



# Exempt Organizations Technical Guide

## TG 13: Cemetery Companies – IRC Section 501(c)(13)

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## I. Overview

- (1) This Technical Guide discusses tax exemption of nonprofit cemetery and crematoria organizations described under Section 501(c)(13).
- (2) Section 501(c)(13) exempt organizations include:
  - a. Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit, and
  - b. 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.

## A. Background / History

- (1) The Tariff Act of 1913, 38 Stat. 114, 172, enacted the first exemption for any cemetery company. The Act exempted from tax cemetery companies, organized and operated exclusively for the mutual benefit of their members.
- (2) Section 231(5) of the Revenue Act of 1921, 42 Stat. 227, 253, was amended to include the statute known as Section 501(c)(13) of 1954, which did not extend exemption to organizations that dispose of bodies through crematoria.
- (3) In December 1970, Section 501(c)(13) was amended to extend exemption to crematoria operations.
- (4) Additionally, Rev. Rul. 71-300, 1971-2 C.B. 238, withdrew Rev. Rul. 69-637, 1969-2 C.B. 127, which had held that crematoria operations had an adverse effect on the exempt status of a cemetery company. With Rev. Rul. 71-300, crematoria operations would no longer adversely affect exemption under Section 501(c)(13).
- (5) Treas. Reg. 1.501(c)(13)-1, last amended in 1980, added crematoria to the exempt activities, clarified the standards for exemption, provided guidance on preferred stock issued under written plans prior to November 28, 1978, and identified when certain property transfers are equity interests rather than debt obligations.

## B. Relevant Terms

- (1) **Equity interest:** An ownership share of an entity. For example, if someone holds a 5% equity interest, they own 5% of that entity. An equity interest entitles holders to a share of dividends. If an entity liquidates, equity interest holders are entitled to a proportionate share of any remaining assets after liabilities.
- (2) **Land vendor:** The seller of land to a cemetery company to be used for burial purposes. The terms of the sales contract determine whether the vendor is a

creditor or an equity interest holder of the cemetery company. *Land vendor*, *transferor*, and *seller* are used interchangeably throughout this Technical Guide.

- (3) **Mortuary**: In general, a funeral home, or a place where the deceased are prepared for burial. Mortuary operations are not exempt activities under Section 501(c)(13).
- (4) **Nonprofit cemetery company**: Nonprofit organization whose purpose is the burial of bodies, that does not engage in any business not necessarily incident to that purpose, and which no part of its net earnings inures to the benefit of any private shareholder or individual.
- (5) **Nonprofit crematorium**: Nonprofit organization whose purpose (after taxable years beginning after December 31, 1970) is the cremation of bodies, that does not engage in any business not necessarily incident to that purpose, and which no part of its net earnings inures to the benefit of any private shareholder or individual.
- (6) **Nonprofit mutual cemetery company**: A nonprofit cemetery company 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. It may also engage in charitable activities, such as burial of paupers.
- (7) **Percentage-based land sales arrangement**: A land sale agreement where the seller receives a percentage of the sale price of each lot. This is also called *percentage-of-sales* in this Technical Guide.
- (8) **Perpetual care fund**: A fund created by a cemetery to generate income to cover its maintenance into perpetuity.
- (9) **Preferred stock**: Stock that has priority over common stock for the payment of dividends. Preferred stockholders have an equity interest in the entity and receive dividends at a fixed rate for as long as they hold that interest.

## C. Law / Authority

- (1) **Section 501(c)(13) of the Internal Revenue Code** describes as exempt from federal income tax under Section 501(a):

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.
- (2) **Treasury Regulation (Treas. Reg.) 1.501(c)(13)-1** provides:
  - (a) Nonprofit mutual cemetery companies. 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. A mutual cemetery company which also engages in charitable activities, such as burial of paupers, will be regarded as operating in conformity with this standard. Further, the fact that a mutual cemetery company limits its membership to a particular class of individuals, such as members of a family, will not affect its status as mutual so long as all the other requirements of section 501(c)(13) are met.

- (b) Nonprofit cemetery companies and crematoria. Any nonprofit corporation, chartered solely for the purpose of the burial, or (for taxable years beginning after December 31, 1970) the 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.
- (c) Preferred stock—
  - (1) In general. Except as provided in subparagraph (3) of this paragraph, a cemetery company or crematorium is not described in section 501(c)(13) if it issues preferred stock on or after November 28, 1978.
  - (2) Transitional rule for preferred stock issued prior to November 28, 1978. In the case of preferred stock issued prior to November 28, 1978, a cemetery company or crematorium which issued such stock shall not fail to be exempt from income tax solely because it issued preferred stock which entitled the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, if its articles of incorporation require:
    - (i) That the preferred stock be retired at par as rapidly as funds therefor become available from operations, and
    - (ii) That all funds not required for the payment of dividends upon or for the retirement of preferred stock be used by the company for the care and improvement of the cemetery property. The term legal rate of interest shall mean the rate of interest prescribed by law in the State of incorporation which prevails in the absence of an agreement between contracting parties fixing a rate.
  - (3) Transitional rule for preferred stock issued on or after November 28, 1978. In the case of preferred stock issued on or after November 28, 1978, a cemetery company or crematorium shall not fail to be exempt from income tax if its articles of incorporation and the preferred stock meet the requirements of paragraph (c)(2) and if such stock is issued pursuant to a plan which has been reduced to writing and adopted prior to November 28, 1978. The adoption of the plan must be shown by the acts of the duly constituted responsible officers and appear upon the official records of the cemetery company or crematorium.

(d) Sales to exempt cemetery companies and crematoria. Except as provided in paragraph (c)(2) or (c)(3) of this section (relating to transitional rules for preferred stock), no person may have any interest in the net earnings of a tax-exempt cemetery company or crematorium. Thus, a cemetery company or crematorium is not exempt from tax if property is transferred to such organization in exchange for an interest in the net earnings of the organization so long as such interest remains outstanding. An interest in a cemetery company or crematorium that constitutes an equity interest within the meaning of section 385 will be considered an interest in the net earnings of the cemetery. However, an interest in a cemetery company or crematorium that does not constitute an equity interest within the meaning of section 385 may nevertheless constitute an interest in the net earnings of the organization. Thus, for example, a bond or other evidence of indebtedness issued by a cemetery company or crematorium which provides for a fixed rate of interest but which, in addition, provides for additional interest payments contingent upon the revenues or income of the organization is considered an interest in the net earnings of the organization. Similarly, a convertible debt obligation issued by a cemetery company or crematorium after July 7, 1975, is considered an interest in the net earnings of the organization.

