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ICCFA Magazine author spotlight

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Editor's note: The Cemetery Impossible column is written by the staff of The Foresight Companies. **If you have a question you want to be featured in this column, please send it to danisard@f4sight.com.** Dan Isard or a member of his staff will call you to get more information and a recommendation will be provided via this column, helping not only you but also others who are facing similar challenges.

A cemetery is a special place, not only to families but also to accountants. It's not a typical business, and decisions about how to record the business of a cemetery need to be made with an eye to consistency.

Cemetery Impossible

How should the purchase of a cemetery be recorded, and what comes after that?

Dear Cemetery Impossible,
I just made an acquisition of a cemetery and my accountant does not know how to book the purchase price. Can you help me educate him?

Dear Needs an Accountant in the Know,
You should know that cemetery accounting is tricky. There are so many things that people do based upon their understanding or lack of understanding of the business. Even the large companies differ in their accounting principles.

Let me start by addressing the issue of cemetery accounting from the origin of an acquisition. In future issues, I will explain how to complete ongoing accounting for cemeteries.

The decisions the lawyers and brokers make affect the actions of the accountant in a cemetery acquisition. The difference between a stock purchase and an asset purchase lies with the two matters of tax and liability.

Buying via a stock purchase

First I will discuss a stock purchase scenario. If the transaction is a stock purchase, then you bought control of the cemetery by purchasing shares. This method is used for a for-profit corporation.

You continue the tax protocols of the past. You have a basis in the enterprise for when you sell the company. You are also assuming any liabilities, known or unknown, from the previous ownership.

As investor, you have basis in the shares purchased. For example, if you paid $1 million for the shares, that is your basis.

Basis is the concept that when you purchase an investment you can sell that investment and have a tax-free recovery of your investment. Your capital gain is the amount above the price you paid for the

investment when purchased. By this example, at the time you sell this investment the first $1 million is tax-free.

In a stock sale situation, your accountant has very little to change from the previous accountant. Your company will have basis in the inventory and there is no change to the basis in the inventory. You have to carry it over. If the previous owner incurred a $5 cost per grave, then it will continue, regardless of how much you paid for the shares, unless you enhance a grave area. Building a feature or adding a statue will change the basis in the interment rights for that area.

For example, let us assume you have a section with 1,000 graves. Assume the previous owner had a basis for each of those graves at $5/grave. Now assume you install a water feature with a laser light show to make the Bellagio blush, and that cost $100,000.

You have two options. First, you can allocate the $100,000 over the 1,000 graves and come up with an adjusted basis for each grave of $1,005 ($1,000 plus $5). That is what I recommend.

Second, your accountant might elect to treat this feature as a stand-alone asset. Then you can write it off via depreciation or accelerate the depreciation as allowed by Section 179.

Section 179 is the tax incentive for small businesses to invest in its business and write assets off in one year, up to a limit. This provides tax repayment more quickly than if you add it to the basis, which does not result in a deduction until you receive income from those grave sales.

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The allocation to the developed and undeveloped land is a matter of tax planning strategy. If you want to recover your costs of purchase more quickly, you would put more value on the graves developed than the land undeveloped.

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Buying via an asset purchase

An asset purchase is the other alternative when you buy a cemetery. With an asset purchase, you receive immediate tax benefits for your investment as you sell internments. Typically you do not assume liabilities—the only liability is whatever you might have caused since buying the cemetery.

In an asset purchase, your purchase document will include a schedule. The schedule shows how much of the purchase price is allocated to each asset. For example, you might have the $1 million allocated as follows:

Graves developed	$100,000
Land undeveloped-	$400,000
Buildings	$200,000
Autos/machinery	$200,000
Goodwill	$100,000

Now your accountant starts pulling his or her hair out. First of all, buildings and autos/machinery are going to be depreciated.

Buildings are typically written down over 39 years. Autos and machinery might be written off over a five to seven-year period, or they might qualify as Section 179 property and be written off in one year.

Goodwill is also written off, but unlike buildings and autos/machinery, it is an intangible asset. Intangible assets are not depreciated, they are amortized. Our firm understanding, based on a tax court case, is that goodwill is written off over its lifetime, but over not less than 15 years.

