

Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements

Department of the Treasury
P.O. Box 2508 - RM 7008
Cincinnati, OH 45201

Date: October 26, 2005

Number: 201428029
Release Date: 7/11/2014

Employer Identification Number:

Person to Contact - I.D. Number:

Contact Telephone Numbers:

Legend:

UIL Nos.: 501.13-00
501.30-00

A =
B =
C =
M =
X =
Y =
Z =

Dear :

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(13) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1120 if you are a corporation.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when

you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings and Agreements

Enclosures: 3
Enclosure I
Publication 892
Form 6018

Enclosure I

Issue:

Does the applicant organization qualify for exemption under section 501(c)(13) of the Internal Revenue Code as an organization owned and operated exclusively for the benefit of its members, no part of the net earnings of which inures to the benefit of any private individual?

Facts:

You were originally incorporated as a non-profit corporation in 1995, under a different name. You applied for tax-exempt status under Code section 501(c)(13) in or about 1996. In 1998, the Internal Revenue Service issued a letter denying your request for recognition of tax-exempt status. A copy of this letter was included in your current application, and is incorporated herein by reference. This denial was based upon prohibited inurement of earnings to private individuals. Specifically, it was found that you were formed by a for-profit entity, and that you had entered into contracts with this entity to sell your interment spaces and other services, and to provide general maintenance and repair services. It was also determined that you paid a price in excess of fair market value to the for-profit company for land that it sold to you. The officers of the for-profit company were also on your own Board of Directors. A was a principal owner of the for-profit management company, through a limited liability company that he controlled. The denial letter included the following statement: "It is clear from the totality of the facts and circumstances that the operations of the for-profit management company are so intertwined with your operations that it may be said that you operate for the benefit of that for-profit entity and certain individuals." It was also concluded that the nature of the land purchase transaction and subsequent indebtedness created an equity interest for the transferor and that payments made in satisfaction of such indebtedness would be distribution of your profits to that entity.

Your articles of incorporation originally stated that you had no members. This provision was amended in 1996 to state that you would have members, and then again in 1997 to state that you would not.

After your first application for tax-exempt status was denied, you took the following steps to reorganize the company:

The name of the corporation was changed. In 2003, amended articles of incorporation were filed to state that the corporation has members (lot owners) as required by State law. The former management company was dissolved in 2003, and you no longer contract with any for-profit entity for either interment

space sales or cemetery maintenance. In 1998, you applied to the State Cemetery Board for permission to issue Certificates of Interest to finance the acquisition of cemetery property. After reviewing the transactions, including requiring land appraisal, the State Cemetery Board approved the issuance of Certificates of Interest totaling \$y. Initially, certificates were issued to A and to four other individuals who had also had ownership interests in the former management company, through various limited liability companies. Subsequently, all of the certificate holders transferred their interests in the certificates to M, LLC, a company owned by A. In 2003, a single certificate of Interest was issued to M, LLC, in the amount of \$y. This Certificate includes the following provisions: "The holder of this certificate shall be entitled, in accordance with [state law] to x votes on all matters requiring a vote of the members of the cemetery company, except that one vote will be deducted for each \$z.00 of principal which has been repaid on this certificate at the time the vote is held, notwithstanding the fact that the holder of this certificate may not otherwise qualify as a member of the Cemetery Company." Interest is payable annually; however, if payment is not made, the current interest is forfeited and does not accrue. Payments are to be applied first to interest. The cemetery company may elect not to make any payments in any given year.

Article II of your bylaws, concerning members, provides that the owner(s) of each interment space will have one vote for each such space, that organizations owning multiple spaces are entitled to a maximum of 100 votes, and that certificate holders are entitled to one vote for each \$z.00. These provisions are consistent with the State statutes governing cemetery companies.

Article IV, section 6, of your bylaws, concerning quorum requirements, provides that x votes shall constitute a quorum at any meeting of your members. Trustees are to be elected annually and need not be members of the corporation. Officers are to be elected annually by the trustees.

You are governed by a three-person Board of Trustees. At the time you filed your current application for tax-exempt status, your Board members were A (president/treasurer), B (vice president/secretary), and C (trustee). B and C are closely related to A; however, you stated that only A has any financial interest in M, LLC.

Your current activities consist of the sale and maintenance of interment spaces including in-ground graves, mausoleum crypts, and niches for cremains, and administrative and maintenance functions incidental to such activities. Much of the property you own has not yet been laid out for graves. In the future, you may construct and operate a crematorium and additional mausoleum space.