## **II. Exemption Considerations**

- (1) An organization whose purpose is to dispose of bodies by burial or cremation may qualify for exemption under Section 501(c)(13) when it is not operated for profit and when no part of its net earnings inures to the benefit of any private shareholder or individual.
- (2) This part of the Technical Guide provides a detailed discussion on the requirements of exemption from income tax for organizations seeking recognition under Section 501(c)(13).

### **A. Overview of Code and Regulations**

- (1) Section 501(c)(13) provides exemption 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 incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.
- (2) The Regulations provide for two types of Section 501(c)(13) organizations: nonprofit mutual cemetery companies and nonprofit cemetery companies and crematoria. They also provide guidance on preferred stock and identify when

property transfers are equity interests rather than debt obligations. See Treas. Reg. 1.501(c)(13)-1.

## B. Nonprofit Criteria

- (1) Section 501(c)(13) and Treas. Regs. 1.501(c)(13)-1(a) and (b) provide for two categories of exempt cemetery companies: **nonprofit mutual cemetery companies** and **nonprofit cemetery companies and crematoria**.

### B.1. Nonprofit Mutual Cemetery Companies

- (1) Section 501(c)(13) describes nonprofit mutual cemetery companies when it provides tax exemption for organizations “owned and operated exclusively for the benefit of their members or which are not operated for profit.”
- (2) Treas. Reg. 1.501(c)(13)-1(a) provides further criteria with respect to membership in nonprofit mutual cemetery companies.
  - a. A nonprofit mutual cemetery company must be owned by and operated exclusively for the benefit of its members, who are the lot owners who hold the lots for *bona fide* burial purposes, not for resale.
  - b. A nonprofit mutual cemetery company may limit its membership to a particular class of individuals, such as members of a family. Nonprofit mutual cemetery companies are also permitted to engage in charitable activities, such as the burial of paupers.
- (3) In *West Laurel Hill Cemetery Co. v. Rothensies*, 139 F.2d 50 (1943), the court stated that the Code intended members to be owners of lots or burial rights in the cemetery. In the instant case, however, the court determined the shareholders were not the parties who held burial rights. Additionally, the parties with burial rights had no say in the operations of the cemetery, nor did they receive any dividends or distributions. The court stated that the stockholders, “to whose large material benefit the cemetery has been operated over the years, are not the members contemplated by the exemption provisions.” Additionally, the court stated a cemetery company not operated for profit must use its earnings “exclusively for the promotion and maintenance of the cemetery purposes for which it was created.”

### B.2. Nonprofit Cemetery Corporations and Crematoria

- (1) Section 501(c)(13) describes nonprofit cemetery companies and crematoria when it provides tax exemption for an organization “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.”
- (2) Treas. Reg. 1.501(c)(13)-1(b) addresses tax exemption for nonprofit cemetery companies and crematoria. This applies to an organization chartered solely for



the purpose of the burial of bodies, or (for years starting after December 31, 1970) the cremation of bodies, whose organizing document does not permit it to engage in any business not necessarily incident to that purpose, and no part of its net earnings inures to the benefit of any private shareholder or individual.

### **B.3. Two (Not Three) Categories of Companies**

- (1) Section 501(c)(13) of the Code begins by providing exemption for “Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit.” The phrase “or which are not operated for profit” does not describe or create a third type of exempt cemetery, nor does it imply that exempt Section 501(c)(13) cemeteries may operate for profit. It simply permits mutual cemeteries that bury nonmember paupers to retain exemption.
- (2) Treas. Reg. 1.501(c)(13)-1(a) and (b) clarify that there are two categories of exempt cemeteries described in Section 501(c)(13) of the Code: nonprofit mutual cemetery companies *and* other nonprofit cemetery companies and crematoria.
- (3) The Congressional Record from November 7, 1921, on the Senate’s debate over the crafting of the Statutory language provides background on the phrase in question. Senator Pomerene of Ohio stated:

I have in mind a cemetery in my own city, which is operated for the benefit of its members, but not exclusively so; that is, they have a potter's field where they bury paupers or those who are not able to pay their burial expenses. I am afraid that under the definition as it is here, that cemetery might be subject to this tax. I do not think it ought to be.... [T]hey take the proceeds of the sale of these lots and they use that as an endowment fund to beautify and keep in repair the cemetery, and in addition to that they bury paupers or others who are in destitute circumstances.

The Senate agreed that burying paupers should not be a taxable undertaking, and they agreed the following Statutory language – proposed by Senator Pomerene, himself – satisfied that effect: “Cemetery companies owned or operated exclusively for the benefit of their members, or which are not operated for profit.” See 61 Cong. Rec., pp. 5824, 7487-7490.

Thus, the phrase “or which are not operated for profit” was added simply to permit mutual cemeteries that were not exclusively mutual because they buried nonmember paupers to retain exemption. The phrase was not intended to describe or create a third type of exempt cemetery, nor was it intended to imply that exempt Section 501(c)(13) cemeteries may operate for profit.

- (4) However, that Statutory phrase has had a history of misinterpretation. The language has been misinterpreted to provide for three mutually independent categories:

- a. Cemetery companies owned and operated exclusively for the benefit of their members,
  - b. Cemetery companies not operated for profit, and
  - c. Cemetery companies chartered solely for the purpose of the disposal of bodies by burial or cremation.
- (5) While the decision in *Restland Mem'l Park of Dallas v. United States*, 371 F. Supp. 164 (N.D. Tex. 1974), *aff'd*, 509 F.2d 187 (5th Cir. 1975), is based on consideration of "three tests," the footnotes do acknowledge Congress likely intended only two:

The government contends in its brief that Congress intended that there be only two classifications of exempt cemeteries. It would say that the first two exemptions listed herein are but really one. If one reads 61 Cong. Rec., pp. 5824, 7487-7490, the Senate debate in which the last two exemptions were given life, the government's contention appears to be borne out.

