



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: September 25, 2008

Number: 200851026

Release Date: 12/29/2008

EO

LEGEND

ORG = Organization name      XX = Date      Address = address  
UIL: 501.15-00

ORG  
ADDRESS

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

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear :

In a determination letter dated March 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 August 1, 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 Form[s] 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*, for the year[s] ended December 31, 20XX, 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, 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,

Vicki L. Hansen  
Acting Director, EO Examinations



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

Dallas, TX 75242

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

March 31, 2008

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 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
Name of Taxpayer ORG		Year/Period Ended September 30, 20XX

LEGEND

ORG = Organization name      XX = Date      XYZ = State      motto = motto

**ISSUES**

1. Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years beginning October 1, 20XX?
2. If ORG does not qualify for tax exempt status for years beginning October 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 the State of ORG back in 19XX. Its purpose since inception has been to provide property and casualty motto to residents of the area. The organization operates on a mutual basis. Members of the organization consist of the policyholders.

The Articles of Incorporation were filed in the State of ORG, on April 4, 19XX. The purpose as stated in the Articles is to mutually protect its members from loss by fire, lightning and tornado.

ORG also maintains an Articles of Association. These Articles state that any person becoming insured shall thereby become a member of the association. Board of directors consists of 7 members chosen from members of the association.

The Bylaws state that the motto will cover fire, lightning, hail, and extended coverage. The Bylaws also state that books of account, deed or commercial papers, money, bullion, mill property and property where steam or gasoline is used, are not covered by the policies issued.

One type of policy is used. The policy includes a copy of the Articles of Association and Bylaws. The policy also provides details on what is covered and what is not covered. During the year ending September 30, 20XX, there were 271 policies issued. As of September 30, 20XX, there were 994 polices outstanding with approximately \$ of property and liability insured.

ORG has not been involved in any reinsurance contracts. No premiums were ceded during the year ending September 30, 20XX.

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> ORG		<b>Year/Period Ended</b> September 30, 20XX

ORG has been filing its Forms 990 on a September year end. On the Forms 990 they have stated that they were tax exempt under Internal Revenue Code Section (IRC) 501(c)(6). The Service's records show that they were granted tax exempt status under IRC 501(c)(15), as a tax exempt motto company.

Form 990 was filed for the year ending September 30, 20XX. The following is a breakdown of the Gross Receipts received by ORG and the percentage of Gross Premiums to Gross Receipts for the same year.

	<b>9/30/20XX</b>
Premiums	
Interest Income	
Dividend Income	
Total Gross Receipts	
Percentage- Gross Premium/Reinsurance Income to 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.

### **LAW AND ANALYSIS**

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

Internal Revenue Code section 501(c)(15)(A) exempts from Federal income tax motto 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 motto 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.

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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 Motto 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 motto companies (motto companies other than life motto 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 motto 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 motto 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).

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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 motto losses and to provide for the payment of dividends and similar distributions to policyholders.

Based on the changes in the limitations under IRC 501(c)(15)(A), and the operation of ORG during the year ending September 30, 20XX, it was determined by the chart above, that ORG did not qualify for tax exempt status for years beginning October 1, 20XX. ORG was able to meet the 50% requirement of Gross Premiums to Gross Receipts (72.36%); however, ORG was not able to meet the \$600,000 gross receipts limitation (\$720,297).

As a non-stock company, (mutual), ORG did meet the requirement of over 35% premiums to gross receipts (72.36%), but ORG could not meet the limitations of under \$150,000 in gross receipts (\$720,297).

To be qualified under IRC 501(c)(15), ORG had to meet all requirements, either under IRC 501(c)(15)(A)(i) or (a)(ii). ORG did not meet the requirements under either section of the code.

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.



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ORG was not involved in a court ordered liquidation for years beginning October 1, 20XX. Therefore, Section 206(e) does not apply to this organization.

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

Since ORG did not qualify for tax exempt status under IRC Section 501(c)(15) for years beginning October 1, 20XX, ORG was required to file Forms 1120-PC .

IRC 831 discusses tax on motto companies other than life motto 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 motto company other than a life motto 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 motto 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 motto 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)

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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 the year 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 is 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 is being revoked for the years beginning October 1, 20XX. Form 1120-PC is required for each year. 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.

ORG has been filing its Forms 990 on a September 30<sup>th</sup> year end. On the Forms 990 they have stated that they were tax exempt under IRC 501(c)(6). The Service's records show that they were granted tax exempt status under IRC 501(c)(15), as a tax exempt motto company. Since ORG was and still is an motto company, it has been required to file its tax returns on a calendar year basis (IRC 843). Therefore, Forms 1120-PC required to be filed must be filed on a calendar year basis. Grange is liable for Forms 1120-PC for years beginning January 1, 20XX.

**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 October 1, 20XX should be revoked based on not meeting the qualifications for exemption under IRC 501(c)(15). Forms 1120-PC would be required to be filed on a calendar year basis without the relief under IRC 831(b) being applied.