



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce St. - 4920 DAL
Dallas, TX 75242

Number: 200909062
Release Date: 2/27/2009

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

ORG November 18, 2008
ADDRESS Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Contact/ID Number:
Contact Numbers:
Telephone

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Dear :

This is our final adverse determination letter as to your exempt status under I.R.C. § 501(c)(15) of the Internal Revenue Code. Our adverse determination was made because, for the year(s) of the examination, you were not operated as an "insurance company" within the meaning of I.R.C. § 501(c)(15) of the Internal Revenue Code.

Because this case involves exemption under I.R.C. § 501(c)(15), you cannot contest the adverse determination in a declaratory judgment action under I.R.C. § 7428. You can, however, contest the revocation of exempt status in the context of any related deficiency case involving adjustments that flow from the loss of exemption. Thus, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, from any deficiency notice issued in this case or a related case after satisfying procedural and jurisdictional requirements as described in Publications 892.

You have filed taxable returns on Form(s) 1120 and 1120-F, for the years ended December 31, 20XX, 20XX & 20XX with us. For future periods, you are required to file Form 1120-F 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 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,

Vicki L. Hansen, Acting,
Director, EO Examinations

Enclosure
Publication 892



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

January 20, 2008

LEGEND

ORG = Organization name Address = address XX = Date

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

cc:

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

LEGEND

ORG = Organization name XX = Date Address = address City = city
 XYZ = State Country = country Founders = founders CPA = CPA
 CO-1, CO-2, CO-3, CO-4 & CO-5 = 1ST, 2ND, 3RD, 4TH & 5TH COMPANIES

ISSUES

1. Does ORG qualify as an insurance company under Internal Revenue Code Section 501(c)(15), for the years beginning January 1, 20XX?
2. If ORG does not qualify as an insurance company under Internal Revenue Code Section 501(c)(15), can ORG rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15)?
3. If ORG can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15), is it entitled to relief under Internal Revenue Code Section 7805(b)?
4. If ORG can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to under Internal Revenue Code Section 501(c)(15), what is the effective date of the revocation?
5. If ORG can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15), based on the facts that it does not meet the requirements of an insurance company under Internal Revenue Code Section 501(c)(15), what are the tax consequences?
6. If ORG does qualify as an insurance company under Internal Revenue Code Section 501(c)(15), does it meet the other requirements under Internal Revenue Code Section 501(c)(15) for tax exemption?
7. If ORG does not meet the other qualifications under Internal Revenue Code Section 501(c)(15), can ORG rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15)?
8. If ORG does not meet the other qualifications under Internal Revenue Code Section 501(c)(15), is it entitled to file an election under IRC 831(b) and be taxed only on its investment income?
9. If ORG can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15), based on the facts that it does not meet the requirements of Internal Revenue Code Section 501(c)(15), what are the tax consequences for 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		Year/Period Ended 12/31/20XX 12/31/20XX

FACTS

ORG (ORG) was formed in the Country and Country on November 19, 19XX. Articles of Association were filed at that time. The sole shareholders are Founders.

ORG filed Application Form 1024 with the Service on May 15, 19XX, seeking tax exempt status under IRC 501(c)(15). Its purpose as stated in the application form is insurance underwriting. It is a casualty insurer that underwrites property coverage. Initiated in early 19XX; the future likelihood is that written premiums will not exceed \$ per year. CO-1, of City, XYZ (CO-1), is a rental retailer of furniture and appliances at 9 various locations in XYZ.

underwrites coverage for the property rented out through these stores. The application form stated that its financial support would come from reinsurance premiums received from . Assets listed at that time included a vehicle/trailer, a condominium, a note receivable from the officer and deposits for real estate in XYZ.

Through various correspondence with the organization and Service it was determined by the Service the ORG was not qualified to be exempt under IRC 501(c)(15) because it was determined not to be an insurance company. A letter dated July 15, 19XX was issued to the organization stating the denial of exemption and the right to protest the determination.

ORG protested the determination and through more correspondence received exemption on October 8, 19XX. In the determination letter it states that CO-1 conducts business as CO-2 through 11 CO-2 subsidiaries located in both XYZ and XYZ. With respect to CO-1's XYZ facilities, the credit property insurance contract is written by CO-3 (CO-3). With respect to CO-1's in XYZ, the credit property insurance contract is written by CO-4 (CO-4). The letter also states that CO-1 ceased doing business in the State of XYZ on April 3, 19XX.