- (6) Other court cases adopting the stance that there were three categories include the following: *Commissioner of Internal Revenue v. Kensico Cemetery*, 96 F.2d 594 (1938); *West Laurel Hill Cemetery Co. v. Rothensies*, 139 F.2d 50 (1943); *John D. Rockefeller Family Cemetery Corp. v. Commissioner of Internal Revenue Service*, 63 T.C. 355 (1974); *Du Pont De Nemours Cemetery Co. v. C. I. R.*, T.C. Memo. 1974-314 (1974); and *Cave Hill Inv. Co. v. United States*, No. 3:00CV-623-J, 2002 (W.D. Ky. Sept. 24, 2002), *aff'd sub nom. Cave Hill Inv. Co. ex rel. Thomas L. Barret Tr. v. United States*, 99 F. App'x 676 (6th Cir. 2004).

### **C. Inurement**

- (1) Section 501(c)(13) precludes exemption if any of the organization's net earnings inure to the benefit of any private shareholder or individual.
- (2) Nonprofit cemetery companies and crematoria are barred from allowing any net earnings to inure to any private shareholder or individual. See *Treas. Reg. 1.501(c)(13)-1(b)*.
- (3) Accumulation of surplus earnings is not permitted if the organization has outstanding preferred stock. This is because outstanding preferred stock must be retired as soon as funds are available. See *Treas. Reg. 1.501(c)(13)-1(c)(2)(i)* and (ii).
- (4) An equity interest was established where land vendors sold cemetery land to a cemetery company for payment on a percentage-basis of sales, without a fixed price nor stated interest rate. The equity interest constituted inurement of net earnings because such payments, at least in part, are distributions of the profits of the cemetery company. See *Rev. Rul. 77-70*, 1977-1 C.B. 150, which

amplified Rev. Rul. 61-137, 1961-2 C.B. 118. See also the section Equity Interest in Land Sales below.

- (5) In *West Laurel Hill Cemetery Co. v. Rothensies*, 139 F.2d 50 (1943), the court denied exemption to a cemetery company under Section 501(c)(13) on the basis on inurement. The company paid the sellers in-full for the land procured for cemetery purposes. The company provided the sellers with trust certificates and continued to make annual distributions from surplus earnings to the certificate holders, who had not actually discharged the liability for the cost of land or retired the cost on a basis of a fixed percentage of the sale prices of the lots. The court found the surplus earnings inured to the trust certificate holders.
- (6) In *Puritan Lawn Mem'l Park Cemetery v. United States*, 15 Cl. Ct. 234 (1988), the court determined inurement, precluding exemption under Section 501(c)(13), resulted from a scheme between the plaintiff and a related for-profit, who issued zero percent interest loans to insiders. Additionally, the organization misrepresented the ownership of the cemetery property and disregarded the rights of lot owners.
- (7) Inurement, brought about by various types of activities of cemetery companies, is the basis of many adverse rulings. See the following sections of this Technical Guide for discussions on specific non-qualifying activities.

#### **D. Issuance of Stock and Dividends**

- (1) Generally, except in very limited circumstances, an organization that issued preferred stock on or after November 28, 1978, will not qualify under Section 501(c)(13). See Treas. Reg. 1.501(c)(13)-1(c).
- (2) There are two “transitional rules” for the issuance of preferred stock:
  - a. When a cemetery company or crematorium issued preferred stock prior to November 28, 1978, it may retain its exemption if the stock entitles the holders to dividends at a fixed rate not exceeding the greater of the legal interest rate in the state of incorporation or 8% annually on the value of the consideration for which the stock was issued, and if the company’s articles of incorporation require: (i) the preferred stock be retired at par as rapidly as funds therefor become available from operation, and (ii) all funds not required for the payment of dividends or for the retirement of preferred stock be used by the company for the care and improvement of the cemetery property. See Treas. Reg. 1.501(c)(13)-1(c)(2).

*Legal rate of interest* means the rate of interest prescribed by law in the state of incorporation which prevails in the absence of an agreement between contracting parties fixing a rate.
  - b. When a cemetery company or crematorium issued the preferred stock on or after November 28, 1978, it may retain its exemption if it issued the stock meeting the requirements of Treas. Reg. 1.501(c)(13)-1(c)(2)

pursuant to a plan that was written and adopted prior to November 28, 1978. See Treas. Reg. 1.501(c)(13)-(1)(c)(3).

- (3) See *equity interest* and *preferred stock* in the Relevant Terms section above.

## E. Equity Interest in Land Sales

- (1) The purchase of land for burial purposes might use a substantial part of the receipts of a cemetery company. It is important to determine whether payments to the land vendor constitute liquidation of purchase price indebtedness, or if there is also an element of profit distribution of the organization's net earnings, similar to stockholders owning an equity interest rather than solely creditors holding debt.
- (2) Sales of land for an equity interest in the cemetery company or crematorium precludes the cemetery's exemption under Section 501(c)(13). This is because no person (entity or individual) may have any interest in the net earnings of a tax-exempt cemetery company or crematorium so long as such interest remains outstanding. See Treas. Reg. 1.501(c)(13)-1(d).
- (3) A limited exception to the prohibition of equity interests in a cemetery company exists for companies that issued or adopted a plan for issuing preferred stock, respectively, before November 28, 1978, as detailed in the transitional rules described in Treas. Regs. 1.501(c)(13)-1(c)(2) and (3). See Treas. Reg. 1.501(c)(13)-1(d).
- (4) Generally, an equity interest within the meaning of Section 385 is an interest in the net earnings of a cemetery. See Treas. Reg. 1.501(c)(13)-1(d). Section 385 provides factors to consider when determining whether an interest is indebtedness (debtor-creditor relationship) or stock (corporation-shareholder relationship). Additionally, an interest that is not an equity interest within the meaning of Section 385 could still be an interest in the net earnings of the organization. Examples of equity interests are (a) a bond that pays additional interest based on the earnings or revenue of the organization, and (b) a convertible debt obligation issued after July 7, 1975, by a cemetery company or crematorium.
- (5) Percentage-based land sales are a type of arrangement where land vendors, who frequently are also the promoters of the cemetery company, sell the land to the cemetery in exchange for a stated percentage of the sales of all the cemetery lots. Many times, the contract does not state a total dollar amount to satisfy the repayment. The benefit to the land vendors is they share in the proceeds from lot sales in this open-ended arrangement, and they seek capital gains treatment for income tax purposes.
- (6) In Rev. Rul. 61-137, 1961-2 C.B. 118, a cemetery company which purchases cemetery property for no fixed total price, but instead for an undeterminable price based on a percentage of the proceeds from the sale of individual lots, is

not entitled to exemption under Section 501(c)(13). The ruling explains how an equity interest provides excess private benefit to the land vendors:

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 in 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.

