

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Patrick Greenleaf
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Tax Exempt Governmental Entities

from: Alexis A. MacIvor
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subject: Application for Exemption under § 501(c)(15)

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LEGEND

Applicant =

Year 1 =

Year 2 =

Country =

X =

Y =

ISSUE

Does Applicant qualify as an insurance company other than a life insurance company within the description of § 501(c)(15)?

CONCLUSION

The information provided does not allow us to reach a definitive conclusion as to whether Applicant qualifies as an insurance company other than a life insurance company; however, even if Applicant does qualify, Applicant's gross receipts for Year 1 and Year 2 appear to exceed the \$600,000 per year limitation in § 501(c)(15).

FACTS

Briefly stated, Applicant was formed in Country during Year 1 and is not a mutual company. Applicant received "purchase payments" in Year 1 and Year 2 under two contracts that are labelled annuity contracts; one is characterized as a deferred variable contract and the other is characterized as an immediate annuity. In the specimen contracts provided, it is not clear whether Applicant provided any contractual guarantees. Specifically, neither contract provides for a guaranteed purchase rate¹ and both contracts allow for selection of an annuity settlement option that is not specified in the contract but is to be agreed between the counterparty and Applicant in the future. Moreover, the terms of the deferred contract may not necessarily comply with § 72(s).

The information provided does not indicate the nature of Applicant's actual activities including, for example, whether and under what binding terms either of the specimen contracts was actually issued, though Applicant reports that it received "purchase payments" of \$ X during Year 1 and \$ Y during Year 2.

LAW AND ANALYSIS

Section 501(a) provides that an organization described in § 501(c) shall be exempt from the income tax, unless denied under § 502 or 503.

The list of organizations described in § 501(c) includes insurance companies (as defined in § 816(a)) other than life (including interinsurers and reciprocal underwriters) if, in the case of a stock insurance company, the gross receipts for the taxable year do not exceed \$600,000 and more than 50% of such gross receipts consist of premiums.

Section 816(a) defines an insurance company to "mean any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies."

Section 816(a) provides that the term life insurance company

means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with accident and health

¹ The "immediate" annuity does not annuitize at inception but within one year of inception and annuitizes at the purchase rate in effect at annuitization (which could be different than the rate in effect at inception).

insurance), or noncancellable contracts of health and accident insurance, if – (1) its life insurance reserves (as defined in § 816(b)), plus (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, accident, or health policies not included in life insurance reserves, comprise more than 50 percent of its total reserves (as defined in § 816(c)).

The House Report explains this provision, and as it relates to what business is an insurance activity, advises that

whether a contract with less than a permanent guarantee should be considered an insurance or annuity contract would depend on the terms of the contract. That is, it will depend on whether the company has assumed a significant insurance risk or has made an annuity guarantee (for life or a fixed period). Generally, the assumption of solely an investment risk would not give rise to an insurance liability.

H. Rep. 98-432 (Pt II) at 1404 (1984). In addition, Rev. Rul. 77-286, 1977-2 C.B. 228, provides

...The deposit administration contract contains a limited annuity purchase rate guarantee lasting for a stated initial period. ... However, since the contract does not provide for permanent purchase rate guarantees during the employees' active lives, it does not constitute an annuity contract during its accumulation phase, and accordingly, the funds held under the deposit administration contract do not qualify as life insurance reserves.

Notice 2006-42, 2006-1 C.B. 878, advises that gross receipts for purposes of § 501(c)(15) include premiums (including deposits and assessments), without reduction for return premiums or premiums paid for reinsurance, items described in § 834(b) (gross investment income of a non-life insurance company), and other items that are properly included in the taxpayer's gross income under subchapter B of chapter 1, subtitle A, of the Code. Gross receipts for purposes of § 501(c)(15) do not include amounts other than premium income or gross investment income unless those amounts are otherwise included in gross income; the term does not include contributions to capital excluded from gross income or salvage or reinsurance recovered that offset losses incurred under §832(b)(5)(A)(i).

Here, from the specimen contracts it cannot be determined whether more than half of Applicant's business involves the issuance of insurance or annuity contracts as

contemplated by § 816(a), and, if so, whether Applicant is a life insurance company within the meaning of § 816(a).

Moreover, to meet the \$600,000 limitation on annual gross receipts in § 501(c)(15), a substantial portion of the “purchase payments” received by Applicant in Year 1 and Year 2 would have to be characterized as amounts other than premiums or other gross income. If the “purchase payments” were so characterized, Applicant has not explained how more than half of its business during each taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by an insurance company. In fact, given that \$ X and \$ Y so significantly exceed \$600,000, it is difficult to imagine any set of circumstances in which Applicant could in each taxable year both (i) qualify as an insurance company because more than half of its business is the issuing of insurance and annuity contracts or the reinsuring of risks underwritten by an insurance company and (ii) have gross receipts of less than \$600,000.

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