



WILLIAM J. SCOTT
ATTORNEY GENERAL
STATE OF ILLINOIS
SPRINGFIELD

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CEMETERIES:
Treatment of the Premium
on Unexercised Security Options
under the Cemetery Care Act

Honorable Michael J. Howlett
Auditor of Public Accounts
State of Illinois
Springfield, Illinois

Dear Auditor Howlett:

Your letter of July 12, 1971, presents the following question:

Are the payments received from unexercised security options to be treated as principal or income of a care fund held pursuant to the requirements of the Illinois Cemetery Care Act?

The answer to your question requires some understanding of the type of security transaction involved. When the trustee managing a care fund executes an option to

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sell a security belonging to the trust for a fixed time at a set price, this option is described as a "call". If the call is exercised, the trust has sold the securities. The consideration for this sale is the sum of the option price and the payment or premium received for the call. As both of these sums are part of the sale price of a trust asset, they are treated as principal of the care fund. If the call expires without being exercised, the trust has both the stock and the premium received for the call. The proper treatment of this payment is the problem raised in your letter.

The Cemetery Care Act (Illinois Revised Statutes, 1969, Chapter 21, Paragraphs 64.1 to 64.24 inclusive) provides for the creation and the permanent existence of a care fund.

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The care fund is to be used in perpetuity for the maintenance of burial places in the cemetery. Section 3 of the Cemetery Care Act provides a description of the proper operation of the care fund.

"Any cemetery authority is hereby authorized and empowered to accept any gift, grant, contribution, payment, devise or bequest, or pursuant to contract, any sum of money, funds, securities or property of any kind, or the income or avails thereof, and to hold the same in trust in perpetuity for the care of its cemetery"

"The carefunds authorized by this Section and provided for in Section 4 of this Act shall be held intact"

"The net income only from the investment of such care funds shall be allocated and used for the purposes specified in the transaction by which the principal was established in the proportion that each contribution bears to the entire sum invested." (Emphasis supplied)

The purpose of this statute is to assure that a continuing income will be available for the maintenance of the cemetery.

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This can be accomplished by interpreting the Cemetery Care Act to avoid any diminution of trust corpus or distributions from the principal of the trust.

The Attorney General has issued three opinions (1961 Attorney General's Opinions, page 155; 1962 Attorney General's Opinions, page 523; and 1963 Attorney General's Opinions, page 256) which deal with the definition of income under the Cemetery Care Act or its sister statute, the Funeral and Burial Funds Act (Illinois Revised Statutes 1969, Chapter 111 1/2, Paragraphs 73.101 through 73.108 inclusive). Those opinions have determined that "income" as used in these statutes is used in the same sense that the term "income" is used in the Illinois Principal and Income Act (Illinois Revised Statutes 1969, Chapter 30, Paragraph 159).

"'Income' as used in this Act means the return derived from principal."

Following this definition the Attorney General has held that income consists of amounts received from the use of principal but does not include amounts representing an advance or increase

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in value in securities or other assets belonging to the trust. These opinions exclude capital gains earned by the trust from inclusion in income.

The premium on an unexercised call is not treated as capital gains for Federal income tax purposes but is taxed as ordinary income (Revenue Rulings, 58-234, 58-1 C.B. 279). The premium does not represent a payment for the sale of a trust asset. The trust assets under these circumstances are neither diminished nor changed in form. The premium represents a payment for the right to use a trust asset. In this respect it is similar to a rent or interest payment. The premium may be viewed as a return derived or received from the principal and, therefore, income. As income, the payment on an unexercised security option may be used for the care and maintenance of the cemetery as are other items of trust income.

Therefore, it is my opinion that the premium on an unexercised call is income as that term is used in the Cemetery Care Act.

Yours very truly,

A T T O R N E Y G E N E R A L