- (7) In Rev. Rul. 77-70, 1977-1 C.B. 150, a percentage-based land sale arrangement caused a cemetery company to not qualify under Section 501(c)(13) on the basis of inurement. In the ruling, a nonprofit cemetery company acquired land from a for-profit cemetery company, under an agreement providing payment to the land vendors on the basis of a percentage of the sales price of each cemetery lot sold. 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 ruling concludes the land vendors acquired an equity interest in the cemetery company. Therefore, payments to the land vendors by the cemetery company constitute inurement of net earnings to a shareholder or individual because such payments, at least in part, would be distributions of the profits of the cemetery company.

The ruling also summarized factors distinguishing a "true debt" from an equity interest. Factors indicating an equity interest are:

- a. No unqualified obligation on the part of the cemetery company to pay because the installments depend on the sale of lots;
- b. No maturity date because the obligation is to continue until all lots are sold;
- c. No sum certain because the price of the lots is subject to change;
- d. No stated interest rate;
- e. No minimum annual payment;
- f. No right to share with general creditors;
- g. No paid-in capitalization of the company; and
- h. The transferors have control of the cemetery company.

Rev. Rul. 77-70 amplifies Rev. Rul. 61-137, 1961-2 C.B. 118.

- (8) As background, the basis for Rev. Rul. 77-70 rests on three court cases:

- a. Knollwood Mem'l Gardens v. Comm'r, 46 T.C. 764 (1966),
- b. Rose Hills Mem'l Park Ass'n v. United States, 463 F.2d 425 (Ct. Cl. 1972),  
and
- c. Restland Mem'l Park of Dallas v. United States, 371 F. Supp. 164 (N.D. Tex. 1974), aff'd, 509 F.2d 187 (5th Cir. 1975).

The courts concluded in those three cases that transactions where a cemetery acquired land under the terms of an open-ended or percentage arrangement contract whereby the transferor received a percentage of the sale price of each lot sold created an equity interest because all the traditional elements of a "true debt" were missing. To establish the equity interest of the transferors, the Knollwood, Rose Hills, and Restland cases relied on the seven factors distinguishing a "true debt" (later listed in Rev. Rul. 77-70), and on the additional fact that the transferors control the cemetery company after the transfer of the land. Non-qualification for exemption was not based solely on the presence of the percentage-of-sales-type contracts *per se*, but on all the relevant case facts. For further (non-precedential) discussion on the background of Rev. Rul. 77-70, see GCM 36810, Aug. 6, 1976.

- (9) The Service's view of equity interest in land sales, as set out in Rev. Rul. 77-70, is firmly endorsed by the courts in the following:

- a. In Knollwood Mem'l Gardens v. Comm'r, 46 T.C. 764 (1966), the court noted the land purchase agreement was missing many elements of "true debt," such as unconditional promise to pay, fixed date of maturity, and fixed amount of principal obligation. Additionally, the interests of the shareholders evidence the principal characteristics of equity interests because the ultimate receipt of payment by the shareholders is completely dependent upon sales by the alleged 'debtor.' The court in Knollwood explained how it determined the cemetery company's profits inured to its shareholders:

[T]he question of 'nonprofit' status for tax-exemption purposes turns upon the analysis of whether in substance someone has an equity interest in the organization which yields returns if the enterprise succeeds so that profits in effect inure to the benefit of the individuals who invest in the venture.

- b. In Rose Hills Mem'l Park Ass'n v. United States, 463 F.2d 425 (Ct. Cl. 1972), an open-ended land sale agreement enabled the land seller to share in the appreciation of the land and receive in-effect an equity interest in the cemetery company. The court held that such an equity interest was inconsistent with Section 501(c)(13) exemption, because it allowed for the distribution of the net earnings which inured to the benefit of the individuals entitled to the percentage of land sale proceeds.
- c. In Restland Mem'l Park of Dallas v. United States, 371 F. Supp. 164 (N.D. Tex. 1974), aff'd, 509 F.2d 187 (5th Cir. 1975), the cemetery company

was not entitled to exemption under Section 501(c)(13) because, among other factors, contracts for the sale of land to the cemetery company entitled the sellers to certain percentages of gross receipts from the sale of lots with no maximum price established. The sellers of the land had an unlimited prospect for profits. As the value of cemetery lots increased, their profit prospects increased at the same rate, and they were not limited to a certain sum above the value of their property.

- d. *Puritan Lawn Mem'l Park Cemetery v. United States*, 15 Cl. Ct. 234 (1988), held that Endicott, the affiliated for-profit corporation providing the land for the cemetery operations, was paid a percentage of the sales proceeds of the cemetery lots. This gave Endicott an equity interest in the organization and caused inurement of the organization's net earnings to Endicott, violating Section 501(c)(13). The court found the cemetery organization was not entitled to tax-exempt status under Section 501(c)(13).

(10) While the most recent court rulings on percentage-based land sales follow the Service's view, two earlier court cases did not accept the Service's position:

- a. In *Commissioner of Internal Revenue v. Kensico Cemetery*, 96 F.2d 594 (1938), the court stated the certificates of land sales that authorized holders to receive one-half of the proceeds of future sales of lots (pursuant to New York Statute, Laws of 1853) were "certificates of indebtedness" and "promises to pay money, differing essentially from certificates of stock which a stock corporation issues." The court believed the payments could not constitute inurement, stating, "[W]hat is paid does not constitute net earnings from the corporation. Here the cemetery net earnings are arrived at only after the elimination of payments made on the certificates." In its decision, the court placed no weight on whether payments had satisfied the initial debt: "Payment on the certificate may or may not constitute net earnings to its holder, depending upon the cost of the security to him."
- b. In *Forest Lawn Memorial Park Ass'n, Inc. v. C.I.R.*, 45 B.T.A. 1091 (1941), the cemetery company paid a portion of the selling price of lots, mausoleum niches, and crypts under contract to the land company from whom they purchased the land. The court ruled that inurement did not result because the land company used the net earnings for the improvement of the cemetery property. IRS did not acquiesce to this opinion and stated it will not follow the court's ruling. For the nonacquiescence, see *IRS Announcement Relating to: Forest Lawn Mem'l Park Assn., Inc.*, 1960-2 C.B. 3 (1960).

