

# [Exemptions]

[Federal income tax exempt status issued by IRS &/or as declared by Taxpayers]

## 26 U.S. Code § 501 (c)(13)



### 501(c)(13) — Cemetery Companies



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#### Part 7. Rulings and Agreements

#### Chapter 25. Exempt Organizations Determinations Manual

#### Section 13. Cemetery Companies

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##### 7.25.13 Cemetery Companies

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### **7.25.13.1 (04-30-1998)**

#### **Technical Overview**

1. This section discusses cemetery companies under IRC 501(c)(13).
2. Cemetery companies have been exempt from taxation since the passage of the 1913 Act which exempted cemetery companies, organized and operated exclusively "for the mutual benefit of their members. "
  - A. In the 1916 Act, the word "organized " was changed to "owned" and the word " mutual" was dropped.
  - B. The 1921 Act added the qualifications " or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual."
3. The addition of the phrase "or which are not operated for profit" apparently was designed to exempt organizations which were operated for the benefit of their members but not " exclusively" so because they had a so-called potters' field where nonmember paupers were buried. (Congressional Record Vol. 61 P. 7489). The remaining language added by the 1921 Act covers incorporated cemetery companies which may have stockholders. (Congressional Record Vol. 61 P. 7490).
4. IRC 501(c)(13) which grants exemption to cemetery companies and the applicable sections of the intervening acts have remained unchanged since the 1921 Revenue Act.
5. In December 1970, IRC 501(c)(13) was amended to extend exemption to crematoria. Pub. L. 91-618, 84 Stat. 1855.

### **7.25.13.1.1 (04-30-1998)**

#### **Exemption Requirements**

1. Currently, IRC 501(c)(13) exempts:
  - 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.

### **7.25.13.1.2 (04-30-1998)**

#### **Regulations**

1. The IRC 501(c)(13) regulations were amended in 1980 to reflect the addition of crematoria to the exemption category, to clarify the standards for exemption, and to identify when certain transfers to IRC 501(c)(13) organizations are in exchange for equity interests rather than for debt obligations. See Federal Register, Vol. 45, No. 100, May 21, 1980. See also Reg. 1.501(c)(13)-1.

### **7.25.13.1.2.1 (04-30-1998)**

#### **Comments on the Regulations**

1. Before the regulations were amended, there was confusion about whether all IRC 501(c)(13) cemeteries had to be nonprofit in order to qualify for exemption. Some had argued that the phrase " or which are not operated for profit" in the statute described a separate category of nonprofit cemetery and implied that some mutual cemeteries operated for profit (another category) could qualify independently for IRC 501(c)(13) exemption.

- A. This argument was answered in Regs. 1.501(c)(13)-1(a) and (b) which clarify that there are only two categories of IRC 501(c)(13) exempt cemeteries, nonprofit mutual cemetery companies and other nonprofit cemetery companies and crematoria. The language "or which are not operated for profit" in IRC 501(c)(13) was added simply to permit mutual cemeteries that were not "exclusively" mutual because they buried nonmember paupers to retain exemption.
  - B. The language was not intended to describe or create a third exempt cemetery; nor was it intended to imply that exempt IRC 501(c)(13) cemeteries may operate for profit.
2. The regulations use the term "members" synonymously with the term "lot owners." The courts have applied the same meaning to the term. See West Laurel Hill Cemetery Co. v. Rothensies, 139 F.2d 50 (3rd Cir. 1943).
  3. The other terms of art used in IRC 501(c)(13), e.g., "inurement," "private benefit," "nonprofit," etc., usually have the same meaning as when used in other IRC 501(c) exemption subsections. However, there are certain financial arrangements common to cemetery companies that give rise to inurement or private benefit.

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#### **7.25.13.2 (04-30-1998)**

##### **Perpetual Care Organizations**

1. Although not specifically described in the law or regulations, perpetual care organizations may come within the meaning of the term "cemetery company." These organizations are usually formed by cemetery companies to receive and hold funds in trust for the perpetual care and maintenance of the cemeteries. In fact many states require that a part of the selling price of each cemetery lot be set aside in a fund to provide income for these purposes.
2. Although these organizations do not own land dedicated to the burial of the dead or perform other services usual to a cemetery company, they provide an essential part of the functions of the cemetery companies. They are thus so closely connected with the actual cemetery companies that they partake of the character of the companies for purposes of determining whether they are exempt under IRC 501(c)(13).
  - A. Under this concept a perpetual care fund operated in connection with a profit-making cemetery company was held not to be exempt (Rev. Rul. 64-217, 1964-2 C.B. 153), while another fund which was administered for the care of a nonprofit cemetery qualified for exemption (Rev. Rul. 58-190, 1958-1 C.B. 15).

