is removed from the donor's body. To be sure, kidney cells die and are replaced, and it could be argued that there should be a bifurcation between long-term and short-term gain, according to what percentage of kidney cells are more or less than one year old. Under the involuntary conversion analysis developed earlier, however, even the youngest kidney cells would have long-term holding periods as a result of tacking under § 1223(1).

The analysis would probably never get to that point, because no court, or tax administrator, for that matter, would think it appropriate to analyze the holding period of a kidney on a cell-by-cell basis rather than a whole-kidney basis. Why does the cell-by-cell approach apparently have some appeal in the case of

146. MAYO CLINIC, *supra* note 31.

147. 42 U.S.C. § 274e (2012).

148. James v. United States, 366 U.S. 213 (1961).

149. To support a charitable deduction for a donated kidney, the donation must be to a charity rather than to the transplant recipient. *See generally* Davis v. United States, 495 U.S. 472 (1990) (holding that amounts paid by parents of Mormon missionaries to support their children during the children's missions were nondeductible payments to the children rather than deductible payments to the Mormon Church). The clearest case for a deduction is a non-directed altruistic kidney donation, in which the donor donates a kidney to a tax-exempt organization for transplantation to an anonymous, non-kin recipient. Not surprisingly, such donations are rare. Between 1999 and 2010, 955 altruistic kidney donations were recorded in the United States. Kristin M. Brethel-Haurwitz & Abigail A. Marsh, *Geographical Differences in Subjective Well-Being Predict Extraordinary Altruism*, 25 PSYCHOLOGICAL SCI. 762, 764 (2014).

blood,[150] but little or no appeal in the case of kidneys? It is likely because common intuitions differ on how to resolve the question of unitary asset versus collection of individual cells, depending on whether a liquid (collection of cells) or a solid (unitary asset) is being considered. It would be bizarre—although not altogether shocking—if the long-term status of kidney gain were to turn on the solidity of kidneys, while the short-term status of blood gain depended on the liquidity of blood.

5. Hair

The easiest analysis has been saved for last. In the case of hair there is no need for arguments about involuntary conversions and tacked holding periods, and no need for the tax-savvy seller or donor to consider the freezing option. Human scalp hair typically grows at the rate of about six inches per year.[151] Assuming this estimate is accurate in your case, if you grow your hair long, then cut it leaving the six inches closest to the scalp,[152] and sell or donate the cut hair, you clearly have a long-term holding period in the hair with which you have parted.[153] A taxpayer might be able to achieve even more favorable results by establishing how long her hair had existed before it emerged from her scalp, or by holding her hair for some additional time after cutting and before sale or donation, but such strategies may not be necessary given the favorability of the results under the simplest approach.

Even here, however, there may be a complication. A study of rates of hair growth by race has found that the hair of Asian (Chinese) study participants grew faster than the hair of Caucasian (French) study participants, which in turn grew faster than the hair of Black (South African) study participants; the difference between the Asian and Black rates was considerable—about five centimeters (two inches) per year.[154] Thus, if the tax holding period rule is translated from length of time to length of hair, the rule will be different for taxpayers of different

150. *See* Lary v. United States, 787 F.2d 1538, 1540, n.3 (11th Cir. 1986) (finding no evidence for a holding period of more than six months, and noting that red blood cells have a life span of four months, and blood platelets a life span of ten days).

151. Zbigniew Rusczak, *Hair Disorders and Alopecia*, *in* TEXTBOOK OF CLINICAL PEDIATRICS 1489, 1489 (Abdelaziz Y. Elzouki, et al. eds., 2d ed. 2012).

152. It is convenient for tax purposes that haircuts naturally take a first-in, first-out (FIFO) approach to hair. Both the nature of a haircut and tax considerations dictate that the hair one sells or donates be the hair with the longer holding period, and the hair one keeps attached to one's scalp be the hair with the shorter holding period.

153. As always, a caveat is in order with respect to the Milot view that the holding period does not begin until human body material is removed from the body. Milot does not discuss the application of her analysis to hair; perhaps she would concede that hair, even while attached to the scalp, is sufficiently separate from the body that the beginning of the holding period need not wait on a haircut. On the resemblance or dissimilarity between a haircut and the extraction of other body material, see braingle.com: "Removing an appendix is called an appendectomy, removing tonsils is called a tonsillectomy. What is it called when they remove a growth from your head? A haircut." http://www.braingle.com/brainteasers/3820/-ectomy.html [https://perma.cc/CAC4-49KT]. This riddle may or may not have federal income tax significance.

154. Genevieve Loussouarn, Charles El Rawadi, & Gilles Genain, *Diversity of Hair Growth Profiles*, 44 INT'L J. DERMATOLOGY (SUPP. 1) 6, 7 (2005).

races—although there is room for argument as to who wins and who loses under the rules expressed in terms of hair length. Asian-American taxpayers, for example, have the most inches of long-term-holding-period hair per year of uncut hair growth, which seems to be a favorable result; on the other hand, Asian-American taxpayers cannot have their hair cut as short as other taxpayers if they want all their sold or donated hair to satisfy the long-term holding period, which sounds like an unfavorable result. In any event, the possibility that the holding period rules require taking into account the race of a seller or donor of hair is yet another example of the strange—and sometimes unsettling—results that may follow from applying to transactions in human body materials tax rules that were developed without any thought to how they would apply to such transactions.

C. Basis In Body Materials

If a transaction in human body materials is characterized as a property transaction, whether or not the property qualifies as a capital asset, it is necessary to determine the taxpayer's basis—more precisely, adjusted basis—in the property. In the case of a sale, basis is subtracted from amount realized to determine the amount of gain or loss on the disposition.[155] In the case of a donation, the charitable deduction is limited to basis if a hypothetical sale of the donated property would not have resulted in long-term capital gain.[156]

There is very little authority on the issue of a taxpayer's basis in her body materials. The Tax Court in *Perez* noted—seemingly with relief—that the case "does not require us to figure out how to allocate basis in the human body,"[157] because the parties agreed that the transaction was not a sale of the taxpayer's eggs. In *Lary*, the charitable blood donation case, the taxpayers' neglect of the basis question enabled the Eleventh Circuit to dispose of the issue in a single sentence: "Taxpayers have proffered no evidence as to *any* basis in the donated blood."[158] The 1975 mother's milk GCM conceded the possibility of some basis in breast milk, but gave the issue scant consideration: "The taxpayer had a zero basis in her milk unless she showed that she incurred expenses directly attributable to its production."[159]

Five years later, in the sale-of-plasma case, *Green*, the Tax Court developed the analysis at which the GCM had only hinted.[160] Because the court concluded that Ms. Green's plasma was property held primarily for sale to customers in the ordinary course of business, and thus was not a capital asset by reason of § 1221(a)(1),[161] the court analyzed her costs as possible business expenses rather than as possible additions to the basis of a capital asset. The court's conclusion

155. I.R.C. § 1001(a) (2012).
156. I.R.C. § 170(e)(1)(A).
157. Perez v. Comm'r, 144 T.C. 51, 56 (2015).
158. Lary v. Comm'r, 787 F.2d 1538, 1540 (11th Cir. 1986).
159. GCM 36,418, *supra* note 6.
160. Green v. Comm'r, 74 T.C. 1229, 1235–38 (1980).
161. *Id.* at 1233–34.

on the capital asset issue was mistaken.[162] If, however, the plasma is considered a capital asset the court's business-expense analysis provides the foundation for an inclusion-in-basis analysis.

