[Exemptions]

[Federal income tax exempt status issued by IRS &/or as declared by Taxpayers]

26 U.S. Code § 501 (c)(15)

501(c)(15) — Mutual Insurance Companies or Associations

Part 7. Rulings and Agreements

Chapter 25. Exempt Organizations Determinations Manual

Section 15. Small Insurance Companies or Associations

7.25.15 Small Insurance Companies or Associations

Manual Transmittal

September 26, 2013

Purpose

(1) This transmits revised IRM 7.25.15, Exempt Organizations Determinations Manual, Small Insurance Companies or Associations.

Material Changes

(1) IRM 7.25.15.6 (15) adds Notice 2006-42, http://www.irs.gov/pub/irs-tege/n06-42.pdf, in providing guidance as to the meaning of "gross receipts" for purposes of IRC 501(c)(25)(A).

(2) Paragraphs were restructured and style and editing changes were made.

Effect on Other Documents

IRM 7.25.15, dated October 1, 2005, is superseded.

Audience

TEGE (Exempt Organizations)

Effective Date

(09-26-2013)

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7.25.15.1 (09-26-2013)
Overview

1. The information on this IRM is a training and research aid for the employees processing exemption applications, conducting effective examinations, developing technical advice requests, and completing modifications, terminations and revocations with respect to small insurance companies or associations under IRC 501(c)(15).

7.25.15.2 (09-26-2013)
Statute

1.) IRC 501(c)(15), as in effect for taxable years beginning after December 31, 2003, exempts from income tax. Insurance companies (as defined in IRC 816(a)) other than life (including interinsurers and reciprocal underwriters) if:

    A. The gross receipts for the taxable year do not exceed $600,000, and more than 50 percent of such gross receipts consist of premiums, or

    B. In the case of a mutual insurance company, the gross receipts for the taxable year do not exceed $150,000 and more than 35 percent of such gross receipts consist of premiums.

2. The current standards of IRC 501(c)(15) took effect pursuant to Section 206 of the Pension Funding Equity (P.L. 108-218 HR 3108) (the 2004 Act). Section 206(e)(2) of the 2004 Act provided a transition rule for insurance companies in receivership or liquidation for the taxable year that included April 1, 2004, and that met the requirements of IRC 501(c)(15)(A), as in effect for the last taxable year beginning before January 1, 2004. If such a company was in a receivership, liquidation, or similar proceeding under the supervision of a state court on April 1, 2004, the current IRC 501(c)(15) rules (i.e., the 2004 Act amendments) apply to taxable years beginning after the earlier of the date of such proceeding ends, or December 31, 2007.

3. For purposes of IRC 501(c)(15), any insurance company or association shall be treated as receiving the premium income received by all other insurance companies or associations that are members of the same

controlled group as the insurance company or association seeking exemption under IRC 501(c)(15), and its gross receipts must be aggregated with those of other members of its controlled group defined by IRC sections 831 and 1563.

4. Prior to the amendments of the 2004 Act, IRC 501(c)(15) exempted from income tax “insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $350,000.”

7.25.15.2.1 (09-26-2013)
Definitions

1. Insurance company; definition. The term "insurance company" has the same meaning under IRC 501(c)(15) as under Subchapter L of the Code (relating to taxation of insurance companies). IRC 816(a) defines an insurance company for life insurance purposes as 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. An insurance company must be in the business of issuing or reinsuring insurance contracts.
   A. The phrase "insurance companies or associations" includes mutual and stock property and casualty companies.
   B. The term "controlled group" means any controlled group of corporations as defined in IRC 1563(a), except that a more than 50-percent ownership test applies.
2. Mutual insurance company; definition. To qualify as a mutual insurance company under IRC 501(c)(15) the following characteristics, while not conclusive, must be present:
   A. the right of policyholders to be members to the exclusion of others;
   B. the right of the members to choose the management;
   C. the sole business purpose is to supply insurance to members substantially at cost;
   D. the right of members to the return of premiums in excess of those amounts needed to cover losses and expenses; and
   E. common equitable ownership by the members of the assets of the company, in which they have the right to share in the event of dissolution.

A mutual insurance company may not issue policies to nonmembers; all of its policyholders must be members. A mutual insurance company may not accumulate reserves beyond the amount necessary to operate the company. Excess premiums may be paid over to the policyholder-members in the form of dividends, or through abatements or reductions of renewal premiums.

7.25.15.2.2 (09-26-2013)
History

1. IRC 501(c)(15) originally referred only to certain mutual insurance companies or associations other than life or marine. The Tax Reform Act of 1986 (TRA-86) eliminated the distinction between small mutual companies and other small companies and extended IRC 501(c)(15) to all eligible small companies, whether stock or mutual. TRA-86 changed the nature of the ceiling amount for tax exemption from certain gross receipts to direct or net written premiums. The ceiling amount was changed from $150,000 to $350,000. These changes were made effective for tax years beginning after December 31, 1986.
2. The 2004 Act changed the statutory income basis for exemption from a premium income test with a maximum limit of $350,000 to a two-part test consisting of a gross receipts test:

- Part 1: Gross receipts for the taxable year do not exceed $600,000; and
- Part 2: More than 50 percent of such gross receipts consists of premiums.

3. For mutual insurance companies, there is also a two-part test:
   - Part 1: Gross receipts for the taxable year do not exceed $150,000; and
   - Part 2: More than 50 percent of such gross receipts consists of premiums.