#### **7.25.13.2.1 (04-30-1998)**

##### **Family Cemeteries**

1. Formerly, the Service considered impermissible inurement to be present where a cemetery company owned, operated, or maintained a private cemetery limited to a particular class of individuals, e.g., the lineal descendants of a particular person and those who inter-marry with those descendants. See Rev. Rul. 65-6, 1965-1 C.B. 229.
  - A. Several court decisions were contrary to that published Service position. The John D. Rockefeller Family Cemetery Corporation, 63 T.C. 355 (Acq. 1977-2 C.B. 2); Du Pont De Nemours Cemetery Company, T.C. Memo. 1974-314 (December 18, 1974).
  - B. The Service has reversed itself on this position, and Reg. 1.501(c)(13)-1(a) now states "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 IRC 501(c)(13) are met."

#### **7.25.13.2.2 (04-30-1998)**

##### **Incidental Activities**

1. A cemetery company may not be permitted by its charter to engage in any business not necessarily incident to its burial purposes.
  - A. The Service has construed this provision to mean that exemption will be denied to a cemetery company that operates a mortuary because that activity is not considered necessary to procuring, sale, holding, and use of land solely as a burial ground. See Rev. Rul. 64-109, 1964-1 (Part 1) C.B. 190.
2. Crematoria, though once considered operated for purposes not incident to burial purposes, are now statutorily defined as operated for cemetery purposes. See P.L. 91-618, 84 Stat. 1855.
3. A mortuary business cannot be operated directly by a cemetery. The cemetery can, however, hold stock for investment purposes only in a mortuary, provided that the mortuary is separately incorporated, and run as an independent business with no overlap between the cemetery's and the mortuary's Board of Directors.

#### **7.25.13.3 (04-30-1998)**

##### **Inurement of Earnings for Private Benefit**

1. Under the regulations an exempt cemetery company must be owned and operated exclusively for the benefit of lot owners and no part of the net earnings may inure to the benefit of any private shareholder or individual.
2. Exemption is allowed only when the company's earnings are used for one or more of the following cemetery purposes:
  - A. Operation, maintenance, and improvement of the cemetery,
  - B. Acquisition of cemetery property,
  - C. Accumulating surplus for investment to provide a source of income for the maintenance and care of the cemetery.

#### **7.25.13.3.1 (04-30-1998)**

##### **Land Sales Problems**

1. A substantial part of the receipts of a cemetery company may be used to amortize indebtedness incurred in the purchase of land for burial purposes. A problem often arises in determining whether payments made to vendors of the land constitute a liquidation of purchase price indebtedness or whether they contain, in addition, an element of profit distribution. The problem is one of distinguishing between creditors of the cemetery company and stockholders or individuals owning an equity interest. Reg. 1.501(c)(13)-1(d) states that generally an equity interest within the meaning of IRC 385 will be considered an interest in the net earnings of a cemetery.

#### **7.25.13.3.2 (04-30-1998)**

##### **Percentage Land Sales**

1. The problem is most often encountered when the vendors, who frequently are also the promoters of the cemetery company, purportedly sell the land under an agreement whereby they receive as payment a stated percentage of the selling price of all cemetery lots. Usually the contract of sale does not provide for a total dollar amount to be paid. The benefits to the vendor promoters in such open-ended deals are obvious. They share in the proceeds from lot sales and seek capital gains treatment on the proceeds for income tax purposes.

