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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's EIN:

Tax Years Involved:

Date of Conference:

LEGEND:

Taxpayer:
State A:

ISSUE:

When must Taxpayer report income from the sale of real property, personal property, and services under a pre-need funeral contract?

CONCLUSION:

Taxpayer must report income from pre-need funeral contracts when amounts under the contracts are due or received, whichever is earlier.

FACTS:

Taxpayer operates a cemetery/funeral home in State A and uses an accrual method of accounting. In the course of its business, Taxpayer sells burial rights (real property), merchandise (personal property), and funeral services. Burial rights include cemetery lots, mausoleum crypts and niches, and lawn crypts. Merchandise includes caskets, vaults, urns, memorials, acknowledgment cards, register books, flowers, etc.

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Services include preparation of the body, use of Taxpayer's facilities and staff for funeral services, and opening and closing of the burial sites. Taxpayer also receives cash advances for death certificates and similar items.

Taxpayer sells these services and property on both an at-need and pre-need basis. For pre-need sales, Taxpayer and its customers generally enter into installment contracts that are paid over several years. The payment terms of Taxpayer's pre-need contracts, including the down payment, length of the payment period, and monthly payment amounts, vary depending on the customer's circumstances. Generally, however, Taxpayer charges interest on the balance due only when the installment period is for more than three years and the customer pays less than 20 percent down or less than $100 per month.

When a pre-need contract is fully paid, Taxpayer is obligated under the contract to convey and provide the property and services as specified in the contract. At that time, the customer receives a certificate of ownership and is thereafter able to transfer the contract rights to others. The customer cannot take possession of or modify the selected burial site in any way prior to payment in full. In the event of a customer's death prior to full payment of the contract price, the balance of the contract price must be paid by the estate or the customer's survivors before Taxpayer will provide for the burial.

Consistent with state law, the terms of the pre-need contracts provide that a customer may cancel the contract within 30 days from the date of purchase and receive a full refund of all amounts paid. A customer may cancel the portion of the contract attributable to services, facilities, and cash advances at any time and will be entitled to a full refund of all amounts paid for those items. A refund for merchandise is provided only if at the time Taxpayer is required to fulfill the obligations under the contract, Taxpayer cannot or does not comply with the contract in delivering the merchandise. Under no circumstances does Taxpayer refund the amounts received for real property. In the case of a customer default, Taxpayer may terminate the contract and withdraw all funds in trust allocable to merchandise and keep all payments as liquidated damages. Taxpayer will return to the customer all funds in trust allocable to services, facilities, and cash advances.

For financial reporting purposes, Taxpayer reports the full amount of the sales price, less the amount put into trust,[1] in income when the contract is executed. For

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[1] Under State A law, Taxpayer is required to put into trust 70 percent of the payments received for future services, 100 percent of the payments received for cash advances, and the greater of 30 percent of the retail price or 110 percent of the cost of

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federal income tax purposes, Taxpayer reports in the year the contract is executed the amount actually received, less the amount put into trust. In the second year of the contract, Taxpayer does not report any income from the contract, regardless of whether any payments are received. In the third year of the contract, Taxpayer reports the remaining sales price of the contract, less the amount put into trust, regardless of whether any payments are received or whether any payments are still owed by the customer.[2] The revenue agent argues that Taxpayer must report income from the sale of real property, personal property, and services when the pre-need contract is executed.

LAW AND ANALYSIS:

Section 451(a) of the Internal Revenue Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) provides that, under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive income and the amount of the income can be determined with reasonable accuracy (the "all-events test"). See also § 1.446-1(c)(1)(ii)(A). All the events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due, or (3) payment is made, whichever happens earliest. See Schlude v. Commissioner, 372 U.S. 128, 133 (1963); Rev. Rul. 84-31, 1984-1 C.B. 127.

