



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

501.15-00

Date: November 15, 2010

Number: **201338051**  
Release Date: 9/20/2013

LEGEND

ORG - Organization name  
XX - Date Address - address

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 May 17, 20XX, 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 19, 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, *U.S. Corporation Income Tax Return*, for the years ended March 31, 20XX & 20XX with us. For future periods, you are required to file Form 1120 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,

Nanette M Downing  
Director, EO Examinations

CC:



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE  
3251 North Evergreen Dr., N.E.  
Grand Rapids, MI 49525

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DATE: July 14, 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 <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG EIN</b>		Year/Period Ended 12/31/20XX

**LEGEND**

ORG - Organization name      EIN - ein      City - city      State - state  
CO-1, CO-2, CO-3 & CO-4 - 1<sup>ST</sup>, 2<sup>ND</sup>, 3<sup>RD</sup> & 4<sup>TH</sup> COMPANIES

**ISSUES:**

1. Is ORG providing insurance to its policyholders?
2. Does ORG qualify as an insurance company under Internal Revenue Code Section 501(c)(15), for the years beginning January 1, 20XX?
3. Is ORG exempt from Federal tax as an organization described under Internal Revenue Code (IRC) section 501(c)(15) for the years beginning January 1, 20XX?
4. If ORG does not qualify for tax exempt status for years beginning January 1, 20XX, what are the consequences?
5. Is ORG entitled to relief pursuant to IRC § 7805(b)?
6. If ORG does not qualify for exemption from Federal Tax as an organization described under IRC 501(c)(15), was is the effective date of revocation.
7. 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?
8. If ORG does qualify as an insurance company under Internal Revenue Code Section 501(c)(15), but does not meet the other requirements under Internal Revenue Code Section 501(c)(15), what are the consequences.
9. If ORG does not meet the other requirements 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?

**FACT:**

ORG (ORG) was formed in the State of State as an unincorporated association on December 30, 20XX. ORG has three members, CO-1., J. CO-2, both State limited partnerships, and CO-3, a State corporation. Each member gave \$ as the initial capital of the organization.

The purpose as stated in the Articles of Association is to provide property and casualty insurance on a nonprofit basis for its members.

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

ORG filed the Application Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, with the Internal Revenue Service in 20XX. Its purpose as stated in the application form is to provide limited mutual insurance protection for owner/investors who do their own repairs. Aim is to provide insurance to numerous small real estate investors who typically own 3-20 single family houses. These investors are priced out of the commercial insurance market due to regulation and litigation. These small investors are the do-it-yourselfers who perform their own maintenance on the properties they own. First policies issued in 20XX. Organization will initially operate in the City, State area. Each member contributes \$.

Benefits of this type of insurance are publicized in the CO-4.

Based on the information provided in Application Form 1024, ORG received a determination letter dated May 17, 20XX granting exemption under Internal Revenue Code (IRC) 501(c)(15). The determination letter states the new requirements for exemption under this code section that became effective for tax years beginning on or after January 1, 20XX

ORG filed the Form 990-EZ for year ending December 31, 20XX. On the Form 990-EZ, ORG reported the following financial information:

FORM 990-EZ INFORMATION	12/31/20XX
Premiums	
Investment Income	
Total Revenue	
Total Expenses	
Total Excess/(Deficit)	
Total Assets	
Total Liabilities	

Two policies were issued for the 8/1/20XX – 7/31/20XX time frame. All premiums were collected during the 20XX calendar year. No premiums received during 20XX. No other policies issued after these two expired. ORG was not involved in any reinsurance agreements.

### **LAW AND ANALYSIS:**

#### **1. Is ORG providing insurance to its policyholders?**

The first issue is whether ORG is providing insurance. Determining whether this qualifies as insurance will assist in determining whether ORG can qualify for exemption pursuant to IRC § 501(c)(15).

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

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 (3<sup>rd</sup> 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 (7<sup>th</sup> Cir. 1978), cert. denied, 439 U.S. 835 (1978).