Upon renting the items, CO-1 would offer insurance issued by CO-3. The insurance provided was for in case of damage to the item(s) due to fire or burglary. Each customer would have their own policy based on what was rented and the duration of the rental.

A master copy of the Form of CO-3, states that CO-3 shall not be liable for more than \$ on consecutive losses on property leased. Premiums paid at a rate of 5% of the scheduled rental fee.

Amount to be paid in the event of a loss:

- The cost of repair or replacement of the property insured
 - 90% of invoice cost for the first 18 months from the date of purchase
 - 80% of invoice cost from 19-24 months from date of purchase

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

- 40% of invoice cost from 25-36 months of from date of purchase
- 25% of invoice cost from 37-48 months from date of purchase
- No coverage over 48 months

As stated above, the assets listed at the time of filing the application form included a vehicle/trailer, a condominium, a note receivable from the officer and deposits for real estate in XYZ. In the denial letter dated July 15, 19XX, stated above, it was stated that the vehicle/trailer was not used more than 50% for business. It stated that it was converted into a note receivable made by Founders. A promissory note was made and dated April 3, 19XX. The note was paid in full on September 30, 19XX.

Also stated in the letter was the condominium that was located in XYZ and was purchased with the assistance of a note payable with Bank. The financial statement provided in the letter showed that the condominium was rented out and received rental income of \$ in 19XX and \$ in 19XX, through September 30th.

The note listed in the application form as "Address" was a note in the amount of \$ that was made on April 3, 19XX by Founders. According to the letter, the note was paid in full.

The Form 990 for year ending December 31, 20XX was selected for examination. A review of the Form 990 showed income from investments and the sale of assets. Statement 3, attached to the return, showed the sale of assets to be CO-5. Statement 4 mentioned the condominium with no beginning or ending balances. There were no premiums reported on the Form 990.

Based on this analysis, an Information Document Request was issued, requesting information on the operation of the organization. A response was received from CPA, through a Power of Attorney. The response received stated that ORG was not currently selling any insurance, nor receiving any income from insurance. All the income from 20XX is from the sales of land in XYZ and interest income from U.S. Banks. CPA stated in a telephone conversation on October 5, 20XX that there had not been any insurance activity since the 20XX or 20XX year.

Based on this information, the Forms 990 for years ending December 31, 20XX through December 31, 20XX were secured. In reviewing the returns, the 20XX return was the last year any premium income was reported. No premium income was reported on any return since 20XX. No other activity, such as claims being filed or paid was reported since 20XX.

The Form 990 for the year ending December 31, 20XX showed the condominium being sold. The note payable outstanding on the condominium was paid off at that time.

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

The Forms 990 for the year ending December 31, 20XX & 20XX showed the sale of CO-5s. In reviewing the Form 990 for year ending December 31, 20XX, it stated the CO-5 to be an investment in a XYZ Shopping Center.

A breakdown of the Gross Receipts received by ORG for the years ending December 31, 20XX & 20XX and the percentage of Gross Premiums to Gross Receipts for the same years can be found in the chart below. As shown in chart, there was no premium income received in any of the years and the only income that was received was interest on investments and gain from the sale of assets.

FORM 990 INFORMATION	20XX	20XX
Premiums		
Interest Income		
Gain on Sale of Investment		
Total Revenue		
Total Assets		
Total Liabilities		
Gross Receipts		
Percentages-Premiums to Gross Receipts		

In 20XX, ORG issued a dividend to the shareholders in the amount of \$.

LAW AND ANALYSIS

1. Does _____ qualify as an insurance company under Internal Revenue Code Section 501(c)(15), for the years beginning January 1, 20 ?

As stated above, _____ has had no direct policies or reinsurance agreements in effect during the years under examination. No premiums have been collected, no claims have been filed or payments made, no reserves maintained. The only activity being conducted by _____ is the maintaining of investment accounts and receiving investment income from those accounts. In 20 , _____ also had the sale of a land trust in a shopping center.

Neither I.R.C. 501(c)(15) nor its corresponding regulations define an "insurance company." Subchapter L of the Code (I.R.C. sections 801-848), however, addresses the taxation of insurance companies. The term "insurance company" has the same meaning under section 501(c)(15) as it does in Subchapter L. See H. Conf. Rep. No. 99-841, 99th Cong., 2nd Sess. (Vol. II) 370-71, reprinted in 1986-3 (Vol. 4) C.B. 370-71.

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

I.R.C. section 816 (formally I.R.C. section 801) defines a life insurance company. As part of this definition, I.R.C. section 816 provides, "the term 'insurance company' means 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."