The IRS had conceded that Ms. Green was entitled to a deduction for the $112 cost of "special drugs" she took in connection with her plasma sales, and the court allowed another $225 as Ms. Green's "additional expense, beyond that necessary for her personal needs, to purchase high protein foods and diet supplements for maintaining the quality of her blood plasma."[163] A year later, in its Action on Decision relating to *Green*, the IRS Chief Counsel's Office characterized the Tax Court's business expense conclusions as "not clearly erroneous."[164] Of course, the IRS had already conceded the principle—if not the exact dollar amount—when it accepted Ms. Green's claimed business expense deduction for the $112 cost of her "special drugs."

It is a bit surprising that the IRS and the Tax Court were so amenable to tax allowances for the cost of food ingested to improve the quality of body materials destined for sale, given the much less taxpayer-favorable position the IRS has taken in the analogous area of work clothes. In both situations the issue is how to resolve the tension between the § 162 allowance of deductions for business expenses[165] and the § 262 disallowance of deductions for "personal, living, or family expenses."[166] In the context of work clothes, the IRS has taken—and successfully defended in the courts—the position that the cost of clothes for work is not deductible if the clothes are appropriate for wear outside of work, even if a particular taxpayer's lifestyle is such that she never wears her work clothes when not at work.[167] If the same approach were taken in the case of special foods allegedly eaten only because of the taxpayer's special business needs, no deduction would be allowed as long as the food in question was suitable for general eating by people not in the same business as the taxpayer. In the unreported *Wheir* decision, involving a professional bodybuilder whose bodybuilding required him to be on an extremely high-protein diet (including a daily three pounds of buffalo meat), the Tax Court drew the analogy to the work clothes cases and concluded that the taxpayer's expenditures for buffalo meat and the like were "inherently personal" and so not deductible.[168] As a matter of doctrine, it is certainly possible to have one rule for special diets in the case of taxpayers (such as Ms. Green) who sell body material and a different rule for taxpayers (such as Mr. Wheir) who do not, but it is not easy to see why it would make sense to have different rules based on that distinction.

162. See the discussion *supra* text accompanying notes 109–10 (arguing that blood in the body is always held *primarily* for health-related reasons, rather than for possible sale).

163. *Green*, 74 T.C. at 1236.

164. Green v. Comm'r, 74 T.C. 1229 (1980), *action on dec.*, 1981-128 (Apr. 23, 1981).

165. I.R.C. § 162(a) (2012).

166. I.R.C. § 262(a).

167. Pevsner v. Comm'r, 628 F.2d 467 (5th Cir. Unit A 1980); Stiner v. United States, 524 F.2d 640 (10th Cir. 1975); Connelly v. Comm'r, 262 F.2d 411 (2d Cir. 1959).

168. Wheir v. Comm'r, No. 4350-03S, 2004 WL 1921830, at *15 (T.C. Aug. 30, 2004).

In any event, *Green* remains the last judicial word on this issue, and the IRS appears to have accepted *Green* in this respect. The issue may be of little practical significance if the facts of *Green* are typical of the situations in which the issue arises; the allowable expenses in *Green* were very small relative to the taxpayer's sales proceeds.[169]

If particular body materials qualify as capital assets (because they are held by their possessor primarily for personal use rather than as inventory), so that the issue is whether the cost of special drugs and foods is includible in basis, even the small tax allowances afforded Ms. Green may be lost in the translation from business expense deduction to inclusion in basis. The classic example of a personal-use capital asset sold at a gain is the owner-occupied residence. In determining what expenditures on the residence are includible in the taxpayer's adjusted basis, the principle is well established that although the cost of home improvements is added to basis, the cost of mere maintenance and repairs (to keep a home in ordinary operating condition) is not.[170] In addition to not being included in basis, maintenance and repair costs of homeowners are not deductible, because they are not related to any business or profit-motivated activity of the taxpayer.[171]

The expenses allowed as deductions in *Green* were in the nature of maintenance and repair, rather than permanent capital improvements; costly diet supplements ingested this year might improve the quality of one's blood for some portion of the current year, but they would likely have no effect on the quality of one's blood in future years. Accordingly, they should not be added to basis for the same reason that the cost of cleaning the gutters and windows of one's home are not added to basis. Thus, even the minimal cost allowance for human body materials permitted in *Green* should generally be disallowed if the material in question is treated as a capital asset rather than as business inventory.

The basis analysis suggested by the Fifth Circuit in its notorious *Garber* opinion can be quickly disposed of: "[I]t may well be that [Ms. Garber's plasma's] value should be deemed equal to the price a willing buyer would pay a willing seller on the open market. If this were the proper basis, the exchange would be a wash resulting in no tax consequences."[172] In fairness to the court, it should be noted that it offers this nonsense only as one possible analysis; the opinion does not conclude that the analysis is correct. On the other hand, the opinion treats the analysis respectfully, and does not conclude that it is wrong. But it is wrong, and shockingly and egregiously so. The quoted passage implicitly assumes that

169. Ms. Green was paid $6,695 for her plasma (not including $475 in travel allowances), and was allowed $337 in deductions for the cost of special drugs and food. Green v. Comm'r, 74 T.C. 1229, 1230, 1236–37 (1980).

170. The IRS spells this out in its publication covering the income tax consequences of home-related transactions. INTERNAL REVENUE SERV., CAT. NO. 15058K, PUBLICATION 530: TAX INFORMATION FOR HOMEOWNERS 11–12 (2015).

171. *See also* I.R.C. § 265(a)(1) (disallowing deductions for expenses relating to the production of tax-exempt income).