2. The Service position has always been that these equity-sales arrangements result in inurement to the vendors and preclude IRC 501(c)(13) exemption.
  - A. The position was first published in Rev. Rul. 61-137, 1961-2 C.B. 118. That ruling involved a newly organized cemetery company. The facts showed that: the organizer sold land to the company, no fixed purchase price had been set for the land, the amount to be received by the vendor was based on a percentage of the sale prices of individual lots sold each year, and if a normal selling period was assumed, the vendor stood to receive ultimately for the property an amount more than double the value of the land at the time of its sale. It was concluded the purchase price of the land was unreasonable and earnings of the company inured to the benefit of the vendor and exemption under IRC 501(c)(13) was denied.
  - B. Rev. Rul. 77-70, 1977-1 C.B. 150, amplifies Rev. Rul. 61-137; it holds 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 lot sold, is not exempt from tax as a cemetery described in IRC 501(c)(13).
3. The IRC 501(c)(13) regulations were amended in 1980 for the purpose (among others) of clarifying the issue of whether percentage of sales, or equity-sales, arrangements result in inurement.
  - A. Reg. 1.501(c)(13)-1(d) states that such arrangements give the vendors an interest in the net earnings of a tax-exempt cemetery company or crematorium and concludes: ". . . 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."

#### **7.25.13.3.3 (04-30-1998)**

##### **Case Law on Land Sales**

1. The current regulations position on inurement arising from percentage of sales, or equity-sales, arrangements addresses a long line of judicial precedent.
  - A. Some early cases held that there was no inurement of "net earnings" because payments to landshare holders were deductions from gross receipts rather than from net earnings. See Forest Lawn Memorial Park Association v. Commissioner, 45 B.T.A. 1091 (1941), nonacq., 1960-2 C.B. 8.
  - B. The Service disagreed with this interpretation. See Commissioner v. Kensico Cemetery, 96 F.2d 594 (1938), and Rev. Rul. 61-137, 1961-2 C.B. 118.
  - C. Later cases, like Knollwood Memorial Gardens v. Commissioner, 46 T.C. 764 (1966), were consistent with Service position. Two more recent cases firmly endorsed the view that was adopted in the regulations.
2. Rose Hills Memorial Park Association v. United States, 463 F.2d 425 (Ct. Cl. 1972), cert. denied, 414 U.S. 822 (1973), held that an open-ended land sale agreement enabled the seller to share in the appreciation of the land and to receive in effect an equity interest in the cemetery company. To reach this result, the court looked at the substance of the transaction and concluded that the traditional elements of debt were absent and thus an equity interest (rather than a creditor interest) was created. The court held that such an equity interest was inconsistent with IRC 501(c)(13) exemption, because the interest inured to the benefit of the individuals entitled to the land sale proceeds.
3. Restland Memorial Park v. United States, 371 F. Supp. 164 (N.D. Tex. 1974), aff'd., 509 F.2d 187 (5th Cir. 1975), also held that a percentage of sales land sale agreement created an equity interest in the vendor inconsistent with IRC 501(c)(13) exemption.

- A. The court discussed whether such arrangements per se were impermissible under IRC 501(c)(13). It concluded that the arrangements in themselves were not improper but that they were impermissible under IRC 501(c)(13) when in substance they constituted an equity interest rather than a creditor interest.
  - B. The court held that the facts and circumstances are determinative. See Rev. Rul. 77-70, 1977-1 C.B. 150, for a discussion of the relevant facts and circumstances.
4. The above cases on the element of inurement in percentage of sales agreements dealt with newly formed cemetery companies where the private profit and tax motives of the promoters were obvious. Case law was not clear about whether holdings in those cases require denial of exemption in all cases where the consideration for the sale of land is based on a percentage of the selling price of lots, particularly if the sale took place long before the Federal income tax came into existence. However, later cases concluded that the income of a cemetery company in existence for many years inured to the benefit of private individuals.
- For example, in one case exemption was denied to a cemetery company which was created in 1869. See West Laurel Hill Cemetery Co. v. Rothensies, 139 F.2d 50 (3rd Cir. 1943). In that case the land was paid for at the time of acquisition. The company later provided for payments to shareholders out of surplus, purportedly as consideration for conveyance of the land. The Court found under the facts that the payments were dividends and that the company operated for the benefit of its shareholders. Reg. 1.501(c)(13)-(d), adopted in 1980, would prohibit these arrangements and preclude exemption "so long as such interests remain outstanding. "
5. The problem of distinguishing between creditors and equity owners is also found in a situation where the owners of a profitable cemetery create a nonprofit company to which they transfer the cemetery in exchange for long-term notes payable out of income from cemetery operations. Usually, the vendors keep the same control over the cemetery operation that they had before the transfer. Frequently, the so-called selling price will be found to exceed the fair market value of the cemetery properties. The principles involved in the land share arrangements discussed above apply to this situation for purposes of determining whether the nonprofit cemetery company qualifies for exemption.

