Audit Technique Guide – Cemetery Companies – IRC Section 501(c)(13)

Introduction

This Audit Technique Guide offers information for identifying and developing issues during the examination of organizations under IRC Section 501(a) as an organization described in IRC Section 501(c)(13) for cemetery companies.

This guide offers help in examining cemetery companies exempt under IRC Section 501(c)(13) and aren't all-inclusive. Its purpose is to supplement the guidelines in IRM 4.75 sections and not meant to restrict the agent in identifying issues or using examination techniques not included here.

This guide doesn't contain technical information on IRC Section 501(c)(13) organizations. Review the technical information in IRM 7.25.13, Cemetery Companies.

Background

IRC Section 501(c)(13) offers exemption from federal income tax of cemetery companies:

- owned and operated for the benefit of their members or which aren't operated for profit and
- any corporation chartered for disposing bodies by burial or cremation which isn't permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Organizational Requirements

Two types of exempt cemetery companies are:

- Nonprofit mutual cemetery companies that must be owned and operated exclusively for the benefit of their members (owners), although they may also engage in charitable activities, such as the burial of indigents.
- Other nonprofit cemetery companies and crematoria that must be chartered solely for burial or cremation. Their charters can't permit them to engage in any business not necessarily incident to that purpose.

Examination Guidelines – Organizational Requirements

Read the organizing document and by-laws to determine if the organization:

- Is allowed to engage in activities not in furtherance of IRC Section 501(c)(13) purposes, such as the operation of a mortuary;
- Has dedicated its earnings to the operation, maintenance, and improvement of the cemetery property;
- Is authorized to issue preferred stock after November 28, 1978. In general, preferred stock can't be issued after this date. See Treas. Reg. 1.501(c)(13)-1(c)(2) and (3) for transitional rules; and
- Is owned and operated exclusively for the benefit of its members (lot owners) (for a nonprofit mutual cemetery company).

Operational Requirements

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.

Other nonprofit cemetery companies and crematoria must be operated solely for disposing bodies by burial or cremation. They aren't 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.

Examination Guidelines – Operational Requirements

Read the minutes to determine:

- The existence of special funds, trusts, or other related entities mentioned such as perpetual care funds.
- Whether authorized acts conform to those specified in the governing instruments and are consistent with IRC Section 501(c)(13).
- Whether other organization's purchase of cemetery land especially in relation to method of purchase, price, and terms, is consistent with IRC Section 501(c)(13) activities.

Review pamphlets and brochures to decide what the organization is offering for sale. Look for items and services not incidental to its burial purposes.

Review stock certificates and organizational documents to determine:

- Whether issuing stock is authorized and the details relative to dividend payment. The requirement of nonprofit operation (and prohibited inurement) is violated if the organization pays dividends on common stock.
- Whether any preferred stock is being retired at par as soon as sufficient funds are realized from sales.
- Whether the dividend rate paid on preferred stock exceeds the greater of the legal rate of interest in the state of incorporation or eight percent on the value of the consideration for which the stock was issued.

Examine the cash receipts journal and related supporting documents to decide whether the income is related to activities that are incidental to burial.

Decide if disbursements were related to exempt purposes and made for:

- Operation, maintenance, and improvement of the cemetery
- Payment for cemetery property
- Dividends on preferred stock (issued before November 28, 1978) or retirement or both of issued preferred stock
- Buying income-producing assets, the income from which is to be used to defray care and improvement costs

Inspect land or property purchase agreements and cost records, appraisals, and related correspondence, etc., for indications of private benefit.

Operation of a Mortuary

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.

Review the cash receipts and disbursements journals to:

- Identify any reversion of income attributable to amounts paid for mortuary services, such as interest income from special accounts in which the sales of pre-need mortuary services are held. These amounts are properly the income of the taxable mortuary.
- Ensure that the organization properly allocates any joint expenses such as advertising between the mortuary and the cemetery company.

Perpetual Care Organizations

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 cemeteries.

When examining related perpetual care organizations, determine whether the fund organization is a separate entity. If a separate entity, determine if it's exempt under IRC Section 501(c) (13), and inspect Form 990, Return of Organization Exempt from Income Tax, to determine if an examination is warranted.

If the perpetual care fund isn't a separate entity, review the:

- Trust agreement or enabling instrument to determine the provisions and conditions to be followed; and
- Activities of the perpetual fund to determine whether these provisions and conditions have been properly carried out under the provisions of IRC Section 501(c) (13).

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 the maintenance of a for-profit cemetery.

Land Sales

A substantial part of a cemetery company's receipts may amortize indebtedness incurred for purchasing land for burial purposes.

Review the purchase contracts and later payments to determine whether the:

- Payments constitute only a liquidation of the purchase price indebtedness, or whether they contain an element of profit distribution; and
- Sales contract contains a fixed purchase price, or instead offers the seller with a percentage of the selling price of all cemetery lots.

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).

Contributions

IRC 170(c)(5) permits the deduction of contributions to cemetery described in IRC Section 501(c) (13). To be deductible, the contributions must be voluntary and made to or for the use of the nonprofit cemetery. The contributions must be irrevocably dedicated to the care of the cemetery as a whole.

Review correspondence files, brochures, pamphlets, etc., to determine if:

- Contributions were for the perpetual care of a particular lot or crypt, rather than for the cemetery as a whole.

- Payments to the cemetery company as part of the purchase price of a burial lot or crypt contains funds for the perpetual care of the cemetery. Amounts that are an actual part of the purchase price aren't deductible as a contribution under IRC Section 170(c)(5).