Be aware that intangible assets that are depreciated and used as an offset to ordinary income can lead to "recapture." When an asset is sold for a gain after deductions for depreciation, depreciation recapture is used to tax the gain.

Because a deduction was previously received from ordinary income for the depreciation of the asset, any gain the seller receives, up to the depreciation amount, must be included as ordinary income to offset the earlier deduction. Therefore, not all gain upon a sale of assets is at the capital gain rate.

There is often some negotiation between the buyer and seller in creating this schedule. If something is credited to real estate, it is written off over 39 years. However, if it is agreed to be goodwill, it is written off over 15 years. Buyers and sellers argue over these points as well as the value of the assets.

A point of confusion on an asset purchase is the handling of the adjusted basis on the graves. In the above example, we have two items that will have an adjusted basis for sale items.

Let's first discuss the graves developed allocation of $100,000. Assume you buy a cemetery with 2,500 graves that remain to be sold. With a $100,000 allocation, each grave has a cost basis of $40 per grave. Therefore, each time you sell a grave that was developed at the time of this acquisition, your cost of goods sold is $40.

The land undeveloped is the second accounting item. In this example, you acquire undeveloped land for $400,000. Assume this is 10 acres. Therefore, each acre has an allocation of $40,000. This is the starting allocation.

If it cost $100,000 to develop one acre with roads, utilities, mapping and features, you now have a basis of $140,000 for this acre. If this land is used solely for graves and you plan 1,000 graves in this acre, the cost of goods sold (COGS) for each of these graves would be $140/grave.

Suppose you plan to take half this acre for above-ground interment. Now you need to add the cost of a mausoleum to your basis of $140,000 (original basis of $40,000 plus the cost of developing this area of $100,000).

As you plan to use half for the mausoleum, you allocate $70,000 for above-ground interments and $70,000 for ground interments.

The COGS for the ground interment rights remains at $140/grave ($70,000 divided by 500 graves).

If a 500-crypt mausoleum costs $400,000 to construct, the basis for the above-ground interment mausoleum area is $470,000. Therefore the COGS for the above-ground interment area is $940 per crypt ($470,000 divided by 500 crypts).

Usually when you build a new mausoleum, some area is allocated to niches. The niches have a cost to construct. There are a few options your accountant has for allocating the land cost to the niches.

First is the square-foot basis. Maybe 5 percent of the land cost is under the niche area (5 percent of $70,000, or $3,500).

Since you may have 250 niches in a 500-crypt area, this is a tiny cost-of-land allocated per niche ($3,500 divided by 250, or $14 per niche).

Since this is such an inconsequential amount, another option is to just allocate all of the land costs to the crypts and none of it to the niches. This is an approach I happen to like, as long as we are not dealing with a columbaria, as opposed to a mausoleum with a niche section. All of the land allocation is accounted for in the crypts.

The allocation between tangible assets and intangible assets is negotiated.

The allocation to the developed and undeveloped land is a matter of tax planning strategy. If you want to recover your costs of purchase quicker, you would put more value on the graves developed than the land undeveloped.

To help figure this out, you need to determine how long it will take you to sell off the graves developed. If you have 2,500 graves and you sell about 250 per year, it will take you 10 years to sell this off.

You might start to develop a portion of the land undeveloped about seven or eight years from now, when you are down to 20 to 30 percent of the current grave inventory.

In accounting, GAAP stands for Generally Accepted Accounting Principles. This is the game plan the American Institute of Certified Public Accountants (AICPA) created for all accountants to follow.

They have not done this for all businesses. Since it is very rare that a cemetery needs an audited financial statement, the AICPA has never created GAAP for the cemetery world.

In the cemetery world, CAAP is used. CAAP stands for Consistently Applied Accounting Principles. This means you do the same procedure year in and year out. To me, consistency is the key.

I recommend you have an accountant who is in the know. Specifically, you need one who knows the cemetery business. This way, for tax compliance you are in the best position to pay the least amount of taxes each year.

And for management purposes, your accountant can interpret the data to give you the best counsel. ❒