Risk shifting issues frequently arise in the case of captives. In Clougherty Packing Co. v. Commissioner, 811 F.2d 1297 (9<sup>th</sup> Cir. 1987), the court defined a "captive" in footnote 1 on page 1298 as,

a corporation organized for the purpose of insuring the liabilities of its owner. At one extreme is the case presented here, where the insured is both the sole shareholder and only customer of the captive. There may be other permutations involving less than 100% ownership or more than a single customer, although at some point the term "captive" is no longer appropriate.

Risk distribution refers to the operation of the statistical phenomenon known as 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 (7<sup>th</sup> 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 (2<sup>nd</sup> 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 (10<sup>th</sup> 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 (5<sup>th</sup> Cir. 1968).

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

The Sixth Circuit touched on the issue of risk distribution in Humana, Inc. v. Commissioner, 881 F.2d 247, 257 (6<sup>th</sup> 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 (9<sup>th</sup> Cir. 1987)

In Revenue Ruling 20XX-90, 20XX-2 CB 985, the question was raised on whether a subsidiary's arrangement to provide liability insurance coverage to 12 of its parent company's subsidiaries constituted insurance contracts for federal tax purposes and thus, the amounts paid as premiums by each subsidiary were deductible as business expenses. Under the arrangement, the subsidiaries were charged arm's length premiums, according to customary industry ratings, and none had liability coverage of less than 5 percent or more than 15 percent, of the total risk insured by the subsidiary.

As a result, the professional liability risks of the 12 subsidiaries were shifted to the insurer subsidiary as required to constitute an insurance contract for federal tax purposes. The common ownership of the subsidiaries, including the insurer, by the parent, did not affect the determination that the arrangements constituted insurance contracts.

As explained in the Revenue Ruling, that organization issued 12 policies and shifted the risk to the subsidiaries as required. ORG issued 2 policies in 20XX and none in 20XX. As in the Revenue Ruling, the risk shifted from the two insured to ORG in 20XX but there was not adequate risk distribution with only two policies issued. In 20XX these policies expired and no new policies were issued so there was no risk shifting or risk distribution because there were no policies.

It is the Service position that since ORG did not issue any policies in 20XX there was no insurance provided, therefore, no risk shifting or risk distribution.

As stated before, 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. With ORG there were no policies to have risk shifting or risk distribution.

As stated in Revenue Ruling 89-61, 1989-1 C.B. 75, risk distribution 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



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

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.

With ORG, there was not the phenomenon known as the "the law of large numbers". In issuing only two policies in 20XX that carried over to 20XX, there was inadequate risk distribution due to the lack of a number of policies to help cover any losses. With no policies issued in 20XX, there was no risk shifting or risk distribution for 20XX.

Therefore, it is the Service's position that since there were only 2 policies in 20XX that carried over to 20XX and no new policies issued in 20XX, ORG was not providing insurance to any policyholders.

**2. Does ORG qualify as an insurance company under Internal Revenue Code Section 501(c)(15), for the years beginning October 1, 20XX?**

Definition of an Insurance Company.

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, 99<sup>th</sup> Cong., 2<sup>nd</sup> Sess. (Vol. II) 370-71, reprinted in 1986-3 (Vol. 4) C.B. 370-71.

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.

The courts and the IRS have also, at times, looked to whether the transaction has characteristics traditionally associated with insurance, and whether the company conducts business like an insurance company. In order for ORG to be considered an

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

"insurance company" entitled to tax exempt status under I.R.C. 501(c)(15) for the taxable years beginning October 1, 20XX, its primary and predominant business activity during that year must have been issuing insurance contracts or reinsuring insurance risks. See I.R.C. section 816; Treas. Reg. section 1.801-3(a)(1).

Based on the conclusions made regarding Question 1 above, that only two policies were issued in 20XX that carried over to 20XX and no policies were issued in 20XX, ORG was not providing insurance. With ORG not providing insurance, it can not qualifying as an insurance company.

**3. Is ORG exempt from Federal tax as an organization described 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 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).

