

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: OCT 5 1999

Contact Person:

ID Number:

Telephone Number:

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

NO PROTEST RECEIVED
Release copies to District

Date 11/18/1999

Surname:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(13). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were formed as an unincorporated association on [REDACTED]. You operate as a mutual cemetery company. You were incorporated under [REDACTED] of [REDACTED]. You have agreed to amend your Articles of Incorporation to comport with section 501(c)(13) of the Internal Revenue Code.

You sell plots, mausoleums, lawn covered crypts and niches to the public and raise funds to maintain the cemetery. You provide interment services, installation of foundations and monuments and maintenance of cemetery grounds. Upon purchasing an interment space an individual becomes a member.

Your cemetery is managed by [REDACTED] hereafter [REDACTED], a for-profit entity, which was formerly known as [REDACTED] (hereafter [REDACTED]) is owned by [REDACTED] (hereafter [REDACTED]), a for-profit entity in the funeral and cemetery business. Your current governing board is composed of seven directors, six of whom are officers and directors of [REDACTED] and one, who is an officer and director of [REDACTED].

[REDACTED] and [REDACTED] each purchased 100 interment spaces for purpose of resale. The 100 interment spaces averaged sales price during this time was approximately \$1,580. [REDACTED] and [REDACTED] each purchased these lots for a total discounted sale price of \$75,000, which is approximately \$750 a space. However, you state that neither [REDACTED] nor [REDACTED] have sold any of such interment spaces. You state that these lots were sold to [REDACTED] and [REDACTED] in order (i) to raise funds, and (ii) to preserve a large section of adjoining lots for resale to organizations such as churches, labor unions, synagogues, etc.

You and [REDACTED] entered into a management agreement on [REDACTED]. The management agreement was for an initial 10 year period with an automatic renewal for 10 years. Pursuant to the terms of the agreement [REDACTED] will make recommendations concerning the management of the trust fund, including but not limited to determination of risk parameters, monthly income projections, custodial selection, and administration of the trust funds. In addition, [REDACTED] will arrange for your participation in its insurance policies and loss control programs.

Article II of the agreement enumerates [redacted] various duties and responsibilities. Article III enumerates your obligations. Under Article III you are responsible for:

- a. expenses incurred by [redacted] on your behalf;
- b. providing all forms and materials;
- c. payment of permit fees;
- d. repair and maintenance of cemetery equipment;
- e. software used on your behalf;
- f. maintaining buildings, roads, water systems, etc.
- g. setting, adjusting, and determining prices; and
- h. advertising cost, brochures, etc.

Under Article III of the agreement you agree to provide [redacted] with office facilities, supplies and equipment. You agree to pay all expenses incurred by [redacted] on your behalf. You agree to be responsible for payment of all advertising, sales, and other costs related to your operation. [redacted] agrees not to incur expenses chargeable to you without your consent. Upon termination of the agreement you agree to pay to [redacted] everything due under the agreement within 10 days.

Article IV of the agreement provides monthly compensation for [redacted] managerial and sales related services of 17% of your gross revenues (excluding trust fund allocations) and a fee equal to 15% of the gross sales of burial spaces. [redacted] is entitled to payment on sales made when you receive at less 15% of the full purchase price of the item. If you receive liquidated damages on a defaulted contract, [redacted] will receive 50% of such amount. Also, [redacted] will receive 103% of cost for services and supplies that cannot be provided by use of your personnel, supplies or resources.

Under the above management agreement, you paid to [redacted] the following amounts for [redacted], [redacted], and [redacted], which represent 15% of the gross sale from burial spaces for each year below.

[redacted]
\$ [redacted] \$1 [redacted] \$ [redacted]

Further, you paid the following amounts to [redacted] for [redacted], [redacted], and [redacted], which represent 17% of all gross sales, including burial spaces, pre-need and at-need interment service revenue, sale of mausoleums, lawn crypts, vaults, liners, markers and bases for each year.

