



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Attn: Mandatory Review, MC 4920 DAL  
1100 Commerce St.  
Dallas, TX 75242

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: April 17, 2008

Number: 200829053  
Release Date: 7/18/2008

LEGEND

ORG = Organization name      XX = Date      Address = address

UIL: 501.15-00

ORG  
ADDRESS

Employer Identification Number:  
Person to Contact/ID Number:  
Contact Numbers:  
Voice  
Fax

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear :

In a determination letter dated August 1944, you were held to be exempt from Federal income tax under section 501(c)(15) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(15) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(15) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On November 13, 20XX you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(15) of the Code.

You are required to file Form 1120/1120-PC U. S. Property and Casualty Insurance Company Income Tax Return with the Ogden Service Center. You have filed taxable returns on Form 1120-PC U. S. Property and Casualty Insurance Company Income Tax Return for the years ended December 31, 20XX and December 31, 20XX with us.

In addition, for future periods, you are required to file Form 1120/1120-PC with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

Dallas, TX 75242

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

October 19, 2007

LEGEND

ORG = Organization name      XX = Date      Address = address

ORG  
ADDRESS

Taxpayer Identification Number:  
Form:  
Tax Year(s) Ended:  
Person to Contact/ID Number:  
Contact Numbers:  
Telephone:  
Fax:

Dear \_\_\_\_\_ :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

We have also enclosed Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues, and Publication 3498, *The Examination Process*. These publications include information on your rights as a taxpayer, including administrative appeal procedures within the Internal Revenue Service.

If you request a conference with Appeals, we will forward your written statement of protest to the Appeals Office, and they will contact you. For your convenience, an envelope is enclosed. If you and Appeals do not agree on some or all of the issues after your Appeals conference, the Appeals Office will advise you of its final decision

If you elect not to request Appeals consideration but instead accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking your exempt status under I.R.C. § 501(c)(15). If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and send a final letter advising of our determination.

In either situation outlined in the paragraph above (execution of Form 6018-A or failure to respond within 30 days), you are required to file federal income tax returns for the tax period shown above. (Form 1120-PC) File the federal tax return for the tax period shown above with this agent within 60 days from the date of this letter, unless a request for an extension of time is granted.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance.

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018-A  
Report of Examination  
Envelope

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>		<b>Year/Period Ended</b>
ORG		12-31, 20XX 12-31, 20XX

LEGEND

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**ISSUES**

1. Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years ending December 31, 20XX & 20XX?
2. If ORG does not qualify for tax exempt status for years ending December, 31, 20XX & 20XX, what are the tax consequences?
3. If the tax exempt status is revoked, how will it affect future years?

**FACTS**

ORG (ORG) was formed in the State of State on December 13, 19XX. Its purpose, according to its Certificate of Incorporation has been insuring its members against loss by fire and lightning, and for that purpose, desire authority to take risk, issue policies, and do what is proper and necessary in conducting the business of a \_\_\_\_\_, for the protection and benefit of its members. It received tax exempt status under IRC Section 501(c)(15) in August 19XX,

ORG operates on a mutual basis, therefore there are no shareholders. Members of the organization consisting of the policyholders are in charge of the organization. During 20XX there were 85 policyholders. There were no reinsurance agreements in effect during 20XX and 20XX.

The insurance provided to its policyholders is fire only coverage. The maximum amount of benefit per risk is \$. ORG assumes all the risks.

The following is a breakdown of the Gross Receipts received by ORG for the years ending December 31, 20XX & 20XX and the percentage of Gross Premiums to Gross Receipts for the same years.

ORG	20XX	20XX
Premiums Earned	\$	\$
Investment Income	\$	\$
Other Income		
Total Gross Receipts	\$	\$
Gross Premiums- (Prem. Earned + Reins. Received + Reins. Loss Adj.)	\$	\$
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	29.12%	28.29%

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**LAW AND ANALYSIS**

**1. Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years ending December 31, 20XX & 20XX?**

Internal Revenue Code section 501(c)(15)(A) exempts from Federal income tax insurance companies (as defined in section 816(a)) other than life (including interinsurers and reciprocal underwriters) if-

- (i.) (I) the gross receipts for the taxable year do not exceed \$600,000, and  
(II) more than 50 percent of such gross receipts consist of premiums, or
- (ii.) in the case of a mutual insurance company-  
(I) the gross receipts of which for the taxable year do not exceed \$150,000 and,  
(II) more than 35 percent of such gross receipts consist of premiums.

Clause (ii) shall not apply to a company if any employee of the company, or a member of the employee's family (as defined in section 2032(A)(e)(2)), is an employee of another company exempt from taxation by reason of this paragraph (or would be so exempt but for this sentence).

Sec. 206, Clarification of Exemption from Tax for Small Property and Casualty Insurance Companies, of the Pension Funding Equity Act of 2004, P.L. 108-218, amended section 501(c)(15)(A) to change the definition of small property and casualty insurance companies (insurance companies other than life insurance companies) exempt from income taxes to: (1) a company whose gross receipts for the taxable year do not exceed \$600,000, and over half such gross receipts consist of premiums (currently, whose net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000); or (2) a mutual insurance company (a) whose gross receipts for the taxable year do not exceed \$150,000 and more than 35 percent of which consist of premiums and (b) none of whose employees (or member of the employee's family) is an employee of another company exempt from tax under section 501(c)(15). These changes were applicable after December 31, 20XX.

