

Cemetery company; property purchased under percentage arrangement. A nonprofit cemetery company that acquires land from a for-profit cemetery company, under an agreement providing payment to the former owners on the basis of a percentage of the sales price of each cemetery lot sold, is not exempt from tax as a cemetery described in section 501(c)(13) of the Code; Rev. Rul. 61-137 amplified.

Advice has been requested whether a cemetery company that acquires land in the manner described below qualifies for exemption from Federal income tax under section 501(c)(13) of the Internal Revenue Code of 1954.

'The organization was incorporated under the nonprofit laws of its state for the purpose of owning and operating a nonprofit cemetery company for the burial or disposal of human remains, with powers to do all things necessary or incident to the carrying out of such purposes. The articles of incorporation provide that the organization shall be under the direction and control of a board of trustees. Under its bylaws, each lot owner is declared to be a member with one vote in the proceedings of the organization. The articles also provide that no part of the net earnings of the organization shall inure to any private shareholder or individual.

'The information presented discloses that subsequent to its organization but prior to commencing sales operations, the organization entered into a stock purchase agreement with the shareholders of a for-profit cemetery company. All the trustees of the newly formed organization were shareholders of the former for-profit cemetery company. Under the terms of the agreement all of the stock of the for-profit company was sold to the organization. In consideration therefor, the organization agreed to pay to the former shareholders 30 percent of the gross selling price of all lots sold from the property thus acquired. Subsequent to the date of the original agreement, the organization acquired additional land from the same sellers. The terms of this purchase agreement were similar to the original agreement, that is, the land was to be paid for on the basis of a percentage of the sales price of each lot sold from the land.

Under the terms of both agreements there was no fixed price, nor a minimum annual payment, and no stated interest rate. The agreement was to continue until all the property was sold.

'The activities of the instant corporation consist of owning, operating, and maintaining a cemetery for the interment of human remains. Its receipts are derived from sales of grave sites and burial and interment services. Expenditures are made for salaries, commissions to salesmen of burial sites, taxes, payments on cemetery property, insurance, maintenance of cemetery property, payments into the perpetual care fund, and miscellaneous operating expenses.

Section 501(c)(13) of the Code describes certain organizations exempt from income tax under section 501(a) and reads as follows:

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, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

'Rev. Rul. 61-137, 1961-2 C.B. 118, deals with a similar question. That Revenue Ruling states, in pertinent part, as follows:

Where a cemetery company acquires land at an undeterminable price, to be paid for on the basis of a percentage of the proceeds from the sale of individual lots from the tract, the vendor of the land has a continuing interest in the land. Any appreciation in value, whether it be due to the state of the market generally or the cemetery's own efforts to undertaking capital improvements, etc., will result in a benefit to the vendor of the land. Continuing participation in the earnings of the cemetery company will also ordinarily result in receipt by the vendor of a total price substantially in excess of the reasonable value of the land at the time of its sale to the cemetery company. (Emphasis added).

'In *Forest Lawn Memorial Park Association, Inc. v. Commissioner*, 45 B.T.A. 1091 (1941), where the association entered into a contract for the purchase of cemetery lands on the basis of a percentage of the gross proceeds from the sale of individual lots, etc., the United States Board of Tax Appeals held, in part, that there was no inurement of the organization's net earnings to the benefit of any private individual, because the amounts paid as the purchase price of the land were deductions from gross receipts and thus never became part of the organization's net earnings. The *Forest Lawn Memorial Park Association, Inc.*, case is not followed by the Service as a precedent in the disposition of similar cases. See *Nonacquiescence*, 1960-2 C.B. 8.

'In more recent cases the courts upheld the Service's views. In considering transactions by which a cemetery acquires land under the terms of an open-ended or percentage arrangement contract in which the transferor receives a percentage of the sale price of each lot, these courts concluded that the substance of the transaction was to create an equity interest in the transferor because all the traditional elements of a true debt are missing: (1) there is no unqualified obligation on the part of the cemetery company to pay because the installments depend on the sale of

lots; (2) there is no maturity date because the obligation is to continue until all lots are sold; (3) there is no sum certain since the price of the lots is subject to change; (4) there is no stated interest rate; (5) there is no minimum annual payment; (6) there is no right to share with general creditors; (7) there is no paid-in capitalization of the company; and (8) the transferors have control of the cemetery company. Restland Memorial Park of Dallas v. United States, 509 F.2d 187 (5th Cir. 1975); 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).

Applying the foregoing reasoning and factors to this case, it is concluded that the transferors acquired an equity interest in the cemetery company. It follows, therefore, that 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.

'Accordingly, the organization in question is not exempt from Federal income tax as a cemetery described in section 501(c)(13) of the Code.

'Rev. Rul. 61-137 is hereby amplified.