



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

501.15-00

Release Number: **201021035**

Release Date: 5/28/10

LEGEND

ORG = Organization name XX = Date

Date: February 16, 2010

Address = address

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 November 3, 19XX, 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 19, 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 therefore required to file Forms 1120-PC, *U.S. Property and Casualty Income Tax Return* for all years the return is required to be filed, with the Ogden Service Center.

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, 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,

Nanette M. Downing
Acting Director, EO Examinations

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

LEGEND

ORG = Organization name XX = Date City = city State = state
Country = country CO-1 = 1st company

ISSUES

1. Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years beginning January 1, 20XX?
2. If ORG does not qualify for tax exempt status for years ending January 1, 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 on May 5, 19XX in the Country under the Companies Ordinance 19XX. The Memorandum of Association included a variety of objectives, none of which specifically mentioned insurance or reinsurance activity.

According to the files located in City, State, regarding the IRC 953(d) election, the Internal Revenue Service has no records that the election under IRC 953(d) was ever made.

In August 19XX, ORG filed Application Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, with the Internal Revenue Service, seeking exemption under Internal Revenue Code (IRC) section 501(c)(15). Its purpose as stated in the application form was reinsurance business, reinsuring bail and casualty policies issued by an insurance company admitted in all states of the United States of America. ORG does not itself issue any primary property or casualty, life, or any other insurance policies. Its sole purpose is to operate as a reinsurance company. The application form stated that ORG had a reinsurance contract with CO-1.

On November 3, 19XX, the organization received a determination letter, granting tax exempt status under IRC 501(c)(15).

In response to the Information Document Request mailed on February 4, 20XX, the organization stated that they had provided reinsurance in the past ORG has not participated in any reinsurance agreements since the last contracts have expired. . ORG only activities are waiting for any future claims and maintaining the notes receivable that are outstanding.

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Form 990 was filed for the 20XX tax year. The following is a breakdown of the Gross Receipts received by ORG for the years ending December 31, 20XX, and the percentage of Gross Premiums to Gross Receipts for the same years per Notice 20XX-42.

ORG	20XX
Premiums Written	\$0
Total Premiums	\$0
Interest Income	\$0
Dividend Income	\$0
Capital Gains	\$0
Other Income	\$0
Total Gross Receipts	\$0
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	0.00%

No premiums were received during audit year. No other income was earned in 20XX either.

An election under IRC 831(b) has never been filed. As of the writing of this report, there has never been a filing of the election, either with the filing of the Forms 990 or separately.

ORG has not been involved in any court ordered liquidation during any part of 20XX.

LAW AND ANALYSIS

- Does** **qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years beginning January 1, 2007?**

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

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- (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, 2003.

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;
- 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

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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).

Based on the computations above, it is determined that _____ did meet the \$600,000 limitation but was unable to meet the 50% requirement for the year. As a stock company, _____ is not able to try to meet the second set of requirements. Those requirements are only for mutual companies.

Section 206(e) of the Pension Funding Act of 2004, P.L. 118-218 provides the effective date of the new requirements for exemption under IRC 501(c)(15). It states:

EFFECTIVE DATE-

(1) **IN GENERAL-** Except as provided in paragraph (2), the amendments made by this section shall apply to **taxable years beginning after December 31, 2003.**

(2) **TRANSITION RULE FOR COMPANIES IN RECEIVERSHIP OR LIQUIDATION-** In the case of a company or association which--
 (A) for the taxable year which includes April 1, 200 _____ meets the requirements of section 501(c)(15)(A) of the Internal Revenue Code of 1986, as in effect for the last taxable year beginning before January 1, 200 _____ and
 (B) on April 1, 200 _____ is in a receivership, liquidation, or similar proceeding under the supervision of a State court,
 the amendments made by this section shall apply to taxable years beginning after the earlier of the date such proceeding ends or December 31, 20

_____ was not involved in a court ordered liquidation during 200

Therefore, for the years beginning January 1, 200 _____ did not qualify for tax exempt status under IRC 501(c)(15).

2. If _____ does not qualify for tax exempt status for years beginning January 1, 20 _____ what are the tax consequences?

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Since _____ did not qualify for tax exempt status under IRC Section 501(c)(15) for the years beginning January 1, 20____ filing of the Forms 990 was incorrect. For the year beginning January 1, 20____ should have filed Forms 1120-PC.

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

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

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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.”

Based on the Code and Regulation sections above, is not entitled to the relief under 831(b), for years under examination and for any future year, until they decide to file the election. The election has never been filed, either with the Form 990 or separately. Any election filed now or in the future would only be effective for the year the election was filed and all subsequent years. The election can not be made retroactive.

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

The tax exempt status should be revoked for the years beginning January 1, 20 Form 1120-PC is required for each year and all future years where does not qualify for exemption. If meets the requirements under IRC 501(c)(15) in future years, it may be allowed to file the Form 990 for each year they qualify, as a self-declared entity. Otherwise, Form 1120-PC would be required. Any year in the future that the Form 1120-PC is required, is allowed to make an election under IRC 831(b). Once the election is made, it is effective for the year the election is made and for all future years that the Form 1120-PC is required. The election can not be made retroactive.

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 beginning January 1, 20XX, should be revoked based on not meeting the qualifications for exemption under IRC 501(c)(15). Form 1120-PC would be required to be filed for any year where ORG does not qualify for exemption under IRC 501(c)(15).