Bond Case Briefs

Municipal Finance Law Since 1971

IRS LTR: Association's Exemption Not Affected by Transactions with For-Profit Sub.

Citations: LTR 201409009

The IRS ruled that the transfer of cash from a nonprofit association that operates a cemetery to a for-profit subsidiary and other transactions involved in preparing to own and operate a funeral home will not affect the association's tax-exempt status and will not result in unrelated business taxable income.

UIL: 501.13-00, 512.00-00, 512.10-00

Release Date: 2/28/2014

Date: December 4, 2013

Dear * * *:

We have considered your ruling request dated August 22, 2013, requesting rulings under §§ 501(c)(13) and 512 of the Internal Revenue Code.

FACTS

You (Taxpayer) are a non-profit association that operates a cemetery. You are recognized as exempt from federal income tax under § 501(c)(13).

You intend to create a wholly owned, for-profit subsidiary corporation, which will be formed as a Subchapter C corporation, for the purpose of owning and operating a funeral home (Subsidiary). As part of this plan, you propose to enter into the following transactions:

In exchange for 100% of the Subsidiary's stock, you will transfer at least $x of cash and a nonexclusive license to use your name and address.

You will lease approximately 1,250 square feet of your existing building for arrangements and administrative offices for a fair market value rental rate which will be determined by you and the Subsidiary through an arm's length negotiation. The employees that engage in the operations and marketing of the funeral home will be employees solely of the Subsidiary.

To the extent that any of the Subsidiary's employees perform services related to your operations, you will reimburse the Subsidiary for the cost of such services on a fair market value basis. Likewise, you may perform certain administrative services for the Subsidiary (e.g., accounting, billing and collection services). However, in the event that you render these services, the Subsidiary will compensate you for such services on a fair market value basis.

The Subsidiary's Board of Directors will consist of no less than six members. Under no circumstances will the Subsidiary's Board of Directors include an individual that is then currently serving as one of your Trustees or employees or any other person directly involved in your day-t--day operations of your cemetery business. The Subsidiary will keep its own books and records separate from you.

The business purpose of the transaction is to provide for your customer's needs in one location in an effort to better serve your customers.

RULINGS REQUESTED

1. The transfer of cash and contributed assets by the Taxpayer to the Subsidiary, ownership of the Subsidiary's stock, the lease of the Taxpayer's land to the Subsidiary, the provision of services to the Subsidiary by the Taxpayer and to the Taxpayer by the Subsidiary in exchange for fair compensation, and the receipt of dividends by the Taxpayer from the Subsidiary will not adversely affect the Taxpayer's status as a tax exempt organization under § 501(c)(13).

2. Based on the facts presented, the Taxpayer will not be deemed to be engaged in the day-to-day management of the Subsidiary.

3. The dividends you receive from the Subsidiary will not constitute unrelated business taxable income to the Taxpayer pursuant to § 512(a)(1) by virtue of § 512(b)(1).

LAW

I.R.C. § 501(c)(13) 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.

I.R.C. § 511 imposes a tax on the unrelated business taxable income of organizations exempt under § 501(c).

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

I.R.C. § 512(b)(1) excludes dividends received by the tax-exempt organization from the computation of unrelated business taxable income under § 512(a)(1).

Rev. Rul. 64-109, 1964-1 C.B. 190, held that a cemetery may not, consistent with § 501(c)(13), engage in activities not necessarily incidental to its burial purpose. 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.

Rev. Rul. 76-91, 1976-1 C.B. 150, held that an organization will not jeopardize its exemption under § 501(c)(3), even though it deals with related parties in a commercial context, as long as the dealings are at arm's length and prices are set by qualified and independent appraisers.

In Restland Memorial Park v. United States, 371 F. Supp. 164 (N.D. Tex. 1974), aff'd, 509 F.2d 187 (5th Cir. 1974), a cemetery's net earnings were found to inure to private individuals, precluding exemption under § 501(c)(13), where it allowed a related for-profit mortuary to benefit from its efforts without compensation. There, an individual 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 individual who controlled the cemetery and used the cemetery's name in joint advertising campaigns. The court held that inurement occurred, inter alia, through the funeral home's "trade of 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 operations, for the benefit of the for-profit operations.

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 U.S. 436 (1943); Britt v. United States, 431 F.2d 227 (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. However, where the parent corporation so controls the affairs of the subsidiary that it 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 (5th Cir. 1973).

ANALYSIS

1. Tax-Exempt Status under 501(c)(13)

Section 501(c)(13) prohibits cemetery companies from engaging in any business incident to the purpose of the disposal of bodies by burial or cremation and from allowing its net earnings to inure to the benefit of any private shareholder or individual. You intend to form the Subsidiary for the substantial business purpose of operating a funeral home. Accordingly, the Subsidiary's business activities will threaten your exempt status if those activities are attributable to you. However, your proposed facts are distinguishable from both Restland Memorial Park v. United States and Rev. Rul. 64-109. First, in Restland Memorial Park, the individual that controlled the cemetery also owned the for-profit funeral home that did business with the cemetery. In this case, the Subsidiary is completely independent from you, and no common ownership or control exists between you and the Subsidiary. Second, the organization in Rev. Rul. 64-109 directly operated a mortuary. Here, the independently operated Subsidiary, not you, will operate the funeral home. Therefore, the proposed transaction will not adversely affect your tax-exempt status under § 501(c)(13).

2. Day-to-Day Management of the Subsidiary

The information and representations presented indicate that you will not control and will not be involved in the day-to-day management of the Subsidiary. The Subsidiary will have its own board of directors and keep its own books and records. You state that, under no circumstances, will the Subsidiary's board consist of any of your current Trustees or any employee involved in your day-t--day operations. The Subsidiary's employees will engage solely in the operations and marketing of the funeral home. Nonetheless, the Subsidiary's employees may perform services related to your operations, and your employees may perform certain administrative duties for the Subsidiary (e.g., accounting, billing and collection services). In this case, you state that reimbursement will be based on the fair market value of the services rendered. See Rev. Rul. 76-91.

3. Unrelated Business Taxable Income

Section 511 imposes a tax on the unrelated business taxable income of organizations exempt under § 501(c). Section 512(a)(1) defines "unrelated business taxable income" as the gross income an organization derives from any unrelated trade or business (defined in § 513) it regularly carries on, less allowable deductions, with certain modifications describe in § 512(b). Specifically, § 512(b)(1) excludes all dividends received by tax-exempt organizations. Accordingly, any dividends you receive from the Subsidiary will be excluded from calculation of UBTI.

CONCLUSION

Based on the foregoing, we rule as follows.

1. The transfer of cash and contributed assets by the Taxpayer to the Subsidiary, ownership of the Subsidiary's stock, the lease of the Taxpayer's land to the Subsidiary, the provision of services to the Subsidiary by the Taxpayer and to the Taxpayer by the Subsidiary in exchange for fair compensation, and the receipt of dividends by the Taxpayer from the Subsidiary will not adversely affect the Taxpayer's status as a tax exempt organization under § 501(c)(13).

2. Based on the facts presented, the Taxpayer will not be deemed to be engaged in the day-to-day management of the Subsidiary.

3. The dividends you receive from the Subsidiary will be excluded from the calculation unrelated business taxable income under § 512(a)(1) by reason of § 512(b)(1).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore Lieber

Manager, Exempt Organizations

Technical Group 3

Enclosure

Notice 437