Treas. Reg. section 1.801-3(a)(1) defines an insurance company as;

A company whose primary and predominant business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Thus, though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a company is authorized and intends to carry on, it is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Internal Revenue Code.

In this case, primary and predominant business activity is not the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. is not involved in either of these two activities. Its sole purpose right now is to collect investment income from the investment accounts.

Another aspect to consider in this case is that there is no insurance contract that provides both risk shifting and risk distribution. In AMERCO & Subsidiaries, 96 T.C. 18 (1991), a case affirmed by the 9th Circuit, the Tax Court adopted a three-part test. The three parts consist of; (1) Is the risk an insurance risk?; (2) Is there risk shifting and risk distribution?; and (3) Is there insurance in its generally accepted sense?

Neither the Internal Revenue Code nor the Regulations specifically define the term "insurance contract." The courts have generally required that a transaction involve both risk shifting (from the insured's perspective) and risk distribution (from the insurer's perspective) in order to be characterized as insurance. Helvering v. LeGierse, 312 U.S. 531, 539 (1941); Gulf Oil Corp. v. Commissioner, 914 F.2d 396, 411 (3rd Cir. 1990).

Risk shifting occurs when a person facing the possibility of a loss transfers some or all of the financial consequences of the loss to the insurer. Rev. Rul. 88-72, 1988-2 C.B. 31, clarified by Rev. Rul. 89-61, 1989-1 C.B. 75. The risk transferred pursuant to an insurance contract must be a risk of economic loss. Allied Fidelity Corp. v. Commissioner, 66 T.C. 1068 (1976), aff'd., 572 F.2d 1190 (7th Cir. 1978), cert. denied, 439 U.S. 835 (1978).

It is exam's position that risk distribution requires both a distribution of exposure units and a distribution of a pool of premiums. In addressing distribution courts have focused on one or the other, but no case has address both.

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

Risk distribution of exposure units refers to the operation of the statistical phenomenon known as the "the law of large numbers." When additional statistically independent risk exposure units are insured, although the potential total losses increase, there is also an increase in the predictability of average loss. This increase in the predictability of the average loss decreases the amount of the capital that an insurance company needs per risk unit to remain at a given solvency level. See Rev. Rul. 89-61, 1989-1 C.B. 75.

The Courts have not spent a great deal of time explaining what they mean by risk distribution. No court has squarely held that there can be no risk distribution if there is only one, or a few, insureds. A fair reading of the court opinions addressing the issue, however, supports the IRS's position. See Barnes v. United States, 801 F.2d 984, 985 (7th Cir. 1986) ("Risk distributing is the spreading of the risk of loss among the participants in an insurance program."). See also, Commissioner v. Treganowan, 183 F.2d 288, 291 (2nd Cir. 1950). Such spreading is effectuated by pooling among unrelated insureds. "[R]isk distribution means that the party assuming the risk distributes his potential liability, in part, among others." Beech Aircraft Corp. v. United States, 797 F.2d 920, 922 (10th Cir. 1986). Risk distribution is accomplished where the risk is distributed among insureds other than the entity that incurred the loss. See Ross v. Odem, 401 F.2d 464 (5th Cir. 1968).

The Sixth Circuit touched on the issue of risk distribution in Humana, Inc. v. Commissioner, 881 F.2d 247, 257 (6th Cir. 1989), noting that there was adequate risk distribution, "where the captive insures several separate corporations within an affiliated group and losses can be spread among the several distinct corporate entities." The Ninth Circuit has also measured risk distribution by explaining, "[i]nsuring many independent risks in return for numerous premiums serves to distribute risk. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smoothes out losses to match more closely its receipt of premiums." Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987)

does not issue or reinsure any policies. Its only activity is collecting investment income from their investment accounts. There is no risk shifting and risk distribution with because has no insurance policies.

Also, to show that is not an insurance company is the lack of reserves to pay claims, and the payment of claims themselves. has no reserves to pay any claims. There are no policyholders so there is no need to have reserves.

Therefore, it is of the Service's position that does not qualify as an insurance company under IRC 501(c)(15). To qualify for tax exempt status under IRC 501(c)(15), an organization must be operating as an insurance company.

2. If does not qualify as an insurance company under Internal Revenue Code Section 501(c)(15), can rely on the

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

determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15)?

To qualify for tax exempt status under IRC 501(c)(15), an organization must be operating as an insurance company. Since does not qualify as an insurance company it does not qualify for tax exempt status under IRC 501(c)(15), therefore it can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to IRC 501(c)(15). The organization's tax exemption should be revoked for years beginning January 1,

3. If can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15), is it entitled to relief under Internal Revenue Code Section 7805(b)?

