



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

501.15-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: July 23, 2010

Release Number: **201045031**

Release Date: 11/12/10

LEGEND

ORG = Organization name XX = Date

Address = address

Employer Identification Number:

Person to Contact/ID Number:

Contact Numbers:

ORG

Voice

ADDRESS

Fax

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

In a determination letter dated September 17, 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 December 15, 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 have filed taxable returns on Forms 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*, for the years ended December 31, 20XX & 20XX with us. For future periods, you are required to file Form 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,

Nanette M Downing
Director, EO Examinations



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

December 4, 2009

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(s) shown above, for all years still open under the statute of limitations, and for all later years. File the federal tax return for the tax period(s) shown above with this agent within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in

the instructions for those returns.

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,

Nanette M. Downing
Acting Director, EO Examinations

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

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

LEGEND

ORG = Organization name XX = Date State = state County = county
CO_1, CO-2 & CO-3 = 1st, 2nd & 3rd COMPANIES

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 beginning 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 in April of 19XX through a merger of two companies; CO-1 and CO-2. ORG was organized and is to be operated pursuant to the provisions of Chapter 26.1-13 of the State Century Code.

The Articles of Incorporation (ARTICLES) was filed in the State of State In April of 19XX. It states that ORG was organized pursuant to the provisions of Chapter 26.1-13 of the State Century Code to insure against all of the risks and to possess all of the powers and to be subject to all of the liabilities and duties of a county mutual company as now provided in Chapter 26.1-13 of the State Century Code, as from time to time amended in the future.

The ARTICLES also state that membership in the company shall be open to any person owning property within the limits of the following counties in which the company is authorized to transact business: County, County, County, County, County, County, County, County, County, County, County and County. Membership is limited to those persons or organizations having insurance in full force and effect.

The ARTICLES also state that ORG is vested in a Board of Directors of not less than five or more than fourteen members.

Application Form 1024, *Application for Recognition of Exemption Under IRC 501(a)*, was filed in June of 19XX. The purpose of the organization as stated in the application form was that the company was formed on 6-1-19XX by combining CO-2 and CO-1. The merged company sells insurance policies for property and casualty and has total receipts under \$\$\$. This company is owned by the policyholders. The policies are sold in a 13 county area of State. The Company takes in premiums, pay claims, and buy reinsurance for larger risks from a reinsurance company.

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Based upon the application form submitted, ORG received a determination letter dated September 17, 19XX granting tax exempt status under IRC 501(c)(15).

ORG provides three different types of insurance; homeowners, farmowners and liability. Most of the insurance is sold through agents with some being sold by the organization itself. Commissions are earned by the agents. The following types of policies are used:

- Home-Guard
 - Coverage on dwelling, personal property, other structures, loss of use and additional coverage such as debris removal, trees, shrubs, and plants, and fire department service charges.
- Personal Liability
 - Coverage on liability to public, damage to property of others and medical payments to others.
- Farmate
 - Coverage on dwelling, household personal property, additional living expenses, farm buildings, farm personal property. Optional coverage for wiring, equipment and pumps.
- Farm-Guard
 - Coverage on liability and medical payments to the public and to farm employees.

At the end of 20XX there were 879 policies outstanding, with a total amount of insurance in force of \$\$.

ORG was involved in a reinsurance agreement with CO-3 (CO-3). The agreement states that CO-3 will reinsure based on the following:

- Individual Occurrence of Loss: \$\$
- Limitations:
 - Livestock/Poultry \$\$
 - Commercial/Public Property \$\$
 - Farm Outbuildings \$\$
 - Dwelling \$\$

Reinsurance premiums are paid by ORG to CO-3. Premiums will be charged at a monthly rate on the Adjusted Gross Fire Risk in Force per \$\$ at the end of each month. A portion of those premiums are returned to ORG in what is labeled as commissions.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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The amount of insurance in force after taking into consideration the reinsurance agreement is \$\$.

Form 990 was filed for the 20XX tax year. The following is a breakdown of the Gross Receipts received by ORG for the year ending December 31, 20XX, based on the Annual Statement provided to the Insurance Commissioner of the State of State and the percentage of Gross Premiums to Gross Receipts for the same year per Notice 20XX-42.

ORG COUNTY	20XX
Premiums Written	\$\$
Total Premiums	\$\$
Interest Income	\$\$
Dividend Income	\$\$
Rental Income	\$\$
Total Gross Receipts	\$\$
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	%

In determining the gross receipts above, premiums refunded and reinsurance premiums are not considered. Also, the amount reported on Form 990 for year ending December 31, 20XX for commissions is not considered part of gross receipts. The amount reported as commissions is the amount that CO-3S gives back to ORG out of the reinsurance premiums paid. This is considered a reduction in expenses, not income or part of gross receipts.

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 was not involved in any court ordered liquidation or receivership during or 20XX.

LAW AND ANALYSIS

- Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years beginning January 1, 20XX?**

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

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 20XX, 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 \$\$); 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 20XX-42, IRB, 20XX-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

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

§ 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 operation of ORG during 20XX, it was determined from the chart above that ORG did not qualify for tax exempt status for the years beginning January 1, 20XX. ORG's gross receipts exceeded the \$600,000 limitation imposed by IRC 501(c)(15).

Section 206(e) of the Pension Funding Act of 20XX, 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, 20XX.**

(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, 20XX, 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, 20XX, and

(B) on April 1, 20XX, 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, 20XX.

ORG was not involved in a court ordered liquidation or receivership during 20XX. Therefore, Section 206(e)(2) does not apply to this organization.

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Therefore, for the years beginning January 1, 20XX, ORG did not qualify for tax exempt status under IRC 501(c)(15) because it exceeded the gross receipts limitation of \$600,000..

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

Since ORG did not qualify for tax exempt status under IRC Section 501(c)(15) for the years beginning January 1, 20XX, ORG' tax exempt status should be revoked for years beginning January 1, 20XX. ORG' filing of the Form 990 for 20XX was incorrect. ORG should have filed Form 1120-PC for years beginning January 1, 20XX.

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-

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- (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 1, 19 (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."

Based on the Code and Regulation sections above, ORG 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, 20XX. Form 1120-PC is required for each year and all future years where ORG does not qualify for exemption. If ORG 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, ORG is allowed to make an election under IRC 831(b). Once the election is made, it is effective for the year the election was 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).