DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200152048

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: OCT 1 - 2001

Contact Person:

SIN: 501.13-01
512.01-00

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

Legend:

X =
Y =

Dear Sir or Madam:

We are responding to a letter dated January 31, 2001, and previous correspondence submitted on behalf of X by its authorized representative requesting a ruling concerning the federal tax consequences of the proposed transaction described below.

X is a nonprofit association that was organized to own and operate a cemetery. X is exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(13). X's operation currently includes the following:

(1) the erection, maintenance and operation of community and private mausoleums and columbariums;
(2) the sale, manufacture and installation of burial vaults, tombs and crypts (only for burials at the cemetery);
(3) maintenance of tool shops, work shops and other incidental buildings and equipment necessary to the operation of the cemetery;
(4) the sale, installation and maintenance of memorials;
(5) the sale, planting and maintenance of flowers, plants, shrubbery, trees and landscaping (sales are made only for burials at the cemetery); and,
(6) the sale of caskets that are used solely for the purpose of burying bodies in the cemetery.

X proposes to form a new, separate for-profit subsidiary that will operate a pet cemetery and mortuary. X will transfer a small piece of land (less than one acre) and $10,000 to Y in return for all of Y's outstanding stock. X will also lease portions of a building it owns to Y at fair

rental value as determined by an independent appraiser. Y's board of directors will be comprised of five individuals, three of whom must not be employees, officers or directors of X. X's chief executive officer ("CEO") will also be Y's CEO. Y will keep its own books and records and will have at least one employee who is not employed by X. Other individuals who are employed on a part-time basis by X may also be employed by Y. Y will separately compensate these individuals on an arm's length basis for services performed for Y. X anticipates that it will receive dividends from Y.

Section 501(c)(13) of the Code provides for the exemption from federal income tax of 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, and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(13)-1(a) of the Income Tax Regulations provides that 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 not for the purpose of resale. The regulations state that 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 under section 501(c)(13) of the Code.

Rev. Rul. 73-454, 1973-2 C.B. 185, holds that a cemetery that owns, operates and maintains a cemetery for pets does not qualify for recognition of exemption under section 501(c)(13) of the Code.

Rev. Rul. 64-109, 1964-1 (Part 1) C.B. 190, holds that a cemetery may not, consistent with section 501(c)(13) of the Code, engage in activities not necessarily incidental to its burial purposes. The ruling concludes that because operating a mortuary is not necessary to procuring, selling, holding and using land solely as a burial ground, an organization engaging in such a business does not meet the requirements for recognition of exemption under section 501(c)(13).

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c).

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business, subject to the modifications provided in section 512(b).

Section 512(b)(1) of the Code excludes dividends from the computation of unrelated business taxable income under section 512(a)(1).

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, 438 (1943); Britt v. United States, 431 F.2d 227, 234 (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. Britt, 431 F.2d at 234. 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, 1106 (5th Cir. 1973).

In general, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is formed, or carried on, are for a business purpose. Hence, the ownership of a subsidiary by an organization exempt under section 501 does not require attribution of the subsidiary's activities to the parent for federal income tax purposes unless the subsidiary lacks a business purpose and the subsidiary is an arm or agent of the parent. See Moline Properties, Inc., and Britt, supra.

The issue in this case is whether Y's activities are attributable to X. If the activities of Y are attributed to X, its exemption from federal income tax under section 501(c)(13) of the Code may be jeopardized because X will be considered as not operating for an exempt purpose. See Rev. Ruls. 73-454 and 64-109, supra. As discussed above, attribution occurs where the subsidiary does not have a business purpose and is merely an arm, agent or integral part of the parent.

The information submitted in this case indicates that Y, a for-profit organization, was formed for a real and substantial business purpose, i.e., operating a pet cemetery and mortuary. Thus, the threshold question of whether Y will have a business purpose must be answered affirmatively. Whether X is involved in, or in control of, the day-to-day operations of Y must also be considered. The information and representations provided indicate that X does not control or is so involved in the day-to-day management or affairs of Y that Y constitutes an agent of X. For example, Y will have its own board of directors and will keep its own books and records. A majority of Y's board members are not X's employees or officers and do not serve on its board of directors. Although Y's CEO is also X's CEO, X represents that Y's employees rather than the CEO run Y's day-to-day operations. X represents that it has no authority to approve Y's budget or request periodic reports from it. X also represents that any transactions between X and Y will be conducted on the basis of fair market value. Based on all the available information, we conclude that Y is not an arm, agent or integral part of X, and Y's activities are not attributable to X.

In accordance with section 512(b)(1) of the Code, dividends are excluded from the computation of unrelated business taxable income. Hence, the dividends X may receive from Y will not be subject to the tax on unrelated business income. We note that section 512(b)(13), which sets forth special rules for certain amounts received by exempt controlling organizations from their controlled organizations, does not apply to dividends.

Based on the facts and information submitted and representations made, we rule as follows:

1. The transfer of cash and land from X to Y, X's ownership of all of the stock of Y, Y's lease of building space to Y, and Y's general operation of a pet cemetery and mortuary business will not jeopardize X's tax-exempt status under section 501(c)(13) of the Code.

2. Dividends X receives from Y will not constitute unrelated business taxable income under sections 511-514 of the Code.

We have not been asked and we express no opinion on whether amounts, if any, that might be received by X from Y in return for providing any administrative services constitute unrelated business taxable income under section 512(a)(1) of the Code. Furthermore, we have not been asked and we express no opinion on whether payments, if any, of interest or rent by Y to X, which would otherwise be excluded from the computation of unrelated business taxable income pursuant to sections 512(b)(1) and (3), respectively, would be subject to tax by reason of section 512(b)(13).

Except as we have specifically ruled above, we express no opinion as to the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any such change should be reported to the Ohio Tax Exempt and Governmental Entities (TE/GE) Customer Service office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is (877) 829-5500 (a toll free number).

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. You should keep a copy of this letter in your permanent records.

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.

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.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3