Based on the conclusion that ORG is not an insurance company, ORG does not qualify for exemption from Federal income tax under IRC 501(c)(15) for years starting January 1, 20XX. IRC 501(c)(15)(A) specifically exempts insurance companies. With ORG not qualifying as an insurance company, ORG can not qualify as an organization exempt from Federal income tax under IRC 510(c)(15).

**4. If ORG does not qualify for tax exempt status for year ending January 1, 20XX, what are the consequences?**

Since ORG did not qualify for tax exemption per IRC 501(c)(15), for years beginning, January 1, 20XX, the tax exempt status is hereby revoked starting January 1, 20XX.

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

In revoking ORG's tax exemption, ORG must file Forms 1120 for years beginning January 1, 20XX.

**5. Is ORG entitled to relief pursuant to IRC § 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. 20XX-4, 14.01 (cross-referencing 13.01 et seq.) 20XX-1 C.B. 514. 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. 20XX-4, 14.01 (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. 20XX-4 14.01 (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 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:

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

**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. 20XX-4, 14.02. See also Rev. Proc. 20XX-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. 20XX-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 (4<sup>th</sup> Cir. 1986). This does not preclude the effective date of revocation being earlier than the date on which the organization first received written notice that its exemption might be revoked. Virginia Education Fund v. Commissioner, 85 T.C. at 753.

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

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).

In this case, ORG issued only 2 policies in 20XX that carried over to 20XX and did not issue any new policies in 20XX. Also, ORG was not involved in any reinsurance agreements during 20XX. ORG's activities are considerably different from the activities that were described in its Application Form 1024. ORG has not been providing insurance to small investors as the application form stated. Therefore, it is the Service's position that ORG is not entitled to relief under IRC 7805(b).

**6. If ORG does not qualify for exemption from Federal Tax as an organization described under IRC 501(c)(15), was is the effective date of revocation?**

Since ORG does not qualify for tax exempt status under IRC 501(c)(15), the effective date of revocation is for years beginning January 1, 20XX. Organization is liable for Forms 1120 for years beginning January 1, 20XX.

**7. 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?**

If for some reason ORG is considered an insurance company under IRC 501(c)(15), then the question is whether ORG 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.

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

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

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.

	<b>9/30/20XX</b>
Premiums Written	
Total Premiums	
Investment Income	
Total Gross Receipts	
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	

Based on the changes in the limitations under IRC 501(c)(15)(A), and the operation of ORG during the year ending December 31, 20XX, it was determined by the chart above, that ORG did not qualify for tax exempt status for years starting January 1, 20XX. ORG was able to meet the \$ and \$ gross receipts limitation (\$). ORG was not able to meet the % or % requirements (%). Therefore, ORG did not qualify for tax exempt status under IRC 501(c)(15).

**8. If ORG does qualify as an insurance company under Internal Revenue Code Section 501(c)(15), but does not meet the other requirements under Internal Revenue Code Section 501(c)(15), what are the tax consequences.**

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 ORG did not meet the other requirements, it does not qualify for tax exempt status under IRC 501(c)(15).

Since ORG did not qualify for tax exemption per IRC 501(c)(15), for years beginning, January 1, 20XX, the tax exempt status is hereby revoked starting January 1, 20XX. In revoking ORG's tax exemption, ORG is liable for Forms 1120-PC.

**9. If ORG does not meet the other requirements 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.

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

IRC 831(a) states as a general rule, "Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company other than a life insurance company."

IRC 831(b) provides an alternative tax for certain small companies. It states in IRC 831(b)(1) that, in general, "In lieu of the tax otherwise applicable under subsection (a), there is hereby imposed for each taxable year on the income of every insurance company to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 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."



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

Based on the Code and Regulation sections above, ORG is not entitled to the relief under IRC 831(b), for 20XX forward, 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 filed, either with the filing of the Form 990/990-EZ 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.

**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 providing insurance and therefore not operating as an insurance company, thereby failing to meet the qualifications for exemption under IRC 501(c)(15). Forms 1120 would be required to be filed for years beginning January 1, 20XX.

If it is determined that ORG was operating as an insurance company, the tax exempt status should still be revoked for years beginning January 1, 20XX because ORG has 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.