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

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NO THIRD PARTY CONTACT

Contact Person:

ID Number:
EP.E.EO.T 3
Telephone Number:

XXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXX
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Employer Identification Number: XXXXXXXXXX

Legend:

X = XXXXXXXXXXXXXXXXXXXXXXXX
Y = XXXXXXXXXXXXX
Z = XXXXXXXXXXXXXXXX

Dear Applicant:

This refers to a letter dated March 27, 2000, and earlier correspondence submitted on behalf of X, which requested certain rulings concerning a proposed transaction under sections 501(c)(3) and 511-513 of the Internal Revenue Code. Specifically, X requests us to rule with respect to the tax consequences attendant to its proposed sale of burial caskets.

X is an organization exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). X, which is a monastery founded by members of the Y religious order, is included in the group ruling issued to the Z Church in the United States. Members of X follow the Y monastic values that are practiced by X. Traditionally, members of X are buried in plain wooden caskets in a manner consistent with the Y monastic values. X proposes to sell burial caskets, which will be designed and manufactured to reflect the style of the burial caskets made for X's members, and which will be modeled after the traditional casket designed for X's monastic community.

The caskets are intended to portray and convey the monastic values practiced by X and its members. Each casket sale will be accompanied by written materials explaining and translating for the purchaser the particular Y monastic values regarding the end of life, funeral rites and burial. The caskets will be hand crafted and made of solid wood. A removable wooden cross may be placed in the lid of the casket. X will contract with local manufacturers to perform the principal manufacturing steps, including the application of any stain or varnish to the outside of the casket and placement of a cloth lining in the casket's interior. Although X's members will have no significant involvement in the manufacturing of the caskets, X will have complete authority over design, markings and style.

X proposes to offer the caskets for sale to its practicing members and their relatives, and to the alumni of the religious schools currently and formerly operated by X. In addition, X plans to make the caskets available to every religious community of the Z Church in the United States. X states that it will directly market the caskets to those who visit its facility and will place

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advertisements about the caskets in local Z Church publications. With regard to sales to the public, X may engage in direct mailings and will develop a website where individuals may either obtain information, or purchase a casket. X will ensure that caskets are available and accessible to individuals who are not associated with X or the Z Church, but who may be receptive to the values and traditions portrayed and conveyed by the caskets. None of the caskets will be sold through funeral directors and funeral homes.

At the time of each casket sale, X will obtain information from the purchaser to determine whether the casket will be used in a burial ceremony of the Z Church, or at a burial service at which one of the Z Church's ordained clergy or those under vows will preside or participate. Moreover, under certain circumstances, X will provide caskets to the needy at below cost. While the caskets will have a base price of $1,750, some members of Z Church's clergy will receive a discount price of approximately half that amount. It is expected that the average price of a casket will be approximately 20% lower than the national average cost for caskets.

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable, religious, educational, and other stated purposes.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax 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 the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.511-2(a)(3)(ii) of the Income Tax Regulations provides, in part, that the term "church" includes a religious order or a religious organization if such order or organization (a) is an integral part of a church, and (b) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise. In determining whether a religious order or organization is an integral part of a church, consideration will be given to the degree to which it is connected with, and controlled by, such church. A religious order or organization shall be considered to be engaged in carrying out the functions of a church if its duties include the ministration of sacerdotal functions and the conduct of religious worship.

Section 1.511-2(a)(3)(iii) of the regulations provides that for taxable years beginning after December 31, 1969, churches and conventions or associations of churches are subject to the taxes

imposed by section 511, unless otherwise entitled to the benefit of the transitional rules of sections 512(b)(14) and 1.512(b)-1(i).

Section 1.512(b)-1(i) of the regulations provides, in part, that in the case of a trade or business carried on before May 27, 1969, by a church or convention or association of churches, all gross income derived from such trade or business will be excluded from the determination of unrelated business taxable income for all taxable years beginning before January 1, 1976.

Section 1.513-1(a) of the regulations, in part, provides that unless one of the specific exceptions of section 512 or 513 applies, the gross income of an exempt organization subject to the section 511 tax is includable in the computation of unrelated business taxable income if, 1) it is income from a trade or business, 2) such trade or business is regularly carried on by the organization, and 3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations provides that for purposes of section 513 the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c)(1) of the regulations provides that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on," within the meaning of section 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued.

Section 1.513-1(d)(2) of the regulations provides that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

In S. Rep. No. 91-552, 91st Cong., 1st Sess. 70 (1969), 1969-3 C.B. 469, the Committee on Finance stated that, "[i]n the case of churches, the term unrelated business income does not include the operation and maintenance of cemeteries, the conduct of charitable institutions, the sale of religious articles and the printing, distribution and sale of religious pamphlets, tracts, calendars, papers, books and magazines with a substantial religious content (even though the document might contain a small amount of advertising), as long as these activities are carried on in connection with the church."

Rev. Rul. 79-359, 1979-2 C.B. 226, provides that an organization, which provides traditional religious burial services, qualifies for recognition of exemption under section 501(c)(3) of the Code. The Rev. Rul. states that through the provision of burial services to members of a religion in compliance with the detailed requirements of religious laws, the organization is preserving and perpetuating traditional religious customs and obligations and is contributing to the advancement of religion. The Rev. Rul. concludes by stating that it "...does not purport to consider whether or under what circumstances a religious burial organization of the kind described herein may be subject to the unrelated business income tax imposed by section 511."

Beginning in 1969 (together with a transition rule covering taxable years beginning before January 1, 1976), churches have been subject to the tax on unrelated business income under

section 511 of the Code. As a monastery of a religious order affiliated with the Z Church, X is subject to the tax on unrelated business income under section 511. See section 1.511-2(a)(3) of the regulations. In order for income to be included in the computation of unrelated business taxable income under section 512(a)(1), such income must be from a regularly carried on trade or business that is unrelated to the organization's exempt purpose or function. See section 1.513-1(a). In the case of X, the proposed marketing and sale of burial caskets appears to be a trade or business that is regularly carried on within the meaning of sections 1.513-1(b) and (c). Thus, the central question in this case is whether such marketing and sales activity is substantially related to X's exempt purposes as required by section 513(a).

Generally, the production and sale of religious articles by a church or a religious order would not result in unrelated business income as long as such activities are carried on in connection with the church. See S. Rep. 91-552, supra. More specifically, such articles must have some special religious significance to the church that produced them. However, for purposes of section 513(a) of the Code, the requisite substantial causal connection is not automatically established merely because articles, such as, for example, church vestments, are somehow religious in nature. The production and sale of vestments by a church or religious order for use by members of its own denomination would be substantially related to an organization's exempt religious purpose. However, a church or religious order's production and sale of such vestments for use by other church denominations would not "contribute importantly" to the organization's exempt function. See section 1.513-1(d)(2) of the regulations.

In the case of burial caskets, the manufacture and sale of such items by a church or religious order is not, in and of itself, an exempt activity under section 501(c)(3) of the Code. Unless it is shown that the sale of burial caskets furthers a section 501(c)(3) purpose, such sales would constitute unrelated trade or business within the meaning of section 513(a). Although the legislative history cited above indicates that a church's operation and maintenance of a cemetery is not unrelated trade or business, the treatment of burial caskets was not discussed. Similarly, Rev. Rul. 79-359, supra, does not address the unrelated business income tax implications with respect to a religious burial organization.

Here, X proposes to sell burial caskets, which are modeled after the traditional casket designed for X's members, and which will convey the monastic values practiced by X and its members. Along with the casket, the purchaser will receive material explaining and translating for the purchaser the particular Y values regarding end of life, funeral rites and burial. Such sales will be made to a variety of purchasers, including X's practicing members and their relatives, to alumni of religious schools currently and formerly operated by X, to religious communities of the Z Church, to those who visit X's facility, and to members of the public. Of particular significance, at the time of sale, X will obtain information to determine whether the caskets will be used in a burial ceremony of the Z Church, or at a burial service at which one of the Z Church's ordained clergy or those under vows will preside or participate.

By selling caskets that will be used in connection with the Z Church's burial ceremonies or burial services under the circumstances described above, X will further an exempt religious purpose under section 501(c)(3) of the Code. Thus, the sales of caskets to be used in connection with such ceremonies and services of the Z Church will be substantially related to X's exempt purpose or function and will not constitute unrelated trade or business under section 513(a). However, sales of caskets to members of the general public that will not be used in connection with ceremonies or services of the Z Church, as described above, will not be substantially related to X's exempt

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purpose or function, and, thus, amounts derived from such sales will constitute unrelated business taxable income under section 512(a)(1) and will be subject to tax under section 511.

Accordingly, based upon the information provided, we rule that:

1. X's sale of caskets to be used in burial ceremonies of the Z Church, or at burial services at which one of the Z Church's ordained clergy or those under vows will preside or participate will be substantially related to X's religious and charitable purposes under section 501(c)(3) of the Code and will not be an unrelated trade or business under section 513(a); that income from the sale of such caskets will not be treated as unrelated business income under section 512(a); and, thus, income generated by the sale of such caskets will not be subject to tax under section 511.

2. X's sale of caskets that will not be used in ceremonies or services of the Z Church, as described above, will not be substantially related to X's religious and charitable purposes under section 501(c)(3) of the Code and will be an unrelated trade or business under section 513(a); income from the sale of such caskets will be treated as unrelated business income under section 512(a); and, thus, income generated by the sale of such caskets will be subject to tax under section 511.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to X's authorized representative. We are providing the Area Manager - with a copy of this ruling. You should keep a copy of this letter in your permanent records.

This ruling letter 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 as precedent.

If you have any questions, please contact the person whose name and telephone number appear in the heading of this letter.

Sincerely,

(signed) Robert C Harper, Jr.

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

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