7.25.15.2.3 (09-26-2013)
Controlled Corporations

1. Small for-profit insurance companies, insurance companies in liquidation, and reinsurance companies have applied for exemption under IRC 501(c)(15). Many reinsurance companies reinsure risks on insurance and service contracts produced by businesses in which their shareholders have a controlling or financial interest.
   A. Many controlled reinsurance companies are incorporated in Bermuda and offshore Caribbean islands, such as Nevis West Indies, the British Virgin Islands, and the Turks and Caicos Islands. These controlled reinsurance companies are generally referred to as controlled foreign corporations (CFCs).
   B. CFCs usually reinsure insurance and service/warranty contracts produced by finance and loan companies and by other businesses involved in the sale or rental of various goods and products, such as automobiles, VCRs, furniture, and other household items.

7.25.15.3 (09-26-2013)
Exemption Requirements

1. In order to qualify for recognition of exemption under IRC 501(c)(15), an organization:
   A. must be an insurance company or association,
   B. must not be a "life insurance company, "
   C. must issue or reinsure contracts of insurance which shift and distribute a risk of loss, and
   D. must not be a "sham" corporation.
2. In addition, for taxable years beginning after December 31, 2003, an organization must have gross receipts not exceeding $600,000, and more than 50 percent of such gross receipts must consist of premiums.
3. For taxable years beginning after December 31, 2003, a mutual insurance company must have gross receipts not exceeding $150,000, and more than 35 percent of such gross receipts must consist of premiums.

7.25.15.3.1 (09-26-2013)
Life Insurance Company

1. IRC 816 establishes a mechanical formula for determining whether an insurance company is a life insurance company. The definition of a life insurance company takes into account "life insurance reserves" and "unearned premiums and unpaid losses on noncancellable life, accident, or health policies not included in life insurance reserves." A company is not a life insurance company unless these amounts exceed 50 percent of its total reserves.
   - Prepaid credit insurance policies which impose no obligation on the issuing company to renew them to age 60 or over, but which are not terminable at the insurance company’s option during a

lesser period (i.e., the period of the debt) are considered cancellable. Credit life insurance reserves may or may not be considered as life insurance reserves, depending on how they are calculated.

7.25.15.3.2 (10-01-2005)
Gross Receipts Test

1. Effective for taxable years beginning after December 31, 2003, insurance companies (as defined in IRC 816(a)) other than life (including interinsurers and reciprocal underwriters) seeking exemption from income tax pursuant to IRC 501(c)(15) must meet the following gross receipts test:

   A. The gross receipts for the taxable year must not exceed $600,000, and more than 50 percent of such gross receipts must consist of premiums, or

   B. In the case of a mutual insurance company, the gross receipts for the taxable year must not exceed $150,000 and more than 35 percent of such gross receipts must consist of premiums.

2. The Service will include amounts received from the following sources during the taxable year in gross receipts for purposes of IRC 501(c)(15)(A):

   A.) Premiums (including deposits and assessments), without reduction for return premiums or premiums paid for reinsurance;

   B.) Items described in IRC 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.

3. 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 IRC 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 IRC 118, or salvage or reinsurance recovered accounted for as offsets to losses incurred under IRC 832(b)(5)(A)(i).

7.25.15.3.3 (09-26-2013)
Risk Shifting and Risk Distribution

1. To qualify for recognition of exemption under IRC 501(c)(15), an organization's primary and predominant activity must be that of an insurance company engaged in the business of issuing and servicing insurance contracts. An insurance contract must shift and distribute a risk of loss and that risk must be an "insurance" risk, as stated in Helvering v. LeGierse, 312 U.S. 531 (1941).

   A. The Service makes a distinction between risk shifting and risk distribution. Simply put, risk shifting requires that a risk pass from the insured to the insurer. Risk distribution requires the pooling by the insurer of a number of independent risks.

   B. An insurance contract must shift and distribute a risk of loss that is an "insurance" risk. Not all contracts that shift and distribute risk qualify as insurance contracts. To qualify as an insurance contract, the risk underwritten or reinsured must be an "insurance" risk within the meaning of Helvering v. LeGierse, supra.

7.25.15.3.4 (10-01-2005)
Self-Insurance

1. The Service's position is that " self-insurance" arrangements do not involve risk shifting or risk distribution and, therefore, do not constitute insurance. See Anesthesia Service Medical Group, Inc. v. Commissioner,

825 F.2d 241 (9th Cir. 1987), and Spring Canyon Coal Co. v. Commissioner , 13 B.T.A. 189 (1928). Some courts have agreed with the Service's position based on various economic factors, such as:

A. whether there is a legitimate business purpose for the establishment of the offshore insurance company;

B. whether the offshore insurance company is thinly capitalized; and

C. whether the offshore's parent has furnished a guarantee to unrelated primary insurers of the performance of the offshore insurance company.

2. In Malone & Hyde Inc. v. Commissioner , 62 F.3d 835 (6th Cir. 1995), the facts showed that the parent company M formed an offshore insurance subsidiary E to reinsure the first $150,000 coverage of the insurance M obtained from the commercial insurer N for itself and its subsidiaries. On appeal, the Sixth Circuit concluded that the Tax Court should have first determined whether M created E for a legitimate business purpose, or determined whether E was a sham corporation. The Sixth Circuit concluded that M had no legitimate business reason for establishing E; that E was thinly capitalized; and that there was no risk shifting or distribution. The Sixth Circuit concluded that since there was no shifting and distribution of the risk of loss to unrelated parties, there was no insurance, and that E was a sham corporation propped up by M, its parent.

7.25.15.4 (10-01-2005)
Insurance Companies in Liquidation

1. Insurance companies in liquidation, or rehabilitation, are insurance companies for the purpose of IRC 501(c)(15), even though they do not issue, or reinsure insurance contracts, when their primary