172. United States v. Garber, 607 F.2d 92, 97 (5th Cir. 1979) (citations omitted).

the basis of an asset is equal to the value of the asset at the time of its sale by the taxpayer. This is absurd. It flies in the face of § 1012(a), which states that "[t]he basis of property shall be the cost of such property,"[173] and it implies that only a sale to a sucker—that is, a sale of property for more than its value—would ever produce a taxable gain. No more need be said about this aspect of *Garber.*

V
A GRAB BAG OF INCOME TAX TOPICS

A. If a Sale Would Be Illegal, Does That Mean It Isn't a Sale?

The insistence in the *Perez* egg-donation contracts, and in many similar contracts, that the payments are not for the sale of eggs was not motivated by hoped-for tax savings resulting from the not-a-sale characterization. The contractual characterization was indeed an attempt to elevate labels over substance, but for the purpose of solving a non-tax problem.

The Society for Assisted Reproductive Technology (SART) is the dominant member organization in the United States for assisted reproduction technology professionals.[174] To be a SART member in good standing, a fertility clinic must comply with the guidelines of the American Society for Reproductive Medicine (ASRM) concerning the compensation of egg donors.[175] The relevant guidelines are set forth in a 2007 ASRM Ethics Committee Report.[176] The report begins by stating that payments to egg donors raise the "ethical question" of whether "financial compensation devalue[s] human life by treating oocytes as property or commodities."[177] The Ethics Committee concludes that compensation is ethically permissible, despite the commodification concern, if two conditions are satisfied: (1) that nobody involved in the transactions says that the clinic is paying the donor for her eggs, and (2) that the clinic does not pay the donor very much.[178] On the first point, the Committee explains:

> Compensation based on a reasonable assessment of the time, inconvenience, and discomfort associated with oocyte retrieval can and should be distinguished from payments for the oocytes themselves. Payment based on such an assessment is also consistent with employment and other situations in which individuals are compensated for activities demanding time, stress, physical effort, and risk.[179]

As for the second point, "As payments to women providing oocytes increase in amount, the ethical concerns increase as well. The higher the payment, the

173. I.R.C. § 1012(a).

174. Kimberly D. Krawiec, *Altruism and Intermediation in the Market for Babies*, 66 WASH. & LEE L. REV. 203, 240 (2009).

175. Kimberly D. Krawiec, *Sunny Samaritans and Egomaniacs: Price-Fixing in the Gamete Market*, 72 LAW & CONTEMP. PROBS. 59, 75 (Summer 2009).

176. Ethics Comm. of the Am. Soc'y of Reprod. Med., *Financial Compensation of Oocyte Donors*, 88 FERTILITY & STERILITY 305 (2007).

177. *Id.* at 305.

178. *Id.*

179. *Id.* at 306.

greater the possibility that women will discount risks. High payments, particularly for women with specific characteristics, also convey the idea that oocytes are commercial property."[180] Translating this principle into dollars, with the aid of a dubious comparison to the (much lower) going rate for sperm donations, the Committee concludes that "at this time sums of $5,000 or more require justification and sums above $10,000 are not appropriate."[181] In keeping with its insistence that transactions not be structured as sales of eggs, the Committee decrees, "In no circumstances should payment be conditioned on successful retrieval of oocytes or number of oocytes retrieved."[182]

As Kimberly Krawiec has forcefully pointed out, the Ethics Committee's prescription for dealing with commodification concerns turns out to be highly advantageous to the economic interests of the SART members who comply with the ASRM guidelines.[183] Assisted reproduction is a large and profitable industry, in which oocytes are fully commodified—apparently without giving rise to any ethical concerns—at every stage except the initial transfer from the egg donor to the donor agency.[184] By artificially depressing the compensation paid to the donors, the assisted reproduction industry increases its own profits. It is unclear to what extent the ASRM guidelines are based on sincere (even if not necessarily well-founded) ethical concerns, and to what extent they are nothing more than a move in a profits grab.

It appears that the ASRM's official disapproval of payments in excess of $5,000, or $10,000 in special circumstances, is on the way out. The plaintiffs in a pending federal lawsuit assert that the guidelines—and the adherence to them by SART members—constitute a price-fixing agreement in violation of the Sherman Act.[185] The complaint has survived a motion to dismiss, and according to recent reports the parties have reached a proposed settlement under which ASRM will remove from its guidelines all language referring to dollar ceilings on appropriate compensation.[186]

In most states, the only external pressure on the Donor Source and similar agencies to insist that they are not in the business of buying eggs comes from the SART–ASRM guidelines. Federal law—the National Organ Transplant Act of

180. *Id.*

181. *Id.* at 308.

182. *Id.*

183. Krawiec, *supra* note 175, at 82.

184. Julia D. Mahoney, *The Market for Human Tissue*, 86 VA. L. REV. 163, 189 (2000) ("To imagine that not compensating the egg provider will prevent ova from being transformed into a commodity is to misunderstand the extent of commercial activity in fertility treatments").

185. 15 U.S.C. § 1; Class Action Complaint, Kamakahi v. Am. Soc'y for Reprod. Med., 305 F.R.D. 164 (N.D. Cal. Apr. 12, 2011) (No. 11-cv-1781-JCS), 2011 WL 1374902.

186. Kamakahi v. Am. Soc'y for Reprod. Med., No. C 11-01781 SBA, 2013 WL 1768706, at *1 (N.D. Cal. Mar. 29 2013) (order denying motion to dismiss); Kelly Knaub, *Egg Donors Get Pay Limits Axed with Antitrust Settlement*, LAW360 (Feb. 1, 2016, 7:01 PM), http://www.law360.com/articles/753389/egg-donors-get-pay-limits-axed-with-antitrust-settlement [https://perma.cc/PD7D-PU45]. For an analysis of the issues in the case, see Kimberly D. Krawiec, *Egg Donor Price Fixing and* Kamakahi v. American Society for Reproductive Medicine, 16 VIRTUAL MENTOR 57 (2014).