[redacted]
\$ [redacted] \$1 [redacted] \$ [redacted]

[redacted] provides working capital to you on a revolving credit basis at market rates of interest. There is a current loan outstanding of \$ [redacted] which is payable at prime plus 1%.

The [redacted] financial statement shows \$ [redacted] due from other cemeteries, and the [redacted] financial statement shows \$ [redacted] due to other cemeteries. These cemeteries are either owned or managed by [redacted]. You indicate that you and the other cemeteries may pay for invoices and/or provide services that benefit all the [redacted] cemeteries. You state that the \$ [redacted] represents the value of services provided to the other cemeteries by you and that the \$ [redacted] due to other cemeteries is due for services you received from the other [redacted] cemeteries.

The [redacted] financial statement shows that you had income of \$ [redacted] in [redacted] of which \$ [redacted] was set aside for permanent maintenance. Also, the [redacted] financial statement shows that you owe [redacted] \$ [redacted]. In addition, your [redacted] financial statement reflects the following in expenses incurred:

[REDACTED]

a. cost of sales	\$ [REDACTED]
b. selling	\$ [REDACTED]
c. administrative	\$ [REDACTED]
d. maintenance	\$ [REDACTED]
e. management fees	\$ [REDACTED]
f. depreciation	\$ [REDACTED]

Total expenses \$ [REDACTED]

Law:

Section 170(c)(5) of the Code defines the term "charitable contribution" to mean a contribution or gift to or for the use of--

A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

Section 501(c)(13) of the Code provides for the exemption of cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(13)-1(a) of the Income Tax Regulations provides that a nonprofit cemetery company may be entitled to exemption if it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide burial purposes and not for the purpose of resale.

Section 1.501(c)(13)-1(b) of the regulations provides that any nonprofit cemetery company chartered solely for the purpose of the burial, or cremation of bodies, and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(13)-1(d) of the regulations provides, in relevant part, that no person may have any interest in the net earnings of a tax-exempt cemetery company or crematorium.

Rev. Rul. 77-70, 1977-1 C.B. 150, holds that when a cemetery company purchases property under a percentage arrangement contract, the transferors acquire an equity interest in the cemetery company. Accordingly the payments to the transferors by the cemetery company constitute prohibited inurement of net earnings to a shareholder or individual since such payments, at least in part, would be distributions of the profits of the cemetery company.

In Restland Memorial Park of Dallas v. United States, 509 F.2d 187 (5th Cir. 1975) the court held that, when a cemetery company acquired land under the terms of an open-ended or percentage arrangement contract, in which the transferor received a percentage of the sale price of each lot, that the substance of the transaction was to create an equity interest in the transferor. The court reasoned that all the traditional elements of a true debt were missing: (1) there was no

unqualified obligation on the part of the cemetery company to pay because the installments depend on the sale of lots; (2) there was no maturity date because the obligation is to continue until all lots are sold; (3) there was no sum certain since the price of the lots was subject to change; (4) there was no stated interest rate; (5) there was no minimum annual payment; (6) there was no right to share with general creditors; (7) there was no paid-in capitalization of the company; and (8) the transferors had control of the cemetery company. (Also, see *Rose Hills Memorial Park Association v. United States*, 463 F.2d 425 (Ct. Cl. 1972), cert. den., 414 U.S. 822; and *Knollwood Memorial Gardens v. Commissioner*, 46 T.C. 764 (1966).