Law

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 and which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremations 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 benefits of any private shareholders or individual.

Section 1.501(c)(13)-1(a) of the Income Tax Regulations provides, in part, that an exempt cemetery company must be "owned 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(d) of the regulations provides that no person may have any interest in the net earnings of any exempt cemetery. Thus, a cemetery company is not exempt if property is transferred to the organization in exchange for an interest remains outstanding. An interest that constitutes an equity interest in the net earnings of the cemetery, However, other interest may also be interests in the cemetery's net earnings, Thus, for example, a bond or other evidence of indebtedness issued by a cemetery company which provides for a fixed rate of interest but which, in addition, provides for additional interest payment contingent on the revenues of income of the organizations is considered an interest in net earnings of the organization.

In Restland Memorial Park v. United States , 371 F.Supp.164 (N.D.Tex 1974), aff'd ,509F 2d 187(5th Cir.1974), a cemetery's net earnings were found to inure to private individuals, precluding exemption under section 501 (c)(13) of the Code, where it allowed a related for-profit mortuary to benefit from its efforts without compensation. There, individuals who controlled the cemetery also owned a for-profit funeral home located on the cemetery grounds. The funeral home was managed and controlled by the same individuals who control the cemetery, and used the cemetery's name in joint advertising campaigns. The courts held that inurement had occurred as a result of the various for profits entities trading upon the goodwill of the plaintiff cemetery and functioning with the cemetery as an integrated for profit business with the intent of maximizing profits from the for profit entities the detriment of the plaintiff cemetery which had sought exemption under section 501 (c)(13). See also , Rose Hill Memorial Park Ass'n v. United States, 463 f.2nd 425 (ct.cl.1972), Cert. denied, 414 U.S. 822 (1973); and Knollwood Memorial Gardens ,46 T.C.764 (1966).

In the case of Munro L. Lyeth v. Hoey, 305 U.S. 188 (1938), it was stated that State laws are not controlling in determining the tax-exempt status of an organization. Thus, an organization may

be recognized as meeting the requirements of State statutes governing a particular type of non-profit organization, and still be denied this status for Federal income tax purposes.

In West Laurel Hill Cemetery Co. v. Rothensies, 139 F.2d 50, 54 (3d Cir. 1943), cert. denied, 321 U.S. 780, 64 S. Ct. 636, 88 L. Ed. 1073 (1944), the Court sustained the Service's position that the cemetery company was not entitled to tax-exempt status under the predecessor to IRC 501(c)(13). Among other issues, it was noted that the corporation was organized on a stock basis and its shareholders were the only persons with voting rights. The corporation's incorporators were the original shareholders and stock shares were subsequently transferred by sale or other means to other persons; stock ownership was unrelated to ownership of cemetery lots. The Court held that, in determining that an exempt cemetery company was owned by and operated exclusively for the benefit of its members, it was the intent of Congress that the term "members" was synonymous with owners of lots or burial rights in the cemetery. This position was later confirmed in Regs. 1.501(c)(13)-1(a), *supra*.

In the case of Puritan Lawn Memorial Park Cemetery v. U.S., 15 Cl. Ct. 234, 241-43 (1988), the Court upheld the revocation of a cemetery company's tax-exempt status based upon inurement to private individuals. The cemetery company was closely affiliated with a for-profit company. Puritan's lot owners had no voting rights under its by-laws. In fact, the board of directors had specifically revoked whatever rights the lot owners may have had to participate in the corporate affairs of Puritan. Only directors of Puritan attended its board of directors' meetings. Although all lot owners held their lots for burial purposes and not for resale, their status permitted them no management or operational responsibilities respecting Puritan's affairs. Citing the West Laurel Hill case, the Court stated: "Although it is possible that a cemetery company may still qualify as a nonprofit company without having had lot owner participation on its board, in such case it must be shown that the lot owners were not prejudiced by this fact and that notwithstanding such non-participation they received all of the benefits of the company's operations to which they were entitled. The facts of this case do not permit such a showing."

Revenue Ruling 77-70, 1977-1 C.B. 150, held that 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. The revenue ruling further held that the substance of the transaction was to create an equity interest in the transfer or 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 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.

Application of Law

Under your bylaws, the sole certificate holder, acting alone, represents a quorum of the members. While the number of current lot owner-members was not determined during the application process, it appears that the certificate holder is likely to be in a position to control Board decisions by virtue of the number of votes held. It is unclear if owners of interment spaces have been advised of their rights as voting members of the corporation or whether they have been advised of, or participated in, any membership meetings. The certificate holder is a member of your Board and holds the positions of both president and treasurer, and other Board members are related to him. These facts tend to indicate that the certificate holder effectively controls the selection of Board members and thus controls the organization.