1984—prohibits the purchase and sale of any "human organ," but the definition of "human organ" does not include gametes.[187] Most states have no laws of any sort addressing human egg donations, and even in the states with such laws the typical legislative concerns are with parental rights with respect to resulting children, and with required disclosures from clinics to potential donors.[188]

Louisiana and Indiana are rare exceptions to the general lack of concern among state legislatures with the commodification of human eggs. A Louisiana statute declares that "[t]he sale of a human ovum . . . is expressly prohibited,"[189] and a provision of the Indiana Code states that anyone who "knowingly or intentionally purchases or sells a human ovum" commits a felony.[190] As with the SART–ASRM guidelines, Indiana's apparently absolute prohibition turns out to be mostly a matter of labeling and price-capping. The Indiana statute does not prohibit "receipt by a . . . woman donor of an ovum . . . of an amount for" for lost earnings, travel expenses, hospital expenses, medical expenses, and "recovery time in an amount not to exceed four thousand dollars," if the donation is pursuant to a "procedure to enhance human reproductive capacity."[191]

Is there any income-tax significance to the SART–ASRM and criminal law requirements that egg donations not be characterized by the parties as sales of property? Although the answer is almost certainly no in the case of the SART–ASRM guidelines, the question is more complicated in the case of the criminal law prohibition, in light of the Supreme Court's 1972 decision in *Commissioner v. First Security Bank of Utah*.[192]

Section 482 of the Internal Revenue Code authorizes the IRS to reallocate income among related taxpayers if the reallocation "is necessary . . . clearly to

187. 42 U.S.C. § 274e (2012).

188. Margaret E. Swain, *Oocyte Donations: Legal Aspects*, *in* THIRD PARTY REPRODUCTION: A COMPREHENSIVE GUIDE 31, 33 (J.M. Goldfarb, ed., 2014) ("[F]ewer than 15 of the states . . . have laws addressing egg donation"); PRESIDENT'S COUNCIL ON BIOETHICS, REPRODUCTION AND RESPONSIBILITY: THE REGULATION OF NEW BIOTECHNOLOGIES 151–52 (2004) ("Some states broadly prohibit or limit the sale of organs or nonrenewable tissues, but it is an open question whether ova fall within the ambit of such prohibitions"). In an *amicus curiae* brief in *Perez*, Timothy M. Todd, Jr., cites CAL. PENAL CODE § 367f (West 2016) for the proposition that "[t]he sale of human eggs is illegal in the state of California" (where Ms. Perez's egg donation took place). Brief for Professor Timothy M. Todd, Jr. as Amicus Curiae Supporting Respondent at 1 n.3, Perez v. Comm'r, 144 T.C. 51 (2015) (No. 9103-12) (filed May 12, 2014). This appears to be incorrect. (Judge Holmes' opinion in *Perez* does not mention § 367f.) The provision makes illegal the purchase and sale of "any human organ, for purposes of transplantation." Although the statutory definition of "any human organ" is arguably broad enough to include eggs (despite the statute's failure to feature eggs in its non-inclusive list of covered organs), it is reasonably clear that transactions in eggs are not covered because the eggs are not obtained "for purposes of transplantation." The statute does not define "transplantation," but the standard terminology for what is done with eggs is "implantation," not "transplantation." *See, e.g.*, MAYO CLINIC, *In Vitro Fertilization (IVF)*, http://www.mayoclinic.org/tests-procedures/in-vitro-fertilization/home/ovc-20206838 [https://perma.cc/BJ4A-KYWF].

189. LA. STAT. ANN. § 9:122 (2016).

190. IND. CODE 35-46-5-3(c) (2016).

191. IND. CODE 35-46-5-3(d). The $4,000 cap applies only to compensation for "recovery time"; the only cap on the other compensable items are the actual amounts of lost earnings and expenses.

192. Comm'r v. First Sec. Bank of Utah, 405 U.S. 394 (1972).

reflect the income" of any of the taxpayers.[193] Pursuant to that authority, the IRS attempted to allocate to the First Security Bank of Utah a portion of the insurance premium income of a related insurance corporation (Security Life), on the grounds that "40% of Security Life's premium income was allocable to [First Security] as compensation for originating and processing the credit life insurance."[194] First Security protested that it could not be allocated premium income for tax purposes because as a bank it was prohibited by federal law from acting as an insurance agent.[195] The Supreme Court held for First Security, commenting:

> We know of no decision of this Court wherein a person has been found to have taxable income that he did not receive and that he was prohibited from receiving. In cases dealing with the concept of income, it has been assumed that the person to whom the income was attributed could have received it.[196]

Under a broad reading of *First Security*, if the parties to an egg donation transaction formally deny that the transaction is a sale of eggs, and if the parties were prohibited from engaging in a sale of eggs, then the transaction should not be treated as a sale for tax purposes. Although the application of the *First Security* doctrine in the *First Security* case itself produced a pro-taxpayer result, the application of the doctrine to egg donors could be to a donor-taxpayer's detriment—if characterization of the transaction as a sale would result in long-term capital gain, and if non-sale characterization would not result in the exclusion of payments as damages on account of personal physical injury under IRC § 104(a)(2).

However, this reading of *First Security* is too broad for several reasons. First, the Court's expressed concern in *First Security* is solely about tax characterizations effectively accusing a taxpayer of criminal conduct.[197] Attributing mere violations of SART–ASRM guidelines to taxpayers should not give rise to the same level of judicial concern. Second, even in the unlikely event that the SART–ASRM guidelines were considered the equivalent of criminal law for this purpose, the guidelines apply only to assisted-reproduction professionals, not to egg donors. Egg donors themselves are not in a position to violate ASRM guidelines, so characterizing a transaction as a sale for tax purposes would not involve accusing a donor–taxpayer of violating the guidelines.

The applicability of *First Security* is a closer call in Indiana or any jurisdiction with a similar criminal prohibition, where treating a donor–taxpayer as having sold her eggs could be construed as accusing her of having committed a felony. Even that situation, however, is probably outside the scope of the *First Security* doctrine. The Court's resistance in *First Security* was to treating a taxpayer as having received income it would have been a crime to have received, when the

193. I.R.C. § 482 (2012).

194. *First Sec. Bank of Utah*, 405 U.S. at 400.

195. *Id.* at 401 (citing 12 U.S.C. § 92).

196. *Id.* at 403.

197. *Id.* at 405.

taxpayer did not actually receive the income.[198] In the Indiana egg donor situation, by contrast, there is no question of a § 482 allocation to a taxpayer of amounts she did not actually receive; the only question is the characterization—legal or illegal—of the payments she did receive. In his opinion for the Court in *First Security,* Justice Powell made just that distinction: "We are not faced with a situation such as existed in those cases, urged by the Commissioner, in which we held the proceeds of criminal activities to be taxable. Those cases concerned situations in which the taxpayer had actually received funds."[199]

To sum up with respect to *First Security*: the case certainly poses no impediment to sale-of-property characterization for donors in jurisdictions without Indiana-type laws, and probably poses no impediment even in Indiana or any other jurisdiction with a similar criminal prohibition.[200]

B. Property Versus Services In Blood Shield Statutes: Are There Tax Implications?

Almost all state legislatures have enacted so-called blood shield statutes, designed to ensure that the no-fault tort liability rules generally applicable in the case of harm caused by consumer products do not apply in the case of transfused human blood.[201] The concern motivating both the original enactment and the continuation of the blood shield statutes is that certain types of blood infections—initially hepatitis and later HIV—might be present in blood but undetectable by existing technology.[202]

198. *Id.* at 405.

