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

TAX EXEMPT AND
GOVERNMENT
ENTITIES DIVISION

Number: **200903082**
Release Date: 1/16/2009

UIL: 501.15-00

Date: October 10, 2008

LEGEND
ORG = Organization name   Address = address   XX = Date

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 April 19, 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 May 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, December 31, 20XX, and December 31, 20XX, with us. For future periods, you are required to file income tax returns 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,

Vicki L. Hansen
Acting Director, EO Examinations

Internal Revenue Service

Department of the Treasury
TE/GE Division
450 Golden Gate Avenue, Stop 7-4-01
San Francisco, CA 94102

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Date: March 27, 2008

ORG
ADDRESS

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, 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, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action.* We will then send you a final letter revoking your exempt status. 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 this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center 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 prefer, you may contact your local Taxpayer Advocate at:

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
Report of Examination
Envelope

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**		Schedule number or exhibit
Name of taxpayer ORG		Tax Identification Number	Year/Period ended 12/31/20XX 12/31/20XX

LEGEND
ORG = Organization name XX = Date City = city XYZ = State Co-1 = 1st company CPA = CPA BM-1. BM-2 & Bm-3 = 1st, 2nd & 3rd Board members

ISSUE:

Whether ORG meets the new requirements for tax-exempt status, under IRC 501(c)(15), as described in the Pension Funding Equity Act of 2004?

FACTS:

ORG was formed, in the State of XYZ, on October 28, 19XX, to organize and operate a separate and independent funeral service association under Act 338 of 1942. On February 13, 19XX, ORG entered into a merger and consolidation agreement with the CO-1, also a non-profit Funeral Service Association organized in accordance with the provisions of Act 338 of 1942. Under the terms of the merger and consolidation agreement, ORG is the surviving corporation, while CO-1 ceased to exist.

As the surviving corporation, ORG, (hereinafter called "ORG") is formed to establish, maintain and operate a non-profit funeral service plan.

ORG was initially governed by a three member Board of Directors elected to serve a life term. The initial directors of ORG were BM-1, BM-2, and BM-3, all residents of City, XYZ.

On January 3, 19XX, the Service received Form 1026, Exemption Application, from ORG, requesting exemption from Federal income tax, as a mutual insurance company, under section 501(c)(15) of the Internal Revenue Code. After careful review of the application, the Service issued a letter dated February 16, 19XX, denying the organization's request for tax-exempt status under IRC 501(c)(15). Exemption was denied because according to the Articles of Incorporation, ORG was not organized as a "mutual insurance company" within the meaning of IRC 501(c)(15). ORG amended its Articles of Incorporation in August 19XX to correct the deficiencies noted in the denial letter.

Based on the language included in the amended Articles of Incorporation, ORG was subsequently granted exemption from Federal income tax under section 501(c)(15) of the Code, on or about April 10, 19XX. The exemption was effective January 1, 19XX.

ORG is required to file annual information return, Form 990. The Form 990 returns filed for the year ended December 31, 20XX, and December 31, 20XX, were examined by TE/GE, San Francisco Post of Duty. During the initial inspection of the Form 990 returns, it was noted that ORG inaccurately reported being exempt under IRC 501(c)(12) on line J in the heading of the return. As previously mentioned, ORG was granted exemption under IRC 501(c)(15), in April 19XX, and the Service has not issued any subsequent ruling or determination letters. Information Document Request #2 was issued on February 21, 20XX, to CPA, to clarify the correct exempt status of the organization.

Since the passage of the Pension Funding Equity Act of 2004, ORG filed Form 990 returns for tax years ended December 31, 20XX, December 31, 20XX, and December 31, 20XX. On its Form 990 returns filed for the years ended December 31, 20XX, and December 31, 20XX, ORG reported the following sources of income:

	20XX	20XX
Gifts, Grants and Contributions	-0-	-0-
Program Service Revenue	-0-	-0-
Membership dues/assessments		
Interest on savings		
Other income	-0-	-0-
Totals		

During the examination of the 20XX and 20XX Form 990 returns, it was determined that the primary activity of ORG is to receive premiums from policyholders and to pay death, funeral and burial benefits under the terms of the policies. The insurance program consisted of five classes of benefits. The policies were based on the age of the insured and the amount of the benefit purchased by the insured. Premiums ranged from $0. to $ per policy period. ORG received assessments of $ from policyholders in 20XX, and $ in 20XX. Assessments are deposited into the organization's checking, savings, and Certificate of Deposit accounts. The funds are placed into a reserve to accumulate until paid out as benefits. Other than the assessments received from policyholders, ORG only other source of income was derived from interest received on funds held in its savings and Certificate of Deposit accounts.