## **F. Perpetual Care Organizations**

- (1) Perpetual care organizations receive, maintain, and administer assets placed into perpetual care funds for the future care of cemetery and crematoria facilities. Generally, these organizations do not own land used for burial of the

dead or perform services that cemetery companies normally do. However, the care and upkeep of cemeteries are essential parts of the functions of cemetery companies. Even though perpetual care organizations are not specifically described in the Code or Regulations, they are so closely connected with the actual cemetery companies they serve that they are considered to share the character (nonprofit vs. for-profit) of those companies for the purpose of determining whether they qualify for exemption under Section 501(c)(13).

(2) Regarding perpetual care organizations, Rev. Rul. 58-190, 1958-1 C.B. 15, provides guidance on Section 501(c)(13) tax exemption, taxability of income, and deductibility of payments with regard to perpetual care organizations. It is important to note how the ruling differentiates treatment for nonprofit compared to for-profit cemetery companies and differentiates benefitting a cemetery as a whole compared to benefitting only a particular lot. The ruling contains four holdings based on various situations, as follows:

- a. Situation 1: A for-profit cemetery company's irrevocable trust fund (as provided for under state law or in accordance with its bylaws and contracts) for the perpetual care of its lots and crypts will not generate taxable income to the company.
- b. Situation 2: A perpetual care organization with an irrevocable perpetual care fund that serves a nonprofit cemetery company may qualify for exemption under Section 501(c)(13) because it performs a service essential to the maintenance of the cemetery.
- c. Situation 3: Contributions voluntarily made to or for the use of a nonprofit cemetery company, the funds of which are irrevocably dedicated to the care of the cemetery as a whole, are deductible by the donors as charitable contributions under Section 170(c)(5).

However, a donor may not deduct a contribution made for the perpetual care of a particular lot or crypt.

Furthermore, payments made to a cemetery company as part of the purchase price of a burial lot or crypt, even though irrevocably dedicated to the perpetual care of the cemetery as a whole, are also not deductible.

- d. Situation 4: Gross income from the trust of a perpetual care fund for the care of a family burial lot in a nonprofit cemetery is not allowable as a deduction under what is now Section 661 in computing the net income of the trust.

(3) In Rev. Rul. 64-217, 1964-2 C.B. 153, the perpetual care fund of a for-profit cemetery does not qualify for exemption under Section 501(c)(13). This is because a perpetual care fund is so closely connected with the actual cemetery company it supports, that it takes on the character of that cemetery company. Additionally, because the operation of the fund provides substantial assistance to the business by affecting the salability and selling price of lots and relieves



the business itself of the contractual obligation, net earnings of such funds inure to the benefit of the for-profit cemetery.

- (4) In Rev. Rul. 78-143, 1978-1 C.B. 161, a group of citizens who maintains a cemetery whose lots were purchased by individuals from a landowner, who never formed a cemetery company, qualified for exemption under Section 501(c)(13).
- (5) Several court opinions have upheld the Service position regarding perpetual care organizations:
  - a. *Rosehill Cemetery Co. v. United States*, 285 F. Supp. 21 (N.D. Ill. 1968), held that where the earnings of perpetual care funds closely connected with a for-profit cemetery company went to pay for a variety of the cemetery company's operating expenses and were also used (on at least one occasion) to increase the surplus account of the for-profit, the perpetual care funds were not exempt under Section 501(c)(13). The court relied on Rev. Ruls. 58-190 and 64-217. Additionally, the court both distinguished *Rosehill Cemetery* from the plaintiff in *Denver U.S. Nat. Bank v. United States*, 302 F. Supp. 801 (D. Colo. 1965), and explained that Denver's ruling was an unsupportable conclusion: "But merely because a legal entity performs a cemetery function and because it does not itself operate at a profit, it cannot be assumed to be an entity described by Congress as a 'cemetery company ... operated not for profit' and hence exempt from taxation." For background, in *Denver U.S. Nat. Bank*, the court held that three irrevocable trusts, formed by an association engaged in selling burial lots and mausoleum compartments, were 'cemetery companies' and exempt from income tax under Section 501(c)(13). The trusts provided for the payment of income to the association for the care and maintenance of cemeteries and mausolea, and the corpus of the trusts could never inure to the benefit of the association or its stockholders.
  - b. *First Nat. Bank of Waco v. United States*, 327 F. Supp. 1119 (W.D. Tex. 1970), held that a perpetual care fund administered in conjunction with a for-profit cemetery was a functional part of the cemetery and directly benefitted that cemetery and was not entitled to exemption under Section 501(c)(13), nor were net capital gains received by the trust deductible from taxable income under Section 642(c).
  - c. *Mercantile Bank & Trust Co. v. U. S.*, 441 F.2d 364 (1971), held the perpetual care funds of a for-profit cemetery company did not qualify for tax exemption under Section 501(c)(13) because they were not *cemetery companies* within the meaning of the Code. The court relied on Rev. Rul. 58-190 and *Rosehill Cemetery*, while also stating it found *Denver U.S. Nat. Bank* to be "unpersuasive."
  - d. In *Trustees of Graceland Cemetery Imp. Fund v. United States*, 515 F.2d 763 (Ct. Cl. 1975), the court pondered adjunct theory as it relates to

Section 501(c)(13) organizations. The issue was whether a corporation, chartered specially to provide perpetual care and maintenance to a cemetery operated by a profit-making company, qualified for exemption under Section 501(c)(13). The court held that the fund took on the non-exempt status of the cemetery company for the general reason that where one organization provides necessary and indispensable services to another, the former assumes the tax status of the latter. It went on to explain:

[W]here one organization serves as a mere adjunct for a primary organization by providing services which are essential to the functioning of the primary organization and which would be normally performed by it, the adjunct will acquire the tax status of the primary company. This adjunct theory has been applied to cemetery companies by the Internal Revenue Service in Rev. Rul. 58-190, 1958-1 C.B. 15, and Rev. Rul. 58-190, 1958-1 C.B. 15.

- e. *Cave Hill Inv. Co. v. United States*, No. 3:00CV-623-J, 2002 (W.D. Ky. Sept. 24, 2002), *aff'd sub nom. Cave Hill Inv. Co. ex rel. Thomas L. Barret Tr. v. United States*, 99 F. App'x 676 (6th Cir. 2004), considered a perpetual care fund, in which contributors endowed a particular lot with their contributions, which were placed in individual trust accounts. The additional services provided to each particular endowed lot was dependent on the amount contributed to its trust account. The court held that the organization was not entitled to exemption from income tax under Section 501(c)(13). The court affirmed the perpetual care trust benefited two particular family grave sites only; any benefit to the cemetery company as a whole occurred only incidentally.