199. *Id.* at 405 (footnote omitted).

200. If some future egg donor, having given up on the § 104(a)(2) exclusion claim following the unfavorable result in *Perez*, decided to argue for long-term capital gains treatment as the next-best tax result, that donor would be in the awkward position of arguing against the not-a-sale-of-eggs characterization contained in the contract she had signed. That donor would have to contend with the so-called non-disavowal doctrine, under which there is a sort of judicial presumption against allowing taxpayers to disavow the forms and labels they chose for their transactions. *See, e.g.*, Maletis v. United States, 200 F.2d 97 (9th Cir. 1952) (holding that where an entity was in substance owned entirely by taxpayer, but in form was co-owned by taxpayer and his two sons, the court would not permit the taxpayer to disavow the form in a year in which the entity produced a loss). For a comprehensive discussion of the doctrine, see Emily Cauble, *supra* note 70. However, courts generally consider the doctrine inapplicable when a taxpayer can establish that the inaccurate labeling of the transaction was adopted for non-tax reasons, rather than as part of a tax planning strategy. Cauble, *supra*, at 11–12 (first citing Comm'r v. Proctor Shop, 82 F.2d 792 (9th Cir. 1936) (allowing disavowal where instrument was labeled "preferred stock" rather than debt to avoid damaging corporation's credit rating); then citing Arthur R. Jones Syndicate v. Comm'r, 23 F.2d 833 (7th Cir. 1927) (same, except that non-tax motive was to avoid violating state usury laws)). Because the motivation for the contractual insistence that egg donation transactions are not sales is entirely non-tax, the non-disavowal doctrine should not present major problems for an egg donor claiming that her payments constitute long-term capital gain.

201. For a comprehensive survey of state blood shield laws (as of 1994), see Michael J. Miller, Note, *Strict Liability, Negligence and the Standard of Care for Transfusion-Transmitted Disease*, 36 ARIZ. L. REV. 473, 488–90 (1994) (noting that only two states—New Jersey and Vermont—did not have blood shield statutes).

202. Donald L. Sweatt, Comment, *Serum Hepatitis Through Blood Transfusions: A Wrong Without a Remedy?*, 24 SW. L.J. 305, 307–08 (1970).

To a lay person, the obvious way to draft a blood shield statute would be simply to declare that a supplier of transfused human blood shall be liable for harm caused by infected blood only if the supplier was at fault for failing to detect the infection. A handful of blood shield statutes follow this straightforward approach.[203] In the vast majority of states, however, the blood shield statutes take the unnecessary—and, to a non-lawyer, puzzling—step of declaring that furnishing human blood for transfusion is "for all purposes to be the rendition of a service by every person participating therein and . . . is . . . not to be a sale of such . . . blood."[204] This approach is a striking example of category-dependent thinking typical of "thinking like a lawyer." It has become so stamped on the legal mind that strict liability in tort applies to products but not to services, that the lawyerly way to express the idea that strict liability does not apply to blood (and, in many states, other human body materials as well) is not simply to say so, but rather to declare that blood is not a product but a service.

Most of the blood shield statutes take the belt-and-suspenders approach, also typical of the legal mind, and add to the service-not-product declaration an express statement that liability for transfused blood is to be based only on willful or negligent conduct.[205] However, several state legislatures—including those of California and New York—are so confident of the category-based approach that their blood shield statutes merely declare that providing blood for transfusion is, "for all purposes whatsoever," the rendition of a service rather than the sale of a product—without any explanation of the legal significance of that declaration.[206]

This strange-but-lawyerly use of assignment to category in place of an express statement of legal consequences would be nothing more than a quirk of the legal mind, but for its possible federal income tax implications. If federal income tax consequences follow from the labels attached to transactions by state law, then taxpayers residing in California, New York, and states with similarly-worded blood shield statutes would be subject to the disadvantageous tax consequences that flow from categorizing their sales and donations of blood as services. Whether this would apply only with respect to blood, or to all human body

203. *See, e.g.*, HAW. REV. STAT. § 327-51 (2016); MD. CODE ANN., HEALTH-GEN. § 18-402 (West 2016); N.M. STAT. ANN. §24-10-5 (2016); 42 PA. CONS. STAT. § 8333 (2016); TEX. CIV. PRAC. & REM. CODE § 77.003(a) (West 2016). *See also* RESTATEMENT (THIRD) OF TORTS § 19(c) (AM. LAW INST. 1998) (stating that "[h]uman blood and human tissue, even when provided commercially, are not subject to the [strict liability for defective products] rules of this Restatement" without taking any position on whether or not human blood and human tissue are products).

204. The quoted language is from ALA. CODE § 7-2-314(4) (2016). Similar declarations appear in the blood shield statutes of most states. Miller, *supra* note 201, at 489 n.120 (citing the statutes of 39 states).

205. *See, e.g.*, WASH. REV. CODE § 70.54.120. *See also* Miller, *supra* note 201, at 489 n.121 and n.122 (citing statutes of this sort).

206. The quoted language is from CAL. HEALTH & SAFETY CODE § 1606 (West 2016). *See also* N.Y. PUB. HEALTH LAW § 580.4 (McKinney 2016) ("[The provision of blood for transfusion] is hereby declared to be a public health service and shall not be construed to be, and is declared not to be, a sale of such blood . . . for any purpose or purposes whatsoever."), and Miller, *supra* note 201, at 490 n.123 (listing eight blood shield statutes, including those of California and New York, which declare transfusion of blood to be a service rather than a product for legal purposes, without offering any explanation of the legal significance of the declaration).

materials, would depend on the scope of a particular state's shield statute. Taxpayers would have no hope of long-term capital gains treatment for their sales, and they would have no hope of charitable deductions for the unrealized appreciation in their donations. Residents of states with belt-and-suspenders blood shield statutes (containing both a services-not-property declaration and an express statement of the tort law consequences of that declaration) would probably suffer the same fate. Only for taxpayers in the handful of states whose shield laws say nothing about whether blood is product or service would there be a good chance of persuading the courts that property—not services—tax rules should apply to their sales and donations of blood and other human body materials.