ORG paid benefits totaling $ in 20XX, and $ in 20XX. Benefits were disbursed either to beneficiaries named in the insurance policies or directly to funeral homes to help cover the cost of funeral expenses and burial of the deceased policyholder. The average amount of benefits paid by ORG was $ per policy. Only very minimal expenses were incurred by ORG during the years under examination. The only other costs reported by the organization was its annual licensing fee paid to the XYZ Department of Insurance, accounting fees, and commissions. Benefits paid under the policies represents 88% and 74% of ORG's total expenses incurred during 20XX and 20XX, respectively.

ORG's gross receipts are less than the $ and $ limitations imposed by the Pension Funding Equity Act of 2004. However, based on the financial information reported on the 20XX and 20XX Form 990 returns, the amount of premiums did not exceed 50% or 35% of total gross receipts.

There is no evidence of any other significant activities conducted by ORG during 20XX and 20XX.

ORG is operated as an insurance company, since more than half of its business during the year involved the insuring or reinsuring of insurance risks. However, ORG does not qualify for tax-exempt status under IRC 501(c)(15), for the 20XX and 20XX tax years, subsequent to the passage of the Pension Funding Equity Act of 2004, because it failed to meet the new "gross receipts" requirements for tax-exempt status.

LAW:

PRIOR LAW

I.R.C. § 501 provides that certain entities are exempt from taxation. Included in these entities are "[i]nsurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $350,000." I.R.C. § 501(c)(15)(A). If an entity is a part of a consolidated group, all net written premiums (or direct written premiums) of the members of the group are aggregated to determine whether the insurance company meets the requirements of I.R.C.
§ 501(c)(15)(A).

The prior law was effective for tax years beginning after December 31, 1986, through December 31, 2004, the effective date of the Pension Funding Equity Act of 2004.[1]

CURRENT LAW

For tax years beginning after December 21, 2005, an organization must meet the following two-part test to qualify for exemption under IRC 501(c)(15):

1. Gross receipts for the year may not exceed $600,000 and
2. Premiums must be more than 50% of the organization's total gross receipts.

Mutual insurance companies must meet either the above test, or the following alternative test:

1. Gross receipts for the year may not exceed $150,000 and
2. Premiums must be more than 35% of the organization's total gross receipts.

The alternative test for a mutual insurance company does not apply if an employee of the company, or a member of the employee's family [as defined in IRC section 2032A(e)(2)] is an employee of another company exempt from tax (or would be exempt) under IRC section 501(c)(15).

If an organization is in a receivership, liquidation, or similar proceeding under the supervision of a state court on April 1, 2004, the new law applies to taxable years beginning after the date such proceeding ends or December 31, 2004, whichever is earlier.

GOVERNMENT'S POSITION:

Internal Revenue Code section 501(c)(15) originally referred only to certain mutual insurance companies or associations other than life or marine. The Tax Reform Act of 1986 ("TRA-86") eliminated the distinction

[1] Prior to 1986, the direct or net written premium ceiling was limited to $. The Tax Reform Act of 1986 increased the direct or net written premium ceiling to $ per year.

between small mutual insurance companies and other small insurance companies and extended exemption under IRC 501(c)(15) to all eligible small insurance companies, whether stock or mutual.

TRA 86 also changed the nature of the ceiling amount for tax exemption from certain gross receipts to direct or net written premiums. The ceiling amount was changed from $. Therefore, under TRA 84, to qualify for exemption as a small insurance company, the direct or net written premiums received by an organization could not exceed $ for a taxable year.

The requirements established under TRA 86 posed serious problems for the Service, because the requirements did not place any limitation of the amount of investment income small insurance companies could earn. Many taxpayers and tax professionals took advantage of the tax-exempt treatment allowed to small insurance companies by contributing highly appreciated income producing assets to the tax-exempt organizations. The assets produced substantial investment income that was not taxed due to the tax-exempt status of the small insurance companies.

Congress intended to curb this loophole in the law by including language in Section 206 of the Pension Funding Act of 2004, which, one again, changed the requirements for tax-exempt status for Small Property and Casualty Insurance Companies.

On April 10, 20XX, President Bush signed H.R. 3108, the Pension Funding Equity Act of 2004, P.L. 108-218. One purpose of the legislation was to tighten the rules for property and casualty insurance companies to qualify as tax-exempt under section 501(c)(15) of the Code, or to elect to be taxed only on their investment income. The bill contained the following comments from the Conference Report:

> The limitation to mutual companies and the limitation on employees are intended to address the conferees' concern about the inappropriate use of tax-exempt insurance companies to shelter investment income, including in the case of companies with gross receipts under $. It is intended that the provision not permit the use of small companies with common owners or employees to shelter investment income for the benefit of such owners or employees.

