



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: June 30, 2011

Release Number: 201341035

Release Date: 10/11/2013

LEGEND:

ORG = Name of Organization

Address = Address of Organization

UIL: 501.15-01

Employer Identification Number:

Person to Contact/ID Number:

ORG

Address

Contact Numbers:

Voice

Fax

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear

In a determination letter dated August 24, 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 March 31, 20 , 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, 20 & 20<sup>1</sup> 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:

**Taxpayer Advocate Service**

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



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
1100 Commerce Street  
Dallas, TX 75242

January 31, 2011

LEGEND :

ORG = Name of Organization

Address = Address of ORG

Year = xx

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*

Nanette M. Downing  
Acting 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
Name of Taxpayer <b>ORG</b>		Year/Period Ended 12/31/20xx

**LEGEND:**

ORG = Name of Organization

State = Name of State

Related = Name of related Insurance Company

**ISSUES**

1. Does ORG Company qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years beginning January 1, 20xx?
2. If ORG Company 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 was formed on October 24, 19xx as the ORG Association and licensed in the State on January 10, 19xx, in the State. On March 23, 19xx ORG was incorporated under the provisions of Section 911.067 (a)(2) of the Code and the State Non Profit Act as ORG Insurance .

Its purpose as stated in its Articles of Incorporation is a voluntary association to function and do business as an Insurance Company. Formed for the purpose of insurance on the mutual or cooperative plan according to the laws of the State governing Insurance Companies against loss or damage by fire or lightning on the following:

- Rural dwellings, barns and other farm buildings;
- Rural church houses and country school houses
- Urban dwellings, cars, houses and other outhouses used for storage, provided the city or town which such buildings are located, have adequate fire protection.

Membership in the organization is limited to the policyholders who are insured by ORG. The Board of Directors consisted of 8 members of the Association.

ORG was unable to provide a copy of the Application Form 1024, *Application for Recognition of Exemption Under Section 501(a), with the Internal Revenue Service*,

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that was filed, during the examination and the Service was unable to locate the application form in its archives.

Based on the information that was provided in the Application Form 1024, *Application for Recognition of Exemption Under Section 501(a), with the Internal Revenue Service*, on August 24, 19xx, the Service issued a determination letter granting tax exempt status under IRC section 501(c)(15) to this organization.

At the end of the calendar year 20xx there were 1 member with 1 policy outstanding. Total amount of insurance in-force was \$ . A portion of the premiums associated with these policies were reinsured through Related. Related manages the reinsurance operation with the actual reinsurers being different insurance companies.

Form 990-EZ was filed for the year ending December 31, 20xx. The following is a breakdown of the gross receipts reported on Form 990-EZ by ORG for that year.

ORG	20xx
Premiums Earned	\$0
Interest/Dividend Income	\$0
Rental Income	\$0
Total Gross Receipts	\$0

**The amount reported as premiums earned above was amount of premiums written of \$0 minus the amount of premiums refunded to policyholders of \$0.**

According to the information, the organization has never made an election under IRC 831(b).

As of the date this report was issued, the Form 990/990-EZ for year ending December 31, 20xx has either not filed or has not been processed by the Service.

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## **LAW AND ANALYSIS**

### **1. Does ORG Company qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years beginning January 1, 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, 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):

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- 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 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).

The chart below shows the computation of Gross Receipts for 20xx.

<b>ORG</b>	<b>20</b>
Premiums Written	\$0
Total Premiums	\$0
Interest/Dividend Income	\$0
Rental Income	\$0
<b>Total Gross Receipts</b>	<b>\$0</b>
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	0%



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**In computing the Total Gross Receipts above, the amount for Premiums Written is used. Premiums Written is the amount of premiums written for the year whether or not the premiums are actually paid in the same year. The Premiums Written also does not take into consideration the amount of any premiums refunded to the policyholders during the year.**

The amount of Premiums Written (\$0) is not reduced by the amount of premiums refunded to policyholders during the year

Based on the computations above, it is determined that ORG did not meet the \$600,000 limitation for the year ended December 31, 20xx. Total Gross Receipts per Notice 2006-42 was \$0 which exceeds the \$600,000 limitation imposed by IRC 501(c)(15).

**2. If ORG Company 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's filing of the Forms 990-EZ was incorrect. For the year beginning January 1, 20xx, ORG 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 1.1(b)."

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

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- (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."

Based on the Code and Regulation sections above, ORG is not entitled to the election under 831(b), for the year under examination and for any future year, until it makes the election. Then ORG will be entitled to the election for the year it was made and future years. The election can not be made for any prior years.

Therefore, ORG is required to file Forms 1120-PC for 20xx, 20xx and any future years where they do not qualify for exemption under IRC 501(c)(15). ORG is not entitled to the election for years ending December 31, 20xx & 20xx. They may be able to make the election for the year ending December 31, 20xx if so desired.

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

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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 990/990-EZ 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 required to attach a copy of the election under IRC 831(b) to its tax return.

### **TAXPAYER'S POSITION**

Unknown at the time of this writing

### **SUMMARY**

It is the Government's 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).