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Regulations 1.501(a)-1(a)(2); Rev. Proc. 2005-4, 14.02 (cross-referencing 13.01 et seq.) 2005-4 C.B. 128. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact, in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Regulations 601.201(n)(3)(ii); Rev. Proc. 90-27, 13.02, 1990-1 C.B. 514. Any such changes must be reported to the Service so that continuing recognition of exempt status can be evaluated.

The Commissioner may revoke a favorable determination letter for good cause. Regulations 1.501(a)-1(a)(2). A favorable determination letter may be revoked by written notice to the organization to whom the determination originally was issued. Regulations 601.201(m) (cross-referencing Reg. 601.201(l)); Rev. Proc. 90-27, 14, 1990-1 C.B. 514, 518.

If the Commissioner revokes the tax exempt status of an organization, the remaining question is whether the revocation should be applied prospectively or retroactively. Generally, revocation of a determination letter is prospective. Rev. Proc. 2007-4, 14.02 (cross-referencing 13.01 et seq.). Revocation of a determination letter may, however, be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Regulations 601.201(n)(6)(i); Rev. Proc. 90-27, 14.01; Rev. Proc. 2007-4 14.02 (cross-referencing 13.01 et seq.).

In cases where the organization omitted or misstated a material fact, revocation may be retroactive to all open years under the statute. Regulations 601.201(l)(1). In cases where revocation is due to a material change, inconsistent with exempt status, in the character, the purpose, or the method of operation, revocation will ordinarily take effect as of the date of the material change. Regulations 601.201(n)(6)(i); Rev. Proc. 90-27. In any event, revocation will

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

ordinarily take effect no later than the time at which the organization received written notice that its exemption ruling or determination letter might be revoked. Regulations 601.201(n)(6)(i).

Under certain circumstances, however, the Commissioner may, in his discretion grant relief from retroactive revocation under I.R.C. 7805(b) of the Code. Section 7805(b)(8) of the Internal Revenue Code provides:

APPLICATION TO RULINGS. The Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws, shall be applied without retroactive effect. Section 301.7805-1(b) of the regulations delegates authority granted by I.R.C. 7805(b) to the Commissioner (or the Commissioner's delegate).

To request I.R.C. 7805(b) relief, the organization must submit a statement in support of this application of I.R.C. 7805(b), as described in Rev. Proc. 2005-4, 14.02. See also Rev. Proc. 2005-5, 19. The organization's statement must expressly assert that the request is being made pursuant to I.R.C. 7805(b). The organization's statement must also indicate the relief requested and give reasons and arguments in support of the relief requested. It must also be accompanied by any documents bearing on the request. The organization's explanation and arguments should discuss the five factors bearing on retroactivity listed in Rev. Proc. 2005-4, 14.02(1) (cross-referencing 13.05), as they relate to the situation at issue. These five items are, in effect, the same as the factors provided in Regulations 601.201(l)(5) and 601.201(m), Statement of Procedural Rules, which states:

Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such a ruling if:

1. there has been no misstatement or omission of material facts;
2. the facts at the time of the transaction are not materially different from the facts on which the [determination letter] was based;
3. there has been no change in applicable law;
4. the [determination letter] was originally issued for a proposed transaction; and
5. the taxpayer directly involved in the [determination letter] acted in good faith in reliance upon the [determination letter] and revoking or modifying the [determination letter] retroactively would be to the taxpayer's detriment.

If relief is granted under I.R.C. 7805(b), the effective date of revocation of a determination letter is no later than the date on which the organization first received written notice that its exemption might be revoked. Regulations 601.201(n)(6)(i); Virginia Education Fund v. Commissioner, 85 T.C. 743, 7522-3 (1985), aff'd 799 F.2d 903 (4th Cir. 1986). This does not preclude the effective date of revocation being earlier than the date on which the organization first received written

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

notice that its exemption might be revoked. Virginia Education Fund v. Commissioner, 85 T.C. at 753.

The Supreme Court has held that the Commissioner has broad discretion under I.R.C. 7805(b) (and its predecessor) in deciding whether to revoke a ruling retroactively. Automobile Club of Michigan v. Commissioner, 353 U.S. 180, 184 (1957). See also Dixon v. United States, 381 U.S. 68, 74-75 (1965). The Commissioner's determination is reviewable by the courts only for abuse of that discretion. Virginia Education Fund v. Commissioner, 85 T.C. 743, 752 (1985).