But do federal income tax consequences follow from state law labels? The federal income tax consequences of state law characterizations are not easily summarized. In a few cases the Internal Revenue Code either explicitly supersedes state law,[207] or explicitly adopts state law.[208] In the vast majority of situations, however, the Code neither explicitly rejects nor explicitly embraces state law labels.[209] In those cases, "when the Code uses familiar legal terms it rarely infuses them with a national meaning but, instead, ordinarily defers to state law by employing the terms as abbreviated ways of designating events and relationships that create [various] tax consequences."[210] For example, if tax results depend on whether or when a taxpayer becomes the owner of found property, federal income tax results may differ among the states due to variations in state property laws.[211] On the other hand, if state law employs "an idiosyncratic label for a transaction, event, or status that seems to be outside the intended reach of the tax provision in question, the local term may be rejected in favor of a more conventional, nationally uniform definition."[212]

All this suggests that the question of whether blood—and other body materials—should be viewed as services or property should be decided without any reference to state shield laws. To characterize blood as not-property for federal tax purposes, simply because a state statute declares it is not property, would be a mistake for two reasons. First, it would give rise to the possibility of different tax results for residents of different states with differently-expressed—but substantively indistinguishable—shield statutes.

Second, even if all states had shield statutes resembling those of California and New York, thus eliminating concerns about lack of national uniformity in the

207. *See, e.g.*, I.R.C. § 6013(d)(2) (2016) (providing that legally-separated spouses are not married for federal income tax purposes).

208. *See, e.g.*, I.R.C. § 66(d)(3) (defining "community property laws" for federal income tax purposes as *state* community property laws).

209. BITTKER, MCMAHON, JR., & ZELENAK, *supra* note 69, at ¶1.02.

210. *Id.* at ¶ 1.02[4].

211. *See, e.g.*, Cesarini v. United States, 296 F. Supp. 3 (N.D. Ohio 1969), *aff'd*, 428 F.2d 812 (6th Cir. 1970) (relying on state property law in determining when taxpayers became taxable on cash found in an old piano).

212. BITTKER, MCMAHON, JR., & ZELENAK, *supra* note 69, at ¶ 1.02[4].

application of the income tax, there would still be no good reason for the federal income tax to defer to this particular state law label. The broad statutory declarations that blood is not property are not based on state legislatures' deep, or even shallow, conceptions of the nature of property. Rather, they are the product of an odd lawyerly tendency to produce results indirectly by assigning things to legal categories, rather than directly by stating the legal results. Once it is understood that the not-property declarations in shield statutes are nothing more than a peculiar way of implementing a fault-based tort regime for blood, it is apparent that shield statutes should have no role to play in the determination of whether blood is property for purposes of the federal income tax.

None of this is to say that blood and other human body materials should necessarily be treated as property for federal income tax purposes. What is offered here is only the narrower argument that state shield statutes should play no role in the federal income tax analysis. If blood would qualify as property for tax purposes in the absence of a state shield law declaring it not to be property, then it should still qualify as property in the presence of such a statute.

C. Egg Donors And Tax Policy Analysis: An Aside

Before the Tax Court rejected the argument in *Perez*, egg donors had opined—despite their conceded lack of income tax expertise—that the payments they received qualified for exclusion from gross income by reason of § 104(a)(2). A group called "We Are the Egg Donors," describing itself as "the first community advocacy group for egg donors," posted online a twenty-seven-page booklet, "An Egg Donor's Guide to Dealing with Taxes."[213] The booklet complained, with good reason, that "searching for quality information on taxing egg donors was going caving without a flashlight," and that "99.99% of egg donor agencies and clinics won't touch the subject [of the income tax treatment of donors] with a ten foot pole." Although the booklet insisted that it did not offer legal or tax advice, it featured an interview with "Elizabeth," who quoted from the legislative history of the 1996 amendments to § 104(a)(2), mistakenly claiming that she was quoting from the statute itself, and who suggested that payments to egg donors qualified for exclusion from gross income under the quoted language.[214] It is, of course, neither surprising nor lamentable that a taxpayer faced with a situation not clearly addressed by existing authority would, upon the discovery of a possibly relevant exclusion provision, optimistically conclude that her situation was within the scope of the provision. After all, Ms. Perez's tax lawyer thought the issue was worth litigating, and Judge Holmes required several pages of analysis—delving into the judicial and legislative history of § 104(a)(2)—

213. We Are Egg Donors, An Egg Donor's Guide to Dealing with Taxes, previously available at http://weareeggdonors.com [https://web.archive.org/web/20150410102858/http:/weareeggdonors.com/2014/09/10/an-egg-donors-guide-to-dealing-with-taxes/] (copy on file with the author). The website now features a statement, dated February 2, 2015, that the booklet is no longer available in the aftermath of the Tax Court's *Perez* opinion.

214. *Id.*

to explain why the exclusion did not apply to compensation for injuries consented to in advance.[215]

It was not enough, however, for either "Elizabeth" or Ms. Perez herself, that there might be a good technical argument for excluding their payments from gross income. Apart from her interpretation of the Internal Revenue Code, "Elizabeth" claimed that she had pursued her reportedly successful administrative appeal "because I felt that it was unethical to tax an occurrence that could impact my health."[216] In a *Bloomberg Business* story, Ms. Perez offered a different principle of justice as the explanation for her decision to pursue her case in Tax Court: "I feel like [by being taxed] I am being penalized for doing something good for another person."[217]

A moment's reflection by any fair-minded lay person would reveal that neither of the asserted principles of justice is enshrined in the current federal income tax. If "Elizabeth" really thought that it was unethical to tax compensation for voluntarily exposing oneself to a health risk, why did she suppose that principle should apply uniquely to the compensation of egg donors, without also making tax-exempt the pay of millions of others, ranging from coal miners to professional football players?[218] And if Ms. Perez really thought there was or should be an income tax exemption for everyone who received compensation for "doing something good for another person," what did she suppose would be left of the base of the income tax after that principle had been generally applied? Did she think that the income of health professionals and teachers, for example, was or should be tax-exempt?

It is tempting to conclude that this rather desperate search for a lofty principle of justice to explain one's pursuit of a hoped-for tax break is explained by particular features of the fertility industry and of egg donors themselves. As Kimberly Krawiec has documented, "There is a clear consensus that egg donors are, and should be, motivated primarily by altruism."[219] Fertility industry professionals believe that their clients are not interested in the eggs of donors motivated primarily by money, and many agencies reject potential donors who admit to an overriding financial motivation.[220] "Indeed," notes Krawiec, "donor-agency staff express disgust and revulsion toward egg donors 'just in it for the money' or 'trying to make a career' out of egg donation."[221] If egg donors are

215. Perez v. Comm'r, 144 T.C. 51, 58–63 (2015).

216. We Are Egg Donors, *supra* note 213.

217. Richard Rubin, *Egg Donor IRS Challenge Offers Future Sperm Tax Certainty*, BLOOMBERG BUSINESS (Feb. 20, 2014, 12:00 AM), http://www.bloomberg.com/news/articles/2014-02-20/egg-donor-irs-challenge-offers-future-sperm-tax-certainty [https://perma.cc/M4BT-D7FM].