## **G. Family Cemeteries**

- (1) Nonprofit mutual cemetery companies may include family cemeteries. The Regulations were amended in 1980 to state, “[T]he fact that a mutual cemetery company limits its membership to a particular class of individuals, such as members of a family, will not affect its status as mutual so long as all the other requirements of section 501(c)(13) are met.” See Treas. Reg. 1.501(c)(13)-1(a).
- (2) Prior to 1980, the Service considered impermissible inurement to be present where a cemetery company owned, operated, or maintained a private cemetery limited to a particular family, their descendants, and persons intermarried with descendants of the family. See Rev. Rul. 65-6, 1965-1 C.B. 229.
- (3) Several court decisions rejected the exclusion of family cemeteries, citing that neither statute nor legislative history require a cemetery company to be public nor to serve exclusively public interests. In contravention of the Service’s

position, two court cases approved nonprofit mutual cemetery companies that were family cemeteries:

- a. John D. Rockefeller Family Cemetery Corp. v. Commissioner of Internal Revenue Service, 63 T.C. 355 (1974), and
- b. Du Pont De Nemours Cemetery Co. v. C. I. R., T.C. Memo. 1974-314 (1974).

## H. For-Profit Relationships

- (1) Relationships with for-profit entities resulted in the denial of exemption in the following cases.
- (2) Entwinement with related for-profit organizations was one of the bases for denial of exemption under Section 501(c)(13) in *Restland Mem'l Park of Dallas v. United States*, 371 F. Supp. 164 (N.D. Tex. 1974), *aff'd*, 509 F.2d 187 (5th Cir. 1975). In *Restland*, a cemetery's net earnings inured to private individuals, precluding exemption under Section 501(c)(13), where it allowed a related for-profit funeral home to benefit from its efforts without compensation. The funeral home was managed and controlled by the same individual who controlled the cemetery and used the cemetery's name in joint advertising campaigns. The court held that inurement had occurred, among other adverse factors, because the funeral home "traded on the goodwill" originally built up by the non-profit cemetery; the joint operation had entwined the cemetery's goodwill with that of the funeral home and related for-profit businesses, for the benefit of the for-profit businesses.
- (3) *Evergreen Cemetery Ass'n v. United States*, 375 F. Supp. 166 (W.D. Ky. 1974), held that the nonprofit cemetery association, which owned the land and approved development plans of a for-profit company, and had only a slight hand in running the cemetery, did not qualify for exemption under Section 501(c)(13). A for-profit company handled sales of lots, maintained and embellished grounds, and funded the perpetual care fund. No money had ever been distributed to the association from the perpetual care fund for the maintenance of the cemetery. In its opinion, the court stated, "The Association does not perform enough vital functions for the Cemetery in order to qualify. Mere ownership of the land and approval of the development plans of a profit-oriented company is not enough. The Association does not perform 'services essential to the maintenance of the Cemetery'."
- (4) While non-precedential, PLRs 200518081 and 201409009 provide additional considerations when contemplating entwinement with for-profits. In those instances, the Service approved two separate private letter ruling requests where each 501(c)(13) cemetery company proposed to form a for-profit subsidiary. The subsidiaries proposed to carry on business activities which, if they were attributed to the cemetery companies themselves, would have threatened their tax-exempt status. One of the subsidiaries intended to sell final

expense insurance products while the other intended to operate a funeral home. The cemetery companies each demonstrated their proposed activities, control, and operations were separate from those of the subsidiaries, and thus, distinguishable from Restland.

## **I. Other Non-Qualifying Activities**

- (1) While this Technical Guide has discussed broad categories of activities adverse to tax exemption under Section 501(c)(13), such as inurement and equity interests in cemetery land, a few additional categories of non-qualifying activities remain.
- (2) In Rev. Rul. 64-109, 1964-1 C.B. 190, an organization operating a mortuary is not described in Section 501(c)(13). The ruling states an organization exempt under Section 501(c)(13) “may not engage in activities which are not necessarily incident to its burial purposes. The operation of a mortuary is not considered necessary to the procuring, sale, holding, and use of land solely as a burial ground.”
- (3) In Rev. Rul. 73-454, 1973-2 C.B. 185, an organization that owns, operates, and maintains a cemetery for pets was held to not qualify for exemption under Section 501(c)(13). “Legislative history clearly supports the conclusion that the term ‘cemetery’ is used in the statute in its commonly understood sense and that the exemption applies only to organizations for the burial or cremation of the remains of human bodies.”

## **J. Incidental Activities**

- (1) Cemetery companies are not permitted to engage in business activities not necessarily incident to the disposal of bodies by burial or crematoria operations.
- (2) Rev. Rul. 72-17, 1972-1 C.B. 151, provides that the sale of items related to burial such as monuments, markers, vaults, and flowers solely for use in the cemetery and the use of such proceeds for maintenance of the cemetery will not adversely affect the exemption under Section 501(c)(13). “Decorating or marking burial sites with monuments or by other means is so closely related to burial purposes that it is necessarily incident to those purposes when the markers or decorations are used solely within that cemetery.”

### **III. Other Considerations**

#### **A. Deductibility of Contributions**

- (1) Section 170(c)(5) provides for the deduction of contributions to cemetery companies of the type described in Section 501(c)(13).
- (2) Rev. Rul. 58-190, 1958-1 C.B. 15, provides guidance on deductibility under Section 170(c)(5) of certain payments made to cemetery companies:
  - a. To be deductible, the contributions must be voluntary and made to or for the use of a nonprofit cemetery, the funds of which are irrevocably dedicated to the care of the cemetery as a whole.
  - b. A donor may not deduct a contribution made for the perpetual care of a particular lot or crypt.
  - c. Payments made to a cemetery company as part of the purchase price of a burial lot or crypt, even though irrevocably dedicated to the perpetual care of the cemetery as a whole, are not deductible.
  - d. The income of any trust, which is used or permanently set aside for the care, maintenance, or beautification of a particular burial lot or mausoleum crypt, is not allowable as a deduction under what is now Section 661 in computing the net income of such a trust.
- (3) Federal Estate and Gift Tax Sections 2055 and 2522 have no deductibility provisions similar to those of Section 170(c)(5). Bequests or gifts to nonprofit cemeteries described in Section 501(c)(13) are not deductible for federal estate and gift tax purposes because they are not considered to be made exclusively for religious or charitable purposes within the meaning of Section 2055(a)(3) or Section 2522(a). See Rul. 67-170, 1967-1 C.B. 272, and *Mellon Bank, N.A. v. United States*, 762 F.2d 283 (3d Cir. 1985).
- (4) An unrestricted contribution made by a private foundation to an exempt cemetery company that is not described in Section 170(c)(2)(B) is not a qualifying distribution within the meaning of Section 4942(g) and is a taxable expenditure within the meaning of Section 4945(d)(5). See Rev. Rul. 80-97, 1980-1 C.B. 257.