It is the Service's position that the activities of the organization have changed dramatically compared to the organizing documents above. If the organization would seek exemption now, based on its current activities, there is a very high probability it would not receive a determination letter from the Service granting tax exempt status under IRC 501(c)(15). The insurance activities that were conducted when the organization applied for exemption are no longer being conducted.

Therefore, it is appropriate for the Commissioner to NOT grant relief from retroactive revocation of determination letter.

4. If [redacted] can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to under Internal Revenue Code Section 501(c)(15), what is the effective date of the revocation?

[redacted] is not entitled to relief under I.R.C. 7805(b). The effective date of revocation should be for years beginning January 1, 20 . This is the first year under examination.

5. If [redacted] can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15), based on the facts that it does not meet the requirements of an insurance company under Internal Revenue Code Section 501(c)(15), what are the tax consequences?

Since [redacted] was formed in the [redacted], when its tax exempt status is revoked for years beginning January 1, 20 , [redacted] would be required to file Form 1120 for the year ended December 31, 20 ; file Form 1120 as a one day return at the beginning of 20 ; and for the remainder of 20 and all future years, it would be required to file Forms 1120-F.

6. If [redacted] does qualify as an insurance company under Internal Revenue Code Section 501(c)(15), does it meet the other requirements under Internal Revenue Code Section 501(c)(15) for tax exemption?

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

If for some reason is considered an insurance company under IRC 501(c)(15), then the question is whether meets the other requirements to qualify under IRC 501(c)(15).

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):

- 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

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

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).

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 IRC 501(c)(15)(A), and the operation of during 20 & 20 , it was determined by the chart above, that did not qualify for tax exempt status for years starting January 1, 20 . was able to meet the \$600,000 gross receipts limitation (20 - \$; 20 - \$) however, it was not able to meet the 50% requirement of Gross Premiums to Gross Receipts (20 - 0.00%; 20 - 0.00%).

As a stock company, was not allowed to meet requirement under IRC 501(c)(15)(A)(ii). These requirements are only for non-stock, mutual insurance companies.

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

Section 206(e) of the Pension Funding Act of 2004, 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, 2003.**

(2) **TRANSITION RULE FOR COMPANIES IN RECEIVERSHIP OR LIQUIDATION-** In the case of a company or association which--

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

(A) for the taxable year which includes April 1, 2004, 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, 2004, and
 (B) on April 1, 2004, 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, 2007.

was not involved in a court ordered liquidation during 20 and 20 . Therefore, Section 206(e) does not apply to this organization.

Based on the information above, even if is considered an insurance company, they did not meet the other requirements under IRC 501(c)(15) and their tax exempt status should be revoked.

7. If does not meet the other qualifications under Internal Revenue Code Section 501(c)(15), can rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15)?

To qualify for tax exempt status under IRC 501(c)(15), an organization must be operating as an insurance company as well as meet the other requirements under this code section. Since did not meet the other requirements, it does not qualify for tax exempt status under IRC 501(c)(15), therefore it can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to IRC 501(c)(15). The organization's tax exemption should be revoked for years beginning January 1, 20 .

8. If does not meet the other qualifications under Internal Revenue Code Section 501(c)(15), is it entitled to file an election under IRC 831(b) and be taxed only on its investment income?

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

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

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-

- (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, is not entitled to the relief under IRC 831(b), for 20 & 20 , because it did not meet the requirements of Regs 301.9100-8(a)(2), and therefore would be required to report all income and expenses on Form 1120-PC for each year. As of this writing, the election has never been filed, either with the filing of the Form 990 or separately. When an election is filed, it would only allow the organization to receive relief under IRC 831(b) in the year it is filed and all future years. The election would not be retroactive to any prior years.

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

9. If _____ can not rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to Internal Revenue Code Section 501(c)(15), based on the facts that it does not meet the requirements of Internal Revenue Code Section 501(c)(15), what are the tax consequences for years beginning January 1, 20__ ?

Since _____ tax exempt status should be revoked for years beginning January 1, 20__ , _____ would be responsible for filing Forms 1120-PC for years beginning January 1, 20__ .

TAXPAYER'S POSITION

Unknown at the time of this writing.

SUMMARY

It is the Service'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 ORG not operating as an insurance company, thereby failing to meet the qualifications for exemption under IRC 501(c)(15).

If it is determined that ORG was operating as an insurance company, the tax exempt status should still be revoked because they have not met the other requirements of IRC 501(c)(15). Then Forms 1120-PC would be required to be filed for years beginning January 1, 20XX.