Notice 2006-42, IRB, 2006-19 provides guidance as to the meaning of "gross receipts" for purposes of section 501(c)(15)(A) of the Internal Revenue Code. This notice advises taxpayers that the Service will include amounts received from the following sources during the taxable year in "gross receipts" for purposes of § 501(c)(15)(A):

- A. Premiums (including deposits and assessments), without reduction for return premiums or premiums paid for reinsurance;

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- B. Items described in § 834(b) (gross investment income of a non-life insurance company); and
- C. Other items that are properly included in the taxpayer's gross income under subchapter B of chapter 1, subtitle A, of the Code.

Thus, gross receipts include both tax-free interest and the gain (but not the entire amount realized) from the sale or exchange of capital assets, because those items are described in § 834(b). Gross receipts do not, however, include amounts other than premium income or gross investment income unless those amounts are otherwise included in gross income. Accordingly, the term gross receipts does not include contributions to capital excluded from gross income under § 118, or salvage or reinsurance recovered accounted for as offsets to losses incurred under § 832(b)(5)(A)(i).

Section 834(b)(1)(D) of the Internal Revenue Code includes under gross receipts the gains from the sale or exchanges of capital assets to the extent provided in subchapter P (section 1201 and following, relating to capital gains and losses).

Section 834(c)(6) of the Internal Revenue Code allows a deduction for Capital Losses to the extent provided in subchapter P (section 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

Based on the changes in the limitations under Internal Revenue Code (IRC) Section 501(c)(15)(A), and the operations of ORG during 20XX & 20XX, it was determined by the chart above, that ORG did not qualify for tax exempt status for 20XX & 20XX. Even though ORG was able to meet the \$600,000 gross receipt limitation, its premiums did not exceed 50% of the gross receipts. As a mutual company, ORG was able to meet the \$150,000 gross receipt limitation, but its premiums did not exceed the 35% limitation (20XX- 29.12%; 20XX- 28.29%), required for mutual companies.

Therefore, ORG did not meet the requirements of IRC 501(c)(15) for 20XX & 20XX. The tax exempt status should be revoked.

**2. If ORG does not qualify for tax exempt status for year ending December, 31, 20XX & 20XX, what are the tax consequences?**

Since ORG did not qualify for tax exempt status under IRC Section 501(c)(15) for the 20XX & 20XX years, ORG was required to file Form 1120/1120-PC for 20XX & 20XX.

IRC 831 discusses tax on insurance companies other than life insurance companies.

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IRC 831(a) states as a general rule, "Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company other than a life insurance company."

IRC 831(b) provides an alternative tax for certain small companies. It states in IRC 831(b)(1) that, in general, "In lieu of the tax otherwise applicable under subsection (a), there is hereby imposed for each taxable year on the income of every insurance company to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 11(b)."

IRC 831(b)(2) discusses the companies to which this subsection applies.

- (A) In general. This subsection shall apply to every insurance company other than life (including interinsurers and reciprocal underwriters) if-
- (i) the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$1,200,000, and
  - (ii) such company elects the application of this subsection for such taxable year.

The election under clause (ii) shall apply to the taxable year for which made and for all subsequent taxable years for which the requirements of clause (1) are met. Such election, once made, may be revoked only with the consent of the Secretary.

Regulations (Regs.) 301.9100-8(a)(2) discusses the time for making elections. Under (i) it states in general that except as otherwise provided in this section, the elections described in paragraph (a)(1) of this section, must be made by the later of-

- (A) The due date (taking into account any extensions of time to file obtained by the taxpayer) of the tax return for the first taxable year for which the election is effective, or
- (B) January 22, 1990 (in which case the election generally must be made by amended return)

Regs. 301.9100-8(a)(1) mentioned above includes IRC 831(b)(2)(A).

Regs. 301.9100-8(a)(3) describes the manner of making elections. It states, "Except otherwise provided in this section, the elections described in paragraph (a)(1) of this section must be made by attaching a statement to the tax return for the first taxable year for which the election is to be effective."



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Based on the Code and Regulation sections above, ORG is not entitled to the relief under 831(b), for 20XX & 20XX, because it did not meet the requirements of Regs 301.9100-8(a)(2), and therefore would be required to report all income and expenses on Form 1120/1120-PC for each year. The election was not filed when required and filing it currently would only allow ORG to use the election for current and future years.

**3. If the tax exempt status is revoked, how will it affect future years?**

The tax exempt status is being revoked for the years ending December 31, 20XX & 20XX. ORG is liable for Forms 1120/1120-PC for 20XX & 20XX, and any future years it does not qualify for exempt status.

**TAXPAYER'S POSITION**

Unknown at the time of this writing.

**SUMMARY**

It is the Governments position, based on the above facts, law and analysis, that the tax exemption status of ORG for the years ending December 31, 20XX & 20XX should be revoked based on not meeting the qualifications for exemption under IRC 501(c)(15). Forms 1120/1120-PC would be required to be filed for years ending December 31, 20XX & 20XX, without the relief under IRC 831(b) being applied.