

Internal Revenue Service

Department of the Treasury

Release Number: **201133016**

Release Date: 8/19/2011

Date: May 24, 2011

UIL: 501.15-00

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LEGEND:

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Certified Mail

Dear

This is a Final Adverse Determination as to your exempt status under section 501(c)(15) of the Internal Revenue Code. We are revoking your organization's exemption from income tax under section 501(c)(15), effective January 1, 20

Our adverse determination was made for the following reasons:

Your organization fails to meet the requirements for exemption under IRC section 501(c)(15). As a result of a recent audit of your organization's exempt status, it was determined that in the 20 tax year, your organization exceeded the \$ gross receipts limitation pursuant to section 501(c)(15)(A).

An insurance company (as defined in section 816(a)), other than a life insurance company, is exempt from income tax under section 501(a), if its gross receipts for the taxable year do not exceed \$600,000 and more than 50 percent of those gross receipts consist of premiums. Section 501(c)(15)(A)(i).

In your 20 Form 990, you improperly excluded return premiums from the calculation of gross receipts, which is not consistent with either the Code or Notice 2006-42.

You are required to file converted Forms 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, for any years which you are not qualified for exemption under

Person to Contact:

Employee ID Number:

Tel: () -

Fax: () -

Refer Reply to:

In Re:

Form Required to be Filed:

Tax Period(s) Ended:

December 31,

section 501(c)(15) and are still open under the statute of limitations. Forms 1120-PC for the years ending December 31, 20 and December 31, 20 should be filed with the Internal Revenue Service TEGE: EO; 1100 Commerce St.; MC 4920 DAL: Mandatory Review; Dallas, TX 75242-1027. Forms 1120-PC for tax periods beginning on and after January 1, 20 for tax years in which you do not qualify for exemption under section 501(c)(15) should be filed with the Cincinnati Service Center, Cincinnati, OH, 45999-0012.

You have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can call the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"* for Taxpayer Advocate telephone numbers and addresses.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax 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.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Douglas H. Schulman
Commissioner

By

Sincerely,

Appeals Team Manager

cc: D



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

April 22, 2010

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 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
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018-A
Report of Examination
Envelope

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

LEGEND

ORG = Organization name XX - Date State - state CO-1 = 1st COMPANY

ISSUES

1. Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years beginning January 1, 20XX?
2. If ORG does not qualify for tax exempt status for years ending January 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 on March 18, 19XX, in the State of State, under State Statutes Chapter 87A. ORG was created to operate as a township mutual insurance company. ORG operates in approximately 182 townships within 11 counties in the state. ORG provides fire and wind insurance to its policyholders.

The Amended Certificate of Incorporation, dated March 20XX, states that it will operate as a mutual insurance company in various townships in various counties of the State of State. Membership of the organization consists of its policyholders. Board members consist of 5-7 members.

The Bylaws restate the purpose of the organization as well as members and the number of board members.

ORG provided copies of letters, one dated October 19, 19XX, granting exemption under IRC 501(c)(15) of the Internal Revenue Code which is equivalent to section 501(c)(15) of the Internal Revenue Code of 1986. Another letter dated November 19, 19XX, stating that exemption was granted in 19XX under IRC 501(c)(15).

At the end of the calendar year 20XX there were _____ policies outstanding. Policies covered insurance on dwellings, personal property, farms, barns, sheds, other structures and liability. A portion of the insurance for the year was reinsured with CO-1 of State (CO-1). A portion of the premiums collected by ORG are paid to CO-1 for the reinsurance. CO-1 will reimburse ORG for any losses it is liable for.

Form 990 was filed for the year ending December 31, 20XX. The following is a breakdown of the Gross Receipts received by ORG for the year ending December 31,

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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20XX, and the percentage of Gross Premiums to Gross Receipts for the same years per Notice 20XX-42.

	20XX
Premiums Written	
Total Premiums	
Investment Income	
Capital Gains	
Total Gross Receipts	
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	

ORG has never made an election under IRC 831(b) for any tax year.

LAW AND ANALYSIS

1. Does ORG 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 20XX, P.L. 108-218, amended section 501(c)(15)(A) to change the definition of small property and casualty

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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, 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 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).

Form 990 was filed for the year ending December 31 20XX. The following is a breakdown of the Gross Receipts received by ORG for the year ending December 31, 20XX, and the percentage of Gross Premiums to Gross Receipts for the same years per Notice 20XX-42.

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

	20XX
Premiums Written	
Total Premiums	
Investment Income	
Capital Gains	
Total Gross Receipts	
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	

Premiums Written above was taken from the Trial Balance. The amount reported on Form 990 and in their statements (\$), was direct premiums minus returned premiums (\$-\$). As stated in Notice 20XX-42, the calculation for premiums does not include any premiums returned.

The amount reported for Capital Gains above does not include any losses incurred for the year per Notice 20XX-42. The Form 990 showed Net Capital Gains which took into consideration a loss of \$

Based on the computations above, it is determined that ORG exceeded the \$ limitation for the year ended December 31, 20XX.

Therefore, for the years beginning January 1, 20XX, ORG did not qualify for tax exempt status under IRC 501(c)(15).

2. If ORG 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 was incorrect. For the year beginning January 1, 20XX, ORG should have filed Form 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."

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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 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 \$ 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 relief under 831(b), for the year under examination and for any future year, until it makes the election. The election is for the year filed and for every year in the future where the organization files a Form 1120/1120-PC. The election can not be made retroactive.

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

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

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 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 allowed to make the election under IRC 831(b). The election will be required to be attached to the organizations tax return yearly and can not be revoked by the organization at any time.

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 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).