Mutual insurance company; definition. To qualify as a mutual insurance company under section 501(c)(15) of the Code the following characteristics, while not conclusive, must be present: (1) the right of policyholders to be members to the exclusion of others and the right of such members to choose the management; (2) the sole business purpose is to supply insurance substantially at cost; (3) the right of members to the return of premiums in excess of those amounts needed to cover losses and expenses; and (4) common equitable ownership of the assets by the members; G.C.M. 25497 superseded.

Advice has been requested whether the company described below qualifies as a 'mutual insurance company other than life' under section 501(c)(15) of the Internal Revenue Code of 1954.

The company, a membership organization without capital stock, issues casualty insurance policies on property and life insurance policies. Membership in the organization is limited to holders of its insurance policies. All policyholders are members and entitled to vote for management. In the event of dissolution, each policyholder is entitled to a pro-rata share of the net assets.

The insurance policies are issued at premiums set by the board of directors based on loss experience, recognized mortality tables, and assumed rates of interest. The policies are nonassessable. While the company's charter authorizes the board of directors to return portions of premiums to the policyholders in the form of dividends if experience under the rates used warrants such action, all of the unearned premiums to date have been retained as reserves for the payment of insurance claims and related expenses. The reserves accumulated for these purposes are reasonable in amount. The company's life insurance reserves, plus unearned premiums and unpaid losses on its life insurance policies not included in its life insurance reserves, comprise less than 50 percent of its total reserves.

During the taxable year, the gross amount received by the company, consisting of premiums and investment income, did not exceed $150,000.

Section 501(c)(15) of the Code provides for the exemption from Federal income tax of mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not exceed $150,000.

The Income Tax Regulations under section 501(c)(15) do not define a mutual insurance company, a mutual life insurance company, or a mutual marine insurance company. Subchapter L of
the Code contains the general rules for taxation of insurance companies. The legislative history of the Revenue Act of 1962, amending Part II of Subchapter L of the Code (sections 821-826 dealing with mutual insurance companies other than life or marine), suggests that 'mutual insurance company' was intended to have the same meaning for the purposes of both section 501(c)(15) and Subchapter L. See H.R. Rept. No. 1447, 87th Cong., 2d Sess., 1962-3 C.B. 405, 555; S. Rept. No. 1881, 87th Cong., 2d Sess., 1962-3 C.B. 707, 763, 902; and Conference Rept. No. 2508, 87th Cong., 2d Sess., 1962-3 C.B 1129, 1153.

Section 821(a) of the Code provides for the taxation of certain mutual insurance companies other than life. Section 1.821-4(a)(1)(i) of the regulations contains a reference to section 501(c)(15) for the exemption from income tax of the companies described therein. Therefore, the same criteria should be used to determine whether an organization is a mutual insurance company, other than life, for purposes of both section 501(c)(15) and section 821.

While neither the Code nor the regulations thereunder defines a mutual insurance company, the courts have found the following characteristics to be among those indicating a mutual insurance company:

1. the right of policyholders to be members to the exclusion of others and the right of such members to choose the management;

2. the sole business purpose is to supply insurance substantially at cost;

3. the right of members to the return of premiums in excess of those amounts needed to cover losses and expenses; and

4. common equitable ownership of the assets by the members.

Cf. Modern Life and Accident Insurance Co. v. Commissioner, 49 T.C. 670 (1968), aff'd. 420 F.2d 36 (7th Cir. 1969). The presence of these characteristics alone, however, will not be considered as conclusive that a company is a mutual insurance company.

In determining whether policyholders have the right to be members to the exclusion of others and to choose the management, the actual exercise of control by the policyholders is essential, not merely the power of the policyholders to exercise control conferred by statute or otherwise. Rev. Rul. 58-616, 1958-2 C.B. 928, clarifying Rev. Rul. 55-240, 1955-1 C.B. 406.

The fact that policies are nonassessable (issued at fixed premiums with no contingent liability of the policyholders for additional assessments) is not contrary to the principle that insurance is furnished substantially at cost. Modern Life and Accident Insurance Co., 49 T.C. at 673-4. Moreover, the fact that
the premium charged is greater than the expected cost of the insurance does not necessarily violate the principle since the excess may furnish the guaranty fund from which extraordinary losses may be met. However, the excess of the premium over actual cost and reserves, as later ascertained, must be returned to the policyholder. Penn Mutual Life Insurance Co. v. Lederer, 252 U.S. 523 (1920). This may take the form of a reduction in renewal premiums or the payment of dividends on the policies. The maintenance of reasonable reserves to pay losses and expenses is consistent with furnishing insurance substantially at cost, but an unreasonable accumulation suggests the company is not providing insurance to its members substantially at cost. See Mutual Fire Insurance Co. of Germantown v. United States, 142 F.2d 344 (3rd Cir. 1944); Keystone Mutual Casualty Co. v. Driscoll, 137 F.2d 907 (3rd Cir. 1943).

Common equitable ownership of the company's net assets by the members is represented by the right to receive the company's net assets in the event the members vote to wind up and dissolve the company. Mutual Fire Insurance Co. of Germantown, v. United States, supra.

The company described in this ruling has the characteristics of a mutual insurance company discussed above. Membership is limited to policyholders; all policyholders are members and have the right to vote for management; the company furnishes insurance substantially at cost while providing reasonable reserves against its policy obligations and operational expenses; the members have the right to return of the portion of premiums in excess of the amounts needed for losses and expenses; and the ownership of the company's net assets is equitably shared by the members who are entitled to receive the net assets pro-rata in the event of dissolution.

Section 501(c)(15) of the Code requires the company to be a mutual insurance company 'other than life.' Insofar as pertinent, section 501(a) and section 1.801-3(b)(1) of the regulations define a life insurance company as an insurance company engaged in the business of issuing life insurance contracts if its life insurance reserves, plus the amount of unearned premiums, and unpaid losses on its life insurance policies not included in its life insurance reserves, comprise more than 50 percent of its total reserves. Accordingly, the mutual insurance company in question is not a life insurance company since its life insurance reserves, plus unearned premiums, and unpaid losses on its life insurance policies not included in such reserves, comprise less than 50 percent of the company's total reserves.

In view of the foregoing, the company described is a mutual insurance company other than life or marine. Since the gross income received during the taxable year from the items described in section 822(b) of the Code (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) did not exceed $150,000, it qualifies for exemption under section
Even though an organization considers itself within the scope of this Revenue Ruling, it must file Form 1026, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(15) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which the principal place of business or principal office of the organization is located. See section 1.501(a)-1 of the regulations.

G.C.M. 25497, 1948-1 C.B. 60, is hereby superseded since the position stated therein is restated under the current law in this Revenue Ruling.