218. Judge Holmes notes in *Perez* that, if § 104(a)(2) were interpreted to apply to egg donors, it would also apply to professional athletes, coal miners, workers on fishing boats, and many others. 144 T.C. at 20.

219. Krawiec, *supra* note 175, at 67.

220. *Id.* at 67–68.

221. *Id.* at 68 (citing Rene Almeling, *Selling Genes, Selling Gender: Egg Agencies, Sperm Banks, and the Medical Market in Genetic Material*, 72 AM. SOC. REV. 319, 333–34 (2007)).

initially uncomfortable with the idea of commodifying their genes, and so are predisposed to understand themselves as altruistic rather than mercenary, that predisposition can only be strengthened by their interactions with fertility clinic staff. Having persuaded themselves that their decisions to become egg donors are not about the money, the donors employ the same mindset in convincing themselves that their efforts to avoid paying tax on their compensation are also not about the money.

This may all be true, but in fairness to egg donors it must be added that the idea of insisting on favorable tax treatment out of principle rather than out of greed is a very American, and perhaps human, phenomenon. It would require another article to fully document the point, but the phenomenon is so familiar that a couple examples here should suffice. When writers and artists realized that the newly-enacted uniform capitalization rules of the Tax Reform Act of 1986 applied to them, along with all other producers of real or tangible personal property,[222] the resulting outrage was supposedly about principle, not dollars. A painter complained, "We're making art, not lawn mowers," and a sculptor explained, "I'm not a bicycle manufacturer. I'm dealing with dreams here." An art gallery assistant director claimed the new law made artists "feel as if someone were stabbing them."[223] The complaints worked. In 1988 Congress enacted an amended version of the uniform capitalization rules, with a special exemption from the rules for "qualified creative expenses."[224]

More recently—and more notoriously—in 2010 private-equity fund billionaire Stephen Schwartzman complained that the Obama administration's efforts to tax as ordinary income the "carried interest" of hedge fund managers was "like when Hitler invaded Poland in 1939."[225] Schwartzman's complaint also succeeded, in that Congress has yet to revise the taxation of carried interest.

Compared with these two examples, the claims of egg donors that justice demands that their compensation be exempt from tax seem a model of reason and restraint.[226]

222. Tax Reform Act of 1986, Pub. L. No. 99-514, § 803, 100 Stat. 2085, 2350 (1986) (codified as amended at I.R.C. § 263A (2012)).

223. Citations to newspaper stories containing the quotations can be found in Lawrence Zelenak, *I Can Sit on It, But Is It Art?*, 70 TAX NOTES 99, 99 (1996).

224. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6026(a), 100 Stat. 3342, 3691 (1988) (codified as amended at I.R.C. § 263A(h)).

225. Jonathan Alter, *Schwarzman: "It's a War" Between Obama, Wall Street*, NEWSWEEK (Aug. 15, 2010, 4:00 AM), http://www.newsweek.com/schwarzman-its-war-between-obama-wall-st-71317 [https://perma.cc/6UGG-FK9X].

226. It could be noted, however, that the artists and the private equity billionaire made their dubious appeals to principle in arguing for or against legislative changes in the law; unlike "Elizabeth" and Ms. Perez, they did not appeal to principle as a guide to the interpretation of current law.

VI
OTHER TAXES

A. Gift And Estate Taxes

A few commentators—but no cases or revenue rulings—have considered the estate and gift tax consequences of non-charitable gratuitous transfers of human body materials. The property-versus-services distinction is crucial here, because § 2501(a)(1) imposes the gift tax on transfers of property but not of services,[227] and because § 2031(a) includes in a decedent's gross estate "the value at the time of his death of all property" owned by the decedent.[228]

The author of the 1973 Columbia Law Review Note opined that the transfer of a human organ should be treated as a transfer of property rather than as a service, with the result that a gift of, for example, a kidney to a relative or friend would be subject to the gift tax.[229] Two years later, the breast milk GCM expressed concern that the publication of a revenue ruling stating that body materials were property for income tax purposes could "have a far reaching effect in the gift and estate tax areas."[230] The implication of such a ruling, according to the GCM, would be that "a gift tax should be levied on the gift of a kidney for transplant if it is not given through a charitable organization," and that "[t]he value of a decedent's body should therefore be includible in his estate" for estate tax purposes.[231] Questioning the advisability of issuing a revenue ruling with those implications, the author of the GCM counseled careful consideration of "whether it is in the best interests of the Service and the taxpayer public to publish a revenue ruling."[232] In the end, no ruling was published.

Much more recently, Lisa Milot and Bridget Crawford have come down on opposite sides of the gift and estate tax issue. Milot's proposed rule—that body materials transferred in commercial transactions are property, but materials transferred gratuitously are not—would apply for purposes of all federal taxes.[233] Accordingly, a gift of a kidney to a relative or friend would not be subject to the gift tax,[234] and the date-of-death value of body materials not commercially transferred would not be subject to the estate tax. Milot's proposed rule appears to be driven largely by transfer tax concerns; the proposed rule provides a plausible technical justification for the current practice of not applying the transfer taxes to gifts of kidneys and to the value of corpses. Milot implicitly assumes, however, that the same property-or-not-property rules must apply for purposes of both the transfer taxes and the income tax.

227. I.R.C. § 2501(a)(1).
228. I.R.C. § 2031(a).
229. *Tax Consequences of Transfers of Bodily Parts, supra* note 7, at 857–59.
230. GCM 36,418, *supra* note 6.
231. *Id.*
232. *Id.*
233. Milot, *supra* note 3, at 1093.
234. *Id.* at 1107.

Alone among the commentators, Crawford both takes the position that under current law the transfer taxes apply to *inter vivos* gifts of body materials and to the date-of-death value of corpses, and seems to find that result untroubling on policy grounds.[235] Although Crawford makes a plausible technical case for her interpretation, she offers little in the way of a policy defense of the results that would follow from its application.