#### **B. Unrelated Business Income**

- (1) Consider any associated Unrelated Business Income (UBI) issues. See Sections 511-514 of the Internal Revenue Code.

## **IV. Applying for Exemption & Filing Requirements**

### **A. Applying for Exemption**

- (1) An organization seeking recognition of exemption under Section 501(c)(13) must electronically file Form 1024, Application for Recognition of Exemption Under Section 501(a), with the correct user fee through Pay.gov. See Rev. Proc. 2024-5, 2024-1 I.R.B. 262, updated annually.
- (2) Adverse rulings may be appealed. After December 2015, organizations described in Section 501(c)(13) may institute a declaratory judgment proceeding in court in response to an adverse ruling under the rules of Section 7428. See Section 9, Procedures for Adverse Determination Letter, and Section 10, Declaratory Judgement Provisions of Section 7428, of Rev. Proc. 2024-5, 2024-1 I.R.B. 262, updated annually.

### **B. Return Filing Requirements**

#### **B.1. Filing Requirements**

- (1) Organizations that are tax-exempt under Section 501(c)(13) are generally required to electronically file an annual Form 990-series return or notice (that is, Form 990, Return of Organization Exempt From Income Tax, Form 990-EZ, Short Form Return of Organization Exempt From Income Tax or 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990EZ) to report certain information required by Section 6033.

The organization's gross receipts and its total assets determine which Form 990-series return it must file. See webpage "Form 990 Series - Which Forms Do Exempt Organizations File - Filing Phase In" on IRS.gov for a chart on gross receipts and asset levels.

- (2) Organizations with unrelated business taxable income (UBTI) must electronically file Form 990-T, Exempt Organization Business Income Tax Return, and electronically pay any required periodic estimated tax payments.
- (3) Organizations with employees must file employment tax returns and unemployment tax returns and electronically pay any required periodic tax deposits. See Publication 15 (Circular E), Employer's Tax Guide, for more information.

#### **B.2. Automatic Revocation**

- (1) In 2006, Congress enacted a law that requires, with very limited exceptions, that all tax-exempt organizations file an annual return or notice with the IRS beginning with the 2007 tax year. The law also provides that any organization that fails to file a required annual return or notice for three consecutive years will automatically lose its tax-exempt status, effective as of the due date for the

third missed return. This automatic revocation is by operation of law, and not by a determination made by the IRS.

- (2) Section 501(c)(13) organizations are subject to automatic revocation.
- (3) See webpage “Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions” on IRS.gov for more information.

## **V. Examination Techniques**

- (1) The information in this section is intended to guide the examiner in identifying and developing issues particular to Section 501(c)(13) cemetery companies. These guidelines are meant to supplement the guidelines provided by IRM 4.70, TE/GE Examinations, and are not all-inclusive nor meant to limit the agent in identifying issues nor using additional examination and legal resources (for example, CPE articles, examination tools and techniques, etc.) that are not included here.

### **A. Organizational Requirements**

- (1) Read the organizing document and bylaws to understand the organization’s exempt purpose, its legal structure, and how it is governed.

#### **A.1. Organizing Documents and Bylaws**

- (1) The review of the organizing documents will identify the organization’s exempt purposes, any amended authorized activities that can jeopardize exemption, who controls the organization (officers, directors, persons authorized to disburse funds), and the duties of these officials.

Review the organizing documents to determine whether the organization:

- a. Has language that permits it to engage in business activities that may subject it to lose its Section 501(c)(13) exemption, such as the operation of a mortuary;
- b. Has dedicated its earnings to the operation, maintenance, and improvement of the cemetery (or crematoria) property;
- c. Is authorized to issue preferred stock on or after November 28, 1978. If it is, see whether it meets any of the exceptions to the general rule under the transitional rules of Treas. Reg. 1.501(c)(13)-1(c)(2) or (3);
- d. Is owned and operated exclusively for the benefit of its members (the lot owners) if it is a nonprofit mutual cemetery company.

### **B. Operational Requirements**

- (1) Review the operations to determine whether the organization qualifies for Section 501(c)(13) tax-exempt status.

- a. Nonprofit mutual cemetery companies must operate exclusively for the benefit of members. Charitable activities, such as offering burial for indigents, are considered to be within the scope of such activities.
  - b. Other nonprofit cemetery companies and crematoria must be operated solely for disposing bodies by burial or cremation. They are not permitted to engage in any business not necessarily incident to that purpose. No part of the net earnings may inure to the benefit of any private shareholder or individual.
- (2) Consider adding interview questions about potential issues you identified and ask about information and records that might resolve them.
  - (3) The examination considerations in the sections below will help document whether the organization operates under Section 501(c)(13) as either:
    - a. A nonprofit mutual cemetery company, or
    - b. A nonprofit cemetery company or crematorium.

### **B.1. Minutes**

- (1) An organization's minutes normally document the key operational decisions of its authorized officers and directors. Review the minutes to determine:
  - a. Existence of special funds, trusts, or related entities, such as perpetual care funds.
  - b. Whether the authorized acts conform with the guidelines specified in the organizing documents and conform with Section 501(c)(13) exemption requirements.
  - c. Whether the land purchases or sales transactions conform with Section 501(c)(13) exemption requirements.

### **B.2. Publications**

- (1) An organization usually uses publications for outreach to its members and supporters and to provide information about its services to the public and potential clients. Many organizations use the internet and provide information about their services and operations on their websites.
- (2) Review their publications (for example, their website, pamphlets, and brochures) to determine what services or items the organization is offering for sale. Look for items and services not incidental to burial or crematoria activities.

### **B.3. Stock Certificates**

- (1) Section 501(c)(13) organizations are precluded from allowing their net profits to inure to the benefit of shareholders or individuals. Review the stock certificates and organizational documents to determine:



- a. Whether issuing stock is authorized and the details relative to dividend payments. Paying dividends on common stock violates Section 501(c)(13) exemption requirements;
- b. Whether the organization is retiring preferred stock at par as soon as sufficient funds are realized from sales;
- c. Whether the dividend rate on the preferred stock exceeds the greater of the legal rate of interest in the state of incorporation, or 8% on the value of the consideration for which the stock was issued.