The Court held in *United Cancer Council Inc. v. Commissioner of Internal Revenue* 109 T.C. No. 17 (1997), that the United Cancer Council's (hereafter UCC) exemption under section 501(c)(3) of the Code should be retroactively revoked because its income inured to the benefit of Watson & Hughey, (hereafter W&H) a professional fundraiser. The Court held that UCC's income inured to the benefit of W&H and that UCC's activities served the private interests of W&H. Even though W&H had no control of UCC, and even though none of W&H's officers and directors served on UCC's Board of Directors, the Court concluded that W&H was an "insider" because W&H effectively controlled UCC's fundraising activities and finances. However, in *United Cancer Council Inc. v. Commissioner of Internal Revenue* 165 F.3d 1173 (U. S. Appeals 1999), the Court reasoned that since none of the governing board of UCC were either owners, managers, or employees of W&H, that W&H was not a "private shareholder or individual" within the meaning of the inurement clause of section 501(c)(3) and therefore was not an "insider", who effectively controlled UCC's fundraising activities. The Court reversed and remanded the case back to the Tax Court to consider whether there was a breach of fiduciary duty by UCC's governing board.

In *Redlands Surgical Services v. Commissioner of Internal Revenue*, 113 T.C. No. 3 (1999), the court held that Redlands had not established that it operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. The court stated that it did not consider one factor as conclusive, but considered the following factors in their totality: (1) the lack of any expressed or implied obligations of the for-profits to put charitable objectives ahead of noncharitable objectives; (2) Redlands lack of voting control over the general partnership; (3) Redlands lack of formal or informal control sufficient to insure charitable purposes; the long-term contract giving the management company control over day-to-day operations as well as profit-maximizing incentives; and the market advantages and competitive benefits secured by the management company affiliates.

Rationale:

The issues are whether you are operating to serve the exclusive benefit of your lot owners, whether you are operating to serve the private benefit of [REDACTED], whether your net earnings inure to the benefit of [REDACTED] and [REDACTED] and whether by virtue of the management agreement and the open-ended loan, [REDACTED] has an equity interest in you.

[REDACTED] and [REDACTED] each purchased 100 interment spaces for purpose of resale. Even though none of these spaces have been resold, the sale to [REDACTED] and [REDACTED] clearly violate the statutory requirements of section 1.501(c)(13)-1(a) of the regulations. Moreover, it appears that [REDACTED] and [REDACTED] purchased the interment spaces for 47% of the average sales price. There is no documentation that you sold the 100 interment spaces to [REDACTED] and [REDACTED] for fair market value.

From the date of your incorporation your governing board has been composed of 7 individuals, all of whom are officers and directors of [REDACTED] and its subsidiary [REDACTED] and [REDACTED] are controlled corporations within the meaning of section 1563(a) the Code. Unlike in *United Cancer Council, supra*, your governing board is composed of individuals who are officers and directors of [REDACTED] and [REDACTED]. Thus, pursuant to the holding in *United Cancer Council, supra*, we conclude that you are under the effective control of [REDACTED] and [REDACTED].

Pursuant to the management agreement with [REDACTED], [REDACTED] is responsible for conducting your day-to-day activities. Article II of the agreement enumerates [REDACTED] various duties and responsibilities, which include bookkeeping and accounting activities; employing and managing accountants, attorneys and other professionals; supervise, administer, and collect accounts; providing financial management including payroll activities; hiring, firing, managing, and supervising employees; and developing and supervising a sales and marketing program. Under this agreement, we conclude that [REDACTED] has virtual control of all aspects of your operation.

Article III of the agreement enumerates your obligations. These obligations include paying expenses incurred by [REDACTED] and maintaining and repairing cemetery equipment, roads, buildings and other facilities among others. Article IV provides that [REDACTED] will receive monthly compensation of 17% of your gross revenues for managerial and sales related services and 15% of the gross sales of burial spaces. Also, [REDACTED] is entitled to receive 50% on defaulted contracts and 103% of cost for services and supplies that cannot be provided by use of your personnel, supplies or resources. Under the agreement your governing board must agree with such expenditures. However, since all of your directors are officers and directors of [REDACTED] and [REDACTED], we conclude that you are not under independent control.