#### **7.25.13.4 (04-30-1998)**

##### **Effect of Dividends on Exempt Status**

1. A cemetery company which issues common stock will not qualify for exemption if it is permitted by its articles of incorporation to pay dividends on the stock. The statutory proscription in IRC 501(c)(13) against inurement of earnings to the benefit of any private shareholder or individual would be violated if such dividends were paid.
2. Formerly, the regulations permitted IRC 501(c)(13) cemetery companies to issue preferred stock under certain conditions. Reg. 1.501(c)(13)-1(c)(1) now generally precludes exemption for cemetery companies that issue preferred stock. There are two "transitional rule" exceptions set out in Regs. 1.501(c)(13)-1(c)(2) and (3).
  - A. Reg. 1.501(c)(13)-1(c)(2) permits a cemetery company to retain its exemption if it issued the preferred stock prior to November 28, 1978, if the stock entitles the holders to dividends at a fixed rate not exceeding the greater of the legal interest rate (in the cemetery company's state) or 8 percent per annum, and if the company's articles of incorporation require that the preferred stock be retired at par as rapidly as funds therefor become available from operations, and 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.
  - B. Reg. 1.501(c)(13)-1(c)(3) permits a cemetery company to retain its exemption if it issued preferred stock meeting the requirements of Reg. 1.501(c)(13)-1(c)(2) pursuant to a plan which had been reduced to writing and adopted prior to November 28, 1978.

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**7.25.13.5 (04-30-1998)****Accumulation and Investment of Surplus**

1. A tax-exempt cemetery company may accumulate surplus for the purpose of investment in income producing assets, but only if no possibility exists of inurement of net earnings to the benefit of any private shareholder or individual. (Of course, accumulation would not be permitted if preferred stock was outstanding under the transitional rule of Reg. 1.501(c)(13)-1(c)(2) or (3) discussed in 13.4.5(2)).
  - A. Typically, contracts for the sale of cemetery lots contain provisions for permanent upkeep of the lots. As a necessary feature of this method of operation, the company ordinarily invests a portion of the sales proceeds in assets to produce income which is used to defray the costs of lot upkeep. Such accumulations and earnings, used for the necessary care or maintenance of an exempt IRC 501(c)(13) organization's property, are devoted to exempt purposes and consistent with exempt status.

**7.25.13.6 (01-07-2009)****Contributions to Cemetery Companies**

1. IRC 170(c)(5) provides for the deduction of contributions to cemetery companies of the type described in IRC 501(c)(13). To be deductible the contributions must be voluntary and must be 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.
  - 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 not deductible. See Rev. Rul. 58-190, 1958-1 C.B. 15.
2. IRC 2055 and 2522 contain no provisions similar to those of IRC 170(c)(5). Bequests or gifts to nonprofit cemeteries described in IRC 501(c)(13) are not deductible for Federal estate and gift tax purposes. See Rev. Rul. 67-170, 1967-1 C.B. 272.
3. The income of any trust which is used or permanently set aside for the care, maintenance, and beautification of a particular burial lot or mausoleum crypt is not deductible under IRC 642(c) in computing the net income of the trust. See Rev. Rul. 58-190, *supra*. See also, Cave Hill Investment Company v. United States, 93 A.F.T.R.2d 2004-2570 (6th Cir. 2004). The Court affirmed that the Trust established by Cave Hill primarily benefits two family grave sites; any benefit to Cave Hill Cemetery as a whole occurs only incidentally to the benefits that are purely individual. The Trust's cause is therefore not helped by IRS Revenue Ruling 58-190, stating that a trust, "the funds of which are irrevocably dedicated to the perpetual care of a non-profit cemetery, as a whole, none of the earnings of which inures to the benefit of any private shareholder or individual, may qualify" for exemption under IRC 501(c)(13).

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**7.25.13.7 (04-30-1998)****Application for Exemption**

1. An organization applying for exemption as an organization described in IRC 501(c)(13) must file its application on Form 1024, Application for Recognition of Exemption.

