



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Date: April 8, 2009

Employer Identification Number:

Person to Contact/ID Number:

Contact Numbers:

Voice

Fax

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated August 30, 19XX, you were held to be exempt from Federal income tax under section 501(c)(15) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(15) of the Code. Accordingly, your exemption from Federal income tax is revoked effective July 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 January 18, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(15) of the Code.

You have filed taxable returns on Forms 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*, for the years ended December 31, 20XX & 20XX with us. For future periods, you are required to file Form 1120-PC with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that

a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Taxpayer Advocate Service

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

Sincerely,

Renee B. Wells
Acting Director, EO Examinations



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

January 15, 2009

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,

Vicki L. Hansen

Vicki L. Hansen
Acting 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		Year/Period Ended June 30, 20XX

ISSUES

1. Does _____ qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years beginning July 1, 20XX?
2. If _____ does not qualify for tax exempt status for years beginning July 1, 20XX, what are the tax consequences?
3. If the tax exempt status is revoked, how will it affect future years?

FACTS

_____ was formed as a trust, in the State of _____, on June 12, 19XX. It was formed in accordance with _____ and all applicable rules of the Department of Insurance of the state of _____.

Its purpose since inception has been to provide excess malpractice insurance coverage to qualified physicians in _____ counties, _____, who are members in good standing of the _____.

The organization operates on a mutual basis. There are no shareholders of the organization.

The Declaration of _____, dated June 12, 19XX, states that it was formed in accordance with _____ and all applicable rules of the Department of Insurance of the state of _____; for the sole purpose of providing excessive insurance coverage to qualified physicians in _____; and who are members in good standing _____.

The Bylaws of _____ state that there will be three Trustees; members are the qualified _____ mentioned in the Trust and that assessments may be made.

Application Form 1024, *Application for Recognition of Exemption Under Section 501(a)* was filed by the organization requesting tax exempt status as a mutual insurance company or association, other than life or marine, under IRC 501(c)(15). In its application form, it stated the following information:

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- The Trust is formed in accordance with _____ and all applicable rules of the Department of Insurance of the state of _____ for the sole purpose of providing excess insurance coverage to qualified _____ who are members in good standing of the _____
- Membership limited to _____, who are existing members of _____
- The Trust shall satisfy all valid judgments for _____ against _____ arising from incidences reported within a _____ in the _____ in excess of _____

Based on the information provided in the application form, the organization was issued a determination letter dated August 30, 19XX, granting tax exempt status under IRC 501(c)(15).

There is only one type of policy is used. The policy provides excess to the members. The policies provide _____ per occurrence and _____ annual aggregate, with a _____ deductible. At the end of June 30, 20XX there were _____ policies outstanding.

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

_____ has been filing its Forms _____ on a _____ year end. The following is a breakdown of the Gross Receipts received by _____ and the percentage of Gross Premiums to Gross Receipts for the year ending June 30, 20XX

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Period Ended June 30, 20XX

	6/20XX
Premiums Written	
Total Premiums	
Interest Income	
Capital Gains	
Total Gross Receipts	
Percentage- Gross Premium/Reinsurance Income to Gross Receipts	

An election under IRC 831(b) has never been filed. As of the writing of this report, there has never been a filing of the election, either with the filing of the Forms 990 or separately.

is not involved in any court ordered liquidation.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended June 30, 20XX

LAW AND ANALYSIS

- 1. Does _____ qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years beginning July 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 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):

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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- 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).

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 the year ending June 30, 20XX, it was determined by the chart above, that did not qualify for tax exempt status for years beginning July 1, 20XX. was able to meet the Gross Receipts limitation of \$600,000 ; however, was not able to meet the percentage of premiums to gross receipts requirement of greater than 50%

As a non-stock company, (mutual), did not meet either the requirement of greater than 35% premiums to gross receipts , or the gross receipts limitation of \$150,000

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

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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--

(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 for years beginning July 1, 20XX. Therefore, Section 206(e) does not apply to this organization.

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

Since _____ did not qualify for tax exempt status under IRC Section 501(c)(15) for years beginning July 1, 20XX, _____ was required to file Forms

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 subsection applies a tax computed by multiplying the taxable

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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 831(b), for the year under examination and for any future year, until they decide to file the election. The election has never been filed, either with the Form or separately. Any election filed now or in the future would only be effective for the year the election is filed and all subsequent years. The election can not be made retroactive.

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

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The tax exempt status is being revoked for the years beginning July 1, 20XX. Form is required for each year. If meets the requirements under IRC 501(c)(15) in future years, it may be allowed to file the Form for each year they qualify, as a self-declared entity. Otherwise, Form would be required.

has been filing its Forms on a June 30th year end. Since was and still is an insurance company, it has been required to file its tax returns on a calendar year basis (IRC 843). Therefore, Forms required to be filed must be filed on a calendar year basis. is liable for Forms for years beginning January 1, 20XX.

TAXPAYER'S POSITION

Unknown at the time of this writing.

SUMMARY

It is the Governments position, based on the above facts, law and analysis, that the tax exemption status of for the years beginning July 1, 20XX should be revoked based on not meeting the qualifications for exemption under IRC 501(c)(15). Forms would be required to be filed on a calendar year basis without the relief under IRC 831(b) being applied.