The new legislation amended IRC 501(c)(15) for tax years beginning after December 31, 20XX. The new law replaced the "written premiums test" with a "gross receipts and percentage of premiums test."

The new law placed an overall limitation on the amount of gross receipts small insurance companies could earn for each taxable year.

Therefore, for years beginning after December 31, 20XX, small insurance companies could not have gross receipts in excess of $ to qualify for tax-exempt status under IRC 501(c)(15). In addition, of its total gross receipts, more than 50% must be derived from premium income. If a mutual insurance company does not meet the above test, it can still qualify for tax-exempt status under IRC 501(c)(15), if it meets the alternative gross receipts test. In such case, gross receipts cannot excess $ and premiums must be more than 35% of the organization's total gross receipts.

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**		Schedule number or exhibit
Name of taxpayer ORG		Tax Identification Number	Year/Period ended 12/31/20XX 12/31/20XX

The facts present in this case, clearly demonstrate that ORG does not meet the new requirements for tax-exempt status under IRC 501(c)(15), in 20XX and 20XX, because its gross receipts do not consists of adequate "premiums" to meet either the 50% or 35% test imposed by the new law. Based on the audit, ORG's gross receipts are as follows:

	20XX	20XX
Gifts, Grants and Contributions	-0-	-0-
Program Service Revenue	-0-	-0-
Membership assessments: Premiums		
Interest on savings		
Other income	-0-	-0-
Totals		

Do Gross Receipts exceed the $600,000 limitation? **No** **No**

50% of Gross Receipts $

Premiums Received $

Do Premiums exceed 50% of Gross Receipts? **NO** **No**

Alternative Test

Do Gross Receipts exceed the $150,000 limitation? **No** **No**

35% of Gross Receipts

Premiums Received $

Do Premiums exceed 35% of Gross Receipts? **NO** **No**

The principal gross receipts tests consist of two parts. The corporation must satisfy both parts of the $/50% gross receipts test. In this case, ORG does meet part-one of the $gross receipts limitation permitted for small insurance companies. However, ORG does not satisfy part-two of the gross receipts test because its premium income does not exceed 50% of gross receipts for 20XX and 20XX. must satisfy both parts of the $/50% gross receipts test in order to meet the new requirements for tax-exempt status under section 501(c)(15) of the Code. If the organization fails to meet one part of either test, then it fails to qualify for exemption as a small insurance company.

As for the alternative "gross receipts test," again, ORG meets the first part of the two-part test since its total gross receipts are less than $. However, the ORG fails to meet the second part of the test. The premium income does not exceed 35% of the organization's total gross receipts received in 20XX and 20XX. In fact, the premiums represent only 11% of the organization's 20XX gross receipts, and only 6% for 20XX.

Based on the above analysis, it is determined that ORG was properly recognized as a tax-exempt small insurance company for years prior to December 31, 20XX. However, due to the change in law, the corporation no longer qualifies for tax-exempt status for the tax year ended December 31, 20XX, and December 31, 20XX, because it is not operated as a small insurance company since it fails to comply with the new gross receipts tests imposed by the Pension Fund Equity Act of 2004.

As such, it is recommended that ORG's tax-exempt status under IRC 501(c)(15) be revoked, effective January 1, 20XX.

TAXPAYER'S POSITION:

The proposed revocation issue was discussed with CPA, during a telephone conversation held on March 25, 20XX. CPA concurred with the Service's conclusion that ORG does not meet the new gross receipts tests necessary to qualify for tax-exempt status under IRC 501(c)(15). CPA verbally agreed with the proposed action to revoke the organization's tax-exempt status, effective January 1, 20XX.

CONCLUSION:

A. ORG is an insurance company pursuant to Subchapter L of the Code for the taxable years 20XX and 20XX.

B. Although ORG is an insurance company pursuant to Subchapter L of the Code, it does not qualify as a tax-exempt small insurance company because its gross receipts do not consists of adequate "premiums" to meet the $/50% or the $/35% gross receipts tests, required for exemption under IRC 501(c)(15) of the Internal Revenue Code, as described in the Pension Funding Equity Act of 2004 and Notice 2006-42.

C. Therefore, revocation of ORG's tax-exempt under IRC 501(c)(15) is proposed, effective January 1, 20XX.

D. ORG is required to file an income tax return for calendar years ended December 31, 20XX and December 31, 20XX.