While the voting interests afforded to the certificate holder are consistent with the provisions of State law governing the organization of cemetery companies, your bylaws permit the certificate holder, acting alone, to constitute a quorum for purposes of Board meetings and votes. Since payments of the Certificate of interest are not made on a fixed schedule and are to be applied to interest first, the principal may remain outstanding and largely unreduced for an indefinite period of time, permitting the certificate holder to retain effective control of the cemetery company.

While the management company whose control led to the previous denial of exemption is no longer extant, and you state that you are self-managed through your Board of trustees, the individual who owns the LLC that is your sole certificate holder is also your president and treasurer. This individual was also a principal in the for-profit management company that created you. Although the transactions that gave rise to this indebtedness were approved by the State Cemetery Board, the transactions cannot be said to have been made "at arm's length" due to the close connections between the parties involved.

Applicant's Position:

You maintain that the circumstances that were the basis for the previous denial of exemption no longer exist. You state that any payments made to the sole holder of a certificate of interest represent only repayment of valid business indebtedness, at a reasonable rate of interest. You further maintain that the certificate holder and related parties have no further financial interest in the earnings of the corporation. You indicate that the fact that you are regulated by the State and that you meet

the requirements of State law supports your claim to tax-exempt status under Code section 501(c)(13).

Service response to applicant's position:

As noted in the Munro L. Lyeth case, the fact that you meet the requirements of State law governing cemetery companies does not establish your qualifications for Federal tax exemption.

Although you may no longer be directly affiliated with a for-profit entity through contractual agreements, you are still effectively controlled by private individuals who do not qualify as *bona fide* members within the meaning of Code section 501(c)(13) i.e., persons who are not owners of burial spaces intended for personal use. For most of your existence, you have not afforded membership rights to lot owners. Although your governing documents now provide that lot owners have membership rights, there is no evidence that such members have participated in the governance of the organization, and the extent of their future participation is uncertain. It is unknown if there are a sufficient number of living lot owner-members to override the votes held by the certificate holder. Under these circumstances, we are unable to conclude that you are owned and operated exclusively for the benefit of your members and that no part of your net earnings will inure to the benefit of private individuals.

Conclusion:

Based on the facts presented above, we hold that you do not meet the requirements for tax exemption under section 501(c)(13) of the Internal Revenue Code.

Based on the facts you have provided in your application for recognition of exemption, we are not able to conclude that you are Cemetery company owned organized and operated exclusively for the benefit of your members and that no part of your net earnings inures to the benefit of any private shareholder or individual. You are effectively controlled by private parties who are not members of the organization within the meaning of the Code and Regulations, rather than by members who own interment spaces. The provisions of your bylaws may allow a single individual to control the decisions of your governing body and the uses of your funds; thus, it cannot be clearly established that you will not be operated for the benefit of private individuals.

Accordingly, you do not qualify for exemption under section 501(c)(13) of the Internal Revenue Code.

Internal Revenue Service

Department of the Treasury

Date: NOV 03 2007

Employer Identification Number:

Tax Year(s) Ending:

Person to Contact:

Employee ID Number:

Contact Telephone Number:

LEGEND:

- A =
- B =
- C =

Dear Sir or Madam:

We have considered your appeal of the adverse action proposed by the Director, Exempt Organizations. The paragraph(s) checked below indicate(s) our decision.

- X Your exemption from Federal income tax under section 501(c)(13) of the Internal Revenue Code is:
 - confirmed.
 - modified. A new determination letter is enclosed.
 - X denied or revoked. You are required to file Federal income tax returns on Form 1120 for the above years. You should file these returns with the appropriate service center listed in the instructions for those returns, within 30 days from the date of this letter, unless a request for extension of time is granted.
- You are not a private foundation because you are described in code section(s) _____.
- You are an operating foundation as described in code section 4942(j)(3).
- You have no liability for excise taxes under IRC _____ for the above year(s).

Your liability for excise taxes under IRC _____ for the above year(s) was properly reported on your return(s).

There is no change to your unrelated business income tax liability as reported for the above years.

Your Form(s) 990-T for the above years are accepted as filed.

You may direct questions about the decision to the appeals officer whose name and telephone number are shown above.

Sincerely,

Charles Fisher
Appeals Team Manager

Enclosures: Notice 437