We believe that the information furnished reflects that your operations are similar to the operations of the cemetery organization described in Restland, supra. That organization acquired cemetery land under the terms of an open-ended or percentage arrangement contract. The substance of the transaction was to create an equity interest in the transferor. Under the terms of the management agreement and the loan agreement with [REDACTED], the traditional elements of a true debt are missing. The loan agreement is open-ended with no fix date of maturity, or fixed annual or monthly payments. There are no fixed management agreement charges since the fees are based on sales and reimbursement of [REDACTED] operating costs. Thus, (1) there is no unqualified obligation on your part to pay because the payments are dependant upon sales and operating costs (2) there is no expressed maturity date; (3) there is no sum certain since the loan is open-ended and the management payment is not fixed; (4) there is no stated interest rate; (5) there is no minimum annual loan payment, management charge; (6) there is no right to share with general creditors; (7) there is no paid-in capitalization; and (8) [REDACTED] have effective control of your operations. Under the circumstances, we conclude that your net earnings inure to the benefit of [REDACTED]

We conclude that [REDACTED] operations of your cemetery, under the management agreement, are similar to the management company's operations of the surgery center in Redlands, supra. Thus, we conclude that [REDACTED] has effective control of your operations. Moreover, unlike the management agreement in United Cancer Council, supra, the management agreement between you and [REDACTED] is not an agreement between unrelated parties. Therefore, we conclude that you have not established that the management agreement between you and [REDACTED] is an arms length agreement at fair market value. Also, a controlling factor in Redlands, supra, was the fact that the management company had control over Redlands' day-to-day operations.

The [REDACTED] financial statement shows that you had income of \$ [REDACTED], of which \$ [REDACTED] was set aside for permanent maintenance and that you currently owe OMC \$ [REDACTED]. Also, the [REDACTED] financial statement shows that you had expenses of \$ [REDACTED], of which approximately thirty percent, \$ [REDACTED], was paid to [REDACTED]. Further, it is unclear whether any or all of the amounts included under the expenditure items identified as (i) cost of sales (\$ [REDACTED]), (ii) selling (\$ [REDACTED]), and (iii) administrative (\$ [REDACTED]), have been paid directly or indirectly to [REDACTED]. If any of your administrative and sales personnel are [REDACTED] leased employees, and if all of the above expense items along with the management fees are paid to [REDACTED], then approximately 88% of your earnings for [REDACTED] were paid to [REDACTED]. Based on the financial data submitted, we conclude that you operated to serve the private benefit of [REDACTED]

Sections 501(c)(13) and 501(c)(3) of the Code both contain inurement language which provides that "no part of [their] net earnings may inure to the benefit of any private shareholder or individual." Similar language is contained in sections 170(c)(2) and 170(c)(5) of the Code, which provides for charitable contributions. The courts in Redlands, supra and in United Cancer Council, supra, have stated, in effect, that if an organization is effectively controlled by a for-profit entity and has entered into a management agreement (that is not an arms-length agreement at fair value) with such for-profit entity, such organization's net earnings will be considered as inuring to the benefit of the for-profit. Even though the Redlands case and the United Cancer Council case only involve section 501(c)(3) organizations, we believe that these standards may be used in determining whether the income of a section 501(c)(13) cemetery company inures to the benefit of any private shareholder or individual because the inurement language in both sections of the Code is the same. Therefore, based on the reasoning set out above, we conclude that your net earnings inure to the benefit of [REDACTED]

[REDACTED] provides working capital to you on a revolving credit basis at market rates of interest. The demand note, which you entered into in [REDACTED], bears interest at prime plus 1%. You received an additional amount of approximately \$ [REDACTED] from [REDACTED] in [REDACTED]. At the end of [REDACTED], the loan amount due was approximately \$ [REDACTED]. Based on the holding in Restland, supra, we conclude that [REDACTED] has an equity interest in you. Since [REDACTED] has an equity interest in you, we conclude that, pursuant to Rev. Rul. 77-70, 1977-1 C.B. 150, you do not qualify for exemption under section 501(c)(13).

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(13) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio EP/EO key district office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, EP/EO Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED], OP:E:EO:T:3, Room 6137
1111 Constitution Ave, N.W.
Washington, D.C. 20224

[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3

[REDACTED]