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**7.25.13.8 (04-30-1998)****Digests of Published Rulings**

1. Perpetual care fund; administration—An organization including a trust, created by formal action, the funds of which are irrevocably dedicated to the perpetual care of a nonprofit cemetery as a whole, none of the earnings of which inures to the benefit of any private shareholder or individual, may qualify for exemption from Federal income tax under IRC 501(c)(13). Rev. Rul. 58–190, 1958–1 C.B. 15.
2. Property purchased for an indeterminable price; cost based on sale of lots—A cemetery company, to acquire property with which to operate, purchased land for an indeterminable total price which was to be paid for on the basis of a percentage of gross proceeds realized from the sale of individual lots. Held, the organization is not entitled to exemption as a cemetery company described in IRC 501(c)(13). Rev. Rul. 61–137, 1961–2 C.B. 118. (Rev. Rul. 77–70, 1977–1 C.B. 150, amplifies this Rev. Rul., and Reg. 1.501(c)(13)–1(d) has been revised to further clarify the issue of sales to exempt cemetery companies and crematoria.)
3. Mortuary; establishment and operation—A cemetery company exempt from Federal income tax under IRC 501(c)(13) will be subject to the loss of its exempt status by the establishment and operation of a mortuary on the cemetery grounds or elsewhere. Rev. Rul. 64–109, 1964–1, (Part 1) C.B. 190.
4. Perpetual care fund; profit-making—A perpetual care fund, the income of which is turned over to a profit-making cemetery for use in connection with the maintenance of the cemetery properties and the burial lots, is not entitled to exemption from Federal income tax under IRC 501(c)(13). Rev. Rul. 64–217, 1964–2 C.B. 153.
5. Private cemetery; maintenance—An organization which owns, operates, and maintains a cemetery for the exclusive burial of lineal descendants of a particular family and those who intermarry with those descendants, and which is supported by funds from the descendants, is not exempt from Federal income tax under either IRC 501(c)(3) or 501(c)(13). Rev. Rul. 65–6, 1965–1 C.B. 229. Reg. 1.501(c)(13)–1(a), however, reverses this position. The regulation states "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 IRC 501(c)(13) are met."
6. Bequest or devise for perpetual care not exempt. Rev. Rul. 67–170, 1967–1 C.B. 272. The issue is whether funds bequeathed to trustees of a cemetery for its perpetual care are considered to be for exclusively charitable purposes within the meaning of IRC 2055(a)(3) where the facts show or the articles and charter provide that the cemetery corporation was formed primarily for the purpose of maintaining a cemetery for purchasers of burial lots therein. The bequest or devise is not for exclusively religious or charitable purposes within the meaning of IRC 2055(a)(3) or 2522(a).
7. Crematorium—The exemption of a cemetery company is adversely affected by engaging in the operation of a crematorium. Rev. Rul. 69–637, 1969–2 C.B. 127. Modified by P.L. 91–618, 1971–1 C.B. 539, and withdrawn by Rev. Rul. 71–300, 1971–2 C.B. 238. See Reg. 1.501(c)(13)–1(a).
8. Sales by an exempt cemetery company—The exempt status of a cemetery company is not adversely affected if it sells monuments, markers, vaults, and flowers solely for use in the cemetery and uses the sales proceeds for maintenance of the cemetery. Rev. Rul. 72–17, 1972–1 C.B. 151.
9. Pet cemetery—An organization that owns, operates, and maintains a cemetery for pets does not qualify for exemption under IRC 501(c)(13). Rev. Rul. 73–454, 1973–2 C.B. 185.
10. Property purchased under percentage arrangement—A nonprofit cemetery company that acquires land from a for-profit cemetery company, under an agreement providing payment to the former owners on the basis of a percentage of the sales price of each cemetery lot sold, is not exempt from tax as a cemetery described in IRC 501(c)(13); Rev. Rul. 61–137 amplified. Rev. Rul. 77–70, 1977–1 C.B. 150.
11. Maintenance of an established cemetery—A nonprofit organization, not associated with a cemetery company, formed by the citizens of a community to maintain a cemetery whose lots were purchased by



individuals from a landowner qualifies for exemption under IRC 501(c)(13). Rev. Rul. 78-143, 1978-1 C.B. 161.

12. Distribution by a private foundation to an exempt cemetery company—

An unrestricted contribution made by a private foundation to an exempt cemetery company that is not described in IRC 170(c)(2)(B) is not a qualifying distribution within the meaning of IRC 4942(g) and is a taxable expenditure within the meaning of IRC 4945(d)(5). Rev. Rul. 80-97, 1980-1 C.B. 257.

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