There are no cases on whether the gift and estate taxes apply to body materials, for the simple reason that the IRS has never claimed that they do. Nor is there any possibility that the IRS will change its mind on the issue. From one perspective, then, any theoretical discussion of the possible application of the transfer taxes to body materials is moot, because the question will never arise in real life. On the other hand, arguably the IRS should not take taxpayer-favorable positions contrary to the dictates of the Code simply because it can get away with doing so.[236] Thus, Milot's offer of an analysis under which the IRS can be understood as interpreting the transfer taxes not to apply to body materials, rather than as declining to enforce the statutorily-mandated application of the taxes, is welcome.

However, Milot's extension of her proposed rule from the transfer taxes to the income tax is unnecessary. The transfer taxes and the income tax are not *in pari materia.* Just as courts have held that the word "gift" has one meaning under the income tax and a different meaning under the gift tax,[237] the courts could similarly adopt Milot's proposed rule for purposes of the transfer taxes, without thereby committing themselves to the same rule for purposes of the income tax. In terms of legislative intent, there could be good reason to favor such a bifurcated approach. In the case of the transfer taxes, it is clear both that Congress has never thought about whether the transfer taxes should treat body materials as property, and that if Congress had thought about the issue, it would have decided that the transfer taxes should not treat body materials as property. In the case of the income tax, by contrast, although it is likewise clear that Congress has never focused on the question of body materials as property, it is distinctly possible that if Congress had thought about the question it would have been comfortable with the income tax consequences flowing from the treatment of dealings in body materials as property transactions.

B. The Self-Employment Tax

Although the question of the applicability of the self-employment tax to sellers of human body materials has received almost no attention, the issue is of

235. Crawford, *supra* note 3, at 758. *See also id.* at 744 (discussing the taxation of a gift of ova to a sister of the taxpayer); *id.* at 745–46 (discussing the application of the estate tax to the value of assets buried with the decedent).

236. *See generally* Lawrence Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 DUKE L.J. 829 (2012).

237. Farid-es-Sultaneh v. Comm'r, 160 F.2d 812, 814–15 (2d Cir. 1947); Comm'r v. Beck's Estate, 129 F.2d 243, 246 (2d Cir. 1942) (suggesting, only half in jest, that "gift," "gaft," and "geft" be used to designate the different meanings for purposes of the three taxes).

considerable practical significance. The tax rate on most income from self-employment is 15.3%.[238] This is similar to the percentage-points difference between ordinary income rates and capital gains rates for most taxpayers.[239] Thus, the economic significance of whether the self-employment tax applies to transactions in body materials is comparable to the economic significance of whether gains from transactions in body materials are taxed at ordinary rates or at the rates applicable to long-term capital gains.

The base of the self-employment tax is "self-employment income," which the statute defines as "net earnings from self-employment," subject to several limitations which are immaterial here.[240] The statute generally defines "net earnings from self-employment" as "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business . . . ."[241] Assuming the correctness of the Tax Court's conclusion in *Perez* that Ms. Perez was compensated for her performance of non-employee services, rather than for the sale of her eggs,[242] it should follow that the payments she received were subject to the self-employment tax as well as to the income tax. Similarly, it should follow from the Tax Court's decision in *Green* that Ms. Green was engaged in the business of selling tangible personal property,[243] that her net income was subject to both taxes. The self-employment tax is not automatically avoided by the characterization of a transaction in body material as a sale of property. Ms. Green, for example, should have been subject to the tax despite the Tax Court's characterization of her plasma as property, because the court found her to be in the business of selling her plasma as inventory.

But what is the result under the self-employment tax if—as this article argues is generally the correct analysis for sellers of human body materials—the taxpayer is viewed as selling property rather than as performing a service, *and* the property qualifies as a capital asset, avoiding inventory status by reason of the primary purpose test?[244] In that case the self-employment tax would not apply, because § 1402(a)(3)(A) specifies that "net earnings from self-employment" does not include any gain or loss "which is considered as gain or

238. I.R.C. §§ 1401(a), (b) (2012). The statute imposes a 12.4% tax on self-employment income (to fund Social Security), and a 2.9% tax on the same base (to fund Medicare). The 12.4% portion of the tax does not apply to self-employment income in excess of the Social Security contribution and benefit base (I.R.C. § 1402(b)(1)). An additional 0.9% tax applies to self-employment income of more than $200,000, or of more than $250,000 in the case of a married couple filing a joint return (I.R.C. § 1401(b)(2)).

239. For example, a taxpayer in the 28% bracket with respect to ordinary income would be taxed at 15% on most long-term capital gains. I.R.C. § 1(h)(C).

240. I.R.C. § 1402(b).

241. I.R.C. § 1402(a).

242. Perez v. Comm'r, 144 T.C. 51, 57 (2015).

243. Green v. Comm'r, 74 T.C. 1229, 1234 (1980).

244. *See supra* text accompany notes 89–101 (discussion of the property-versus-services issue); *supra* text accompanying notes 107–18 (discussion of the § 1221(a)(1) inventory exception to capital asset status).

loss from the sale or exchange of a capital asset."[245] This result does not depend on the taxpayer not being engaged in a trade or business. The result also does not depend on the resolution of the vexed question of taxpayers' holding periods for their various body materials. If the income in question is capital gain it is not included in self-employment income, whether or not the gain is associated with a trade or business of the taxpayer, and whether the gain is short-term or long-term.

In short, there is very little independent legal analysis applicable to the self-employment tax issue. The answers to the crucial income tax questions will determine the answers to the self-employment tax question. If, as this article argues, the income tax answers are property (not services) and capital (not ordinary) asset status, the self-employment tax answer is that the tax does not apply.

VII
CONCLUSION

My hope (perhaps an unusual hope for an author) is that the reader will have found much of the analysis in this article rather infuriating—not because it is implausible as an interpretation of current law, but because there is no remotely plausible policy reason why the tax consequences of body materials transactions should differ greatly depending on whether the label of services or property is attached to particular transactions, and because (to take a striking example from a judicial opinion) it is bizarre that federal income tax consequences should turn on the lifespans of red blood cells.[246] If tax distinctions—between income from services and income from property, between sales of capital and non-capital assets, and between long-term and short-term gain—seem irrational in the unfamiliar context of human body transactions, that might lead one to examine more critically the justifications for those distinctions in other, more familiar, areas. Perhaps the broader lesson to be drawn from the consideration of the tax treatment of transactions in human body materials is that it would be better to have a tax system which did not draw so many distinctions between different types of income.

245. I.R.C. § 1402(a)(3)(A).

246. Lary v. Comm'r, 787 F.2d 1538, 1540 n.3 (11th Cir. 1986).