See Treas. Reg. 1.501(c)(13)-1(c).

#### **B.4. Income Sources**

- (1) Organizations exempt under Section 501(c)(13) are allowed to conduct activities for disposal of bodies through burial and cremation and activities incident to those. Examine the cash receipts journal, related receipts, and supporting documents to determine whether the income is from activities incident to burial or cremation.
- (2) Review the income received from the sale of burial lots and any related services, such as perpetual care. Review related records such as receipts and contracts. Similarly, review income received from sale of crematoria services and items incident to that purpose.
- (3) Section 170(c)(5) permits deduction of contributions to cemetery organizations described in Section 501(c)(13). To be deductible, the contributions must be voluntary and made for the use of the nonprofit cemetery as a whole, and not designated by the donor for upkeep of a particular lot, nor as a payment for services the cemetery provides. Review the income received from contributions and look at related documentation, such as receipts, correspondence files, brochures, and pamphlets, to determine if:
  - a. Contributions were designated for a perpetual care of a particular lot or a crypt, rather than for the benefit of the cemetery as a whole;
  - b. Payments were made as part of the purchase price of a burial lot or crypt and contain funds for the perpetual care of the cemetery.

See Rev. Rul. 58-190, 1958-1 C.B. 15.

#### **B.5. Disbursements**

- (1) Review the disbursements to determine whether these serve exempt purposes, including:
  - a. Operation, maintenance, and improvement of the cemetery;
  - b. Buying cemetery property;
  - c. Dividends for preferred stocks (issued before Nov. 28, 1978) or retirement of those, or both purposes with regard to issued preferred stock; and/or

- d. Buying income-producing assets (the income from which is to be used for the care and improvement of the cemetery).
- (2) Inspect land or property purchase contracts and related payments, cost records, and related correspondence, for indications of private benefit. The review should determine:
- a. Whether the payments constitute only a liquidation of purchase price debt, or whether they contain an element of profit distribution (equity); or
  - b. Whether the purchase contract contains a fixed purchase price, or instead offers the seller with a percentage of the selling price of the cemetery lots. Sales of property to a cemetery organization in exchange for providing the seller an equity interest based in whole or in part on the revenues or income of the organization, including distributions based on the burial lots' sales price, are prohibited equity interest transactions in the organization. See Treas. Reg. 1.501(c)(13)-1(d).

## **B.6. Land Acquisition**

- (1) A substantial part of a cemetery company's receipts may amortize indebtedness incurred for purchasing land for burial purposes.
- (2) Review the purchase contracts and later payments to determine whether the:
  - a. Payments constitute only a liquidation of the purchase price indebtedness, or whether they contain an element of profit distribution; and
  - b. Sales contract contains a fixed purchase price, or instead offers the seller a percentage of the selling price of all cemetery lots.
- (3) Distributions based in whole or in part on revenues or income of the organization, including distributions based on the burial lots' sales price, are a prohibited equity interest in the organization. Treas. Reg. 1.501(c)(13)-1(d).
- (4) Review accounts in the balance sheet for transactions that may be linked to land purchases or the financing of land purchases to determine whether the purchase was made using debt instruments or arrangements with equity interest features.
- (5) Review the deeds and title documents, purchase agreements, appraisals, and related correspondence for indications of private benefit and to verify:
  - a. Ownership of any real property by the organization;
  - b. From whom the property was acquired; and
  - c. Details of the terms of the purchase or financing arrangements.
- (6) Consider reviewing the loans and mortgage documents with land sellers, particularly those transactions with related parties, to determine whether they have equity interest features (for example, repayments based on percentage of burial plot sales or organization's income).

- (7) Ask for an explanation of the arrangement used to purchase land for the cemetery during your interview. Corroborate the information by reviewing pertinent documentation and notes discussed in the minutes.

## **B.7. Mortuary Operations**

- (1) An exempt cemetery company can't directly operate a mortuary business. The cemetery can hold stock in a mortuary for investment purposes, if the mortuary is separately incorporated and run as an independent business with no overlap between the cemetery's and the mortuary's boards of directors.
  - a. Review the cash receipts and identify reversal of income attributable to amounts paid for mortuary service, such as prepaid mortuary services and interest received on funds held in an account for sales of pre-need mortuary services. These amounts represent property of the taxable mortuary company.
  - b. Review disbursement accounts for joint expenses, such as advertising, to ensure those are properly allocated between the cemetery and the mortuary.

See Rev. Rul. 64-109, 1964-1 C.B. 190.

## **B.8. Perpetual Care Funds**

- (1) Perpetual care organizations may come within the meaning of the term *cemetery company*. Cemetery companies usually create these organizations to receive and hold funds for the perpetual care and maintenance of the cemetery. A potential exemption issue involves perpetual care organizations that serve private benefit, such as by providing funding for maintenance of a for-profit cemetery.
  - a. When examining related perpetual care organizations, determine whether the organization is a separate entity. If it is a separate entity, determine whether it is exempt under Section 501(c)(13), and inspect the organization's Form 990-series return to determine whether an examination is warranted.
  - b. If the perpetual care fund is not a separate entity, review the trust agreement or enabling instrument to determine the conditions the fund must follow. Review the activities of the perpetual fund to determine whether the activities comply with Section 501(c)(13).
  - c. Examine any payments of a perpetual care fund to determine whether any net earnings of the perpetual care fund are used for private benefit, such as to pay for maintenance of a for-profit cemetery.

See section above on Perpetual Care Organizations.

## **B.9. Related Entities**

- (1) To understand whether the cemetery is furthering private interests, you need to identify whether any special funds, trusts, or other related entities such as perpetual care organizations exist, and whether the organization has financial transactions with related entities. Schedule R of Form 990 may offer information about related entities.
- (2) The interview should include questions regarding affiliated entities. For example, consider questions asking which of the organization's directors and officers also serve on other entities' boards. Ask about activities of the cemetery organization that are carried out by the identified affiliated entities.
- (3) When you review the financial transactions, check whether the transactions with the related entities raise any Section 501(c)(13) compliance issues (for example, land purchase arrangement with equity interest features, other transactions that provide for inurement of earnings to private shareholders, or a perpetual care fund benefiting a for-profit entity).