



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

Y =

Z =

Dear _____ :

We have considered your request dated August 20, 2004 concerning the federal tax implications of the following proposed transactions.

1. Whether your creation, ownership, and operation of Y would cause you to lose your status as a tax exempt organization under section 501(c)(13) of the Internal Revenue Code ("Code").
2. Whether the dividends you receive from Y would be taxable to you as unrelated business income under section 512(b)(1) of the Code.

You are a non-profit corporation which operates a cemetery, and you are recognized as exempt from federal income tax under section 501(c)(13) of the Code. According to your Articles of Incorporation, your limited purpose is:

[T]he establishment, conducting and maintenance of a burial park and cemetery for the internment of human remains, in which may be erected suitable memorials and other embellishments; and the doing of any and all other acts necessary or helpful in the carrying out of such purpose, subject only to the limitations upon such acts now in force or hereafter made a part of the general laws of Z

You intend to form a for-profit subsidiary corporation, Y. Y will market and sell "final expense" insurance products. You will provide all of Y's initial capital, and in return, you will

receive all of the issued and outstanding stock of Y. You will also lease a portion of the building that you own and occupy to Y for fair rental value, as determined by an independent appraiser.

The Board of Directors of Y will consist of five members, including: the president of your organization; a member of your Board of Trustees; and three individuals who are not employees, officers, or directors of your organization. The president of your organization will also serve as the president of Y until Y's board is fully constituted and appointed, at which time the board of Y will select a new president for their organization. Your president will assist with the establishment of Y, but will have a very limited role in the day-to-day operation of Y.

Y will develop, maintain, and manage its own financial systems independent of your organization. Y will have at least one full-time employee, who is not also employed by you. This employee will be selected by the board of Y and will be responsible for the day-to-day activities of Y. Other individuals, who are employed by your organization, may assist Y in their initial years of operation; they will be compensated by Y pursuant to a written contract agreement.

Section 501(c)(13) of the Code provides an exemption from federal income tax for 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 incidental to that purpose, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(13)-1(d) 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 purposes, not for purposes of resale.

Rev. Rul. 64-109, 1964-1 (Part 1) C.B. 190, held that a cemetery company may not, consistent with section 501(c)(13) of the Code, engage in activities not necessarily incidental to its burial purposes. The ruling concluded that because operating a mortuary is not necessary to procuring, selling, holding, and using land solely as a burial ground, an organization that engaged in such a business was subject to loss of its exempt status.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c).

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income an organization derives from any unrelated trade or business (defined in section 513) it regularly carries on, less allowable deductions, with certain modifications.

Section 512(b)(1) of the Code excludes from the computation of unrelated business taxable income, under section 512(a)(1), dividends received by the tax exempt organization.

For federal income tax purposes, a parent corporation and its subsidiaries are separate taxable entities so long as the purposes for which the subsidiary is incorporated are the equivalent of business activities, or the subsidiary subsequently carries on business activities. *Moline Properties, Inc. v. Commissioner*, 319 US 436, 438 (1943); *Britt v. United States*, 431

F.2d 227, 234 (5th Cir. 1970). That is, where a corporation is organized with a bona fide intention that it will have some real and substantial business function, its existence may not generally be disregarded for tax purposes. *Britt*, 431 F.2d at 234. However, where the parent corporation so controls the affairs of the subsidiary that is merely an instrumentality of the parent, the corporate entity of the subsidiary may be disregarded. *Krivo Industrial Supply Co. v. National Distillers and Chemical Corp.*, 483 F.2d 1098, 1106 (5th Cir. 1973).

In general, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is formed are for a business purpose. Hence, the ownership of a subsidiary by an organization exempt under section 501 does not require attribution of the subsidiary's activities to the parent for federal income tax purposes unless the subsidiary lacks a business purpose, and the subsidiary is an arm or agent of the parent. See *Moline Properties* and *Britt*, *supra*.

The main issue presented in this case is whether Y's activities are attributable to your organization. If the activities of Y are attributed to you, your exemption from federal income tax under section 501(c)(13) of the Code may be in jeopardy. Attribution occurs where the subsidiary does not have a business purpose, and is merely an arm or agent of the parent. The information submitted in this case indicates that Y, a for-profit organization, was formed for the real and substantial business purpose of selling final expense insurance products.

Whether you are involved in, or in control of, the day-to-day operations of Y must also be considered. From the information provided, you do not appear to control or to be so involved in the the day-to-day management of Y so that Y is an agent of your organization. Y will have its own board of directors and will keep its own books and records. A majority of Y's board members are not employees, officers, or directors of your organization. Although your president is also the president of Y, you represent that your president will not be involved in Y's day-to-day operations and that a new president will be selected by Y as soon as their board is fully constituted and appointed. Therefore, we conclude that Y is not an arm, agent, or integral part of your organization, and the activities of Y are not attributable to you.

In accordance with section 512(b)(1) of the Code, dividends are excluded from the computation of unrelated business taxable income. The dividends you may receive from Y will not be subject to the tax on unrelated business income. Section 512(b)(13), which sets forth special rules for certain amounts received by exempt controlling organizations from their controlled organization, does not apply to dividends.

Based on the facts and the representations made, we rule as follows:

1. The creation, ownership, and operation of Y will not cause you to lose your status as an exempt organization under section 501(c)(13) of the Code.
2. Dividends you receive from Y will not constitute unrelated business taxable income under section 512(b)(1) of the Code.

Except as we have specifically ruled above, we express no opinion as to the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. You should keep a copy of this letter in your permanent records.

This ruling is directed only to the organization that has requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

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

Sincerely,

Jane Baniewicz
Manager, Exempt Organizations
Technical Group 2