In the instant case, Taxpayer's pre-need contracts provide for the sale of real property, personal property, and services. With regard to real and personal property, the revenue agent argues that, under the all-events test, the required performance occurs when the property is sold by Taxpayer to the customer. The agent contends that the sale of real and personal property occurs when the pre-need contract is executed. Taxpayer, on the other hand, argues that the sale does not occur until all payments under the pre-need contract have been received.

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the merchandise it sells. The treatment of the amounts put into trust is not at issue in this technical advice request.

[2] In a letter dated October 22, 1998, however, Taxpayer stated it does not dispute that income for all items under the pre-need contracts should be accrued when amounts under the contract are due or received, whichever occurs earliest.

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The determination of when a sale occurs is essentially a question that requires consideration of all the facts and circumstances of a particular situation. Clodfelter v. Commissioner, 426 F.2d 1391, 1393-94 (9th Cir. 1970); Commissioner v. Segall, 114 F.2d 706, 709 (6th Cir. 1940); Baird v. Commissioner, 68 T.C. 115, 124 (1977). One important factor to consider in determining whether a sale of property has occurred is whether under the contract the seller has an unqualified right to receive the contract price. Lucas v. North Texas Lumber Co., 281 U.S. 11, 13 (1930); Commissioner v. Union Pacific R.R. Co., 86 F.2d 637, 639 (2d Cir. 1936).

Due in large part to applicable State A law, Taxpayer does not have an unqualified right to receive income attributable to the real and personal property at the time the pre-need contract is executed. At the time the contract is executed, the customer is expected to make regular payments to Taxpayer for the entire purchase price of the contract but has no duty under the contract to make any future payments. If the customer fails to pay the entire contract price, Taxpayer does not have the right to legally enforce the contract and cannot require the customer to pay the balance of any installments or interest due. Taxpayer may only terminate the contract, keeping certain amounts the customer has already paid as liquidated damages.

Other factors to be considered in determining when a sale is complete for tax purposes are the transfer of legal title and the shift of benefits and burdens of ownership of the property. Merrill v. Commissioner, 40 T.C. 66, 76 (1963), aff'd per curiam, 336 F.2d 771 (9th Cir. 1964). Generally, a sale of property is complete upon the first of these events to occur. Deyoe v. Commissioner, 66 T.C. 904, 910 (1976), citing Dettners v. Commissioner, 430 F.2d 1019 (6th Cir. 1970).

Under Taxpayer's pre-need contracts, legal title to the real and personal property is not transferred at the time the contract is executed; instead, title is transferred only after the customer has paid the entire contract price. Further, the benefits and burdens of ownership of the real and personal property do not pass to the customer at the time the pre-need contract is executed. One of the primary benefits associated with the ownership of property is possession and use of the property. In the instant case, a customer has no right to possess or use the property prior to full payment of the contract price, even in the event of the customer's death. Another benefit of property ownership is the right to transfer the property to others. Under Taxpayer's pre-need contracts, a customer can only transfer the rights under the contract after the customer has paid in full and Taxpayer has issued a certificate of ownership.

Based on all the facts and circumstances discussed above, we conclude that the sale of real and personal property occurs for tax purposes only when all amounts under the contracts are received from the customer. Thus, we do not agree with the agent that the required performance occurs under the all-events test for real and personal property at the time the contract is executed. We must now determine when the all-events test is met with regard to real and personal property, as well as for services.

As noted earlier, the all-events test is met when all the events have occurred that fix the right to receive income and the amount of the income can be determined with reasonable accuracy. The first part of the all-events test is met when (1) the required performance takes place, (2) payment is due, or (3) payment is made, whichever happens earliest. See Schlude; Rev. Rul. 84-31.

With regard to services in the instant case, the required performance will not occur until after a customer's death. Thus, income from services must be included in income when payment is due under the pre-need contract or payment is made, whichever happens earlier. With regard to real and personal property, the required performance does not take place until the property is sold. We have determined that the sale of real and personal property does not occur until all payments under the pre-need contract have been received in full. Thus, income from real and personal property must be included in income at the earlier of when payment is made or when payment is due under the contract.

A copy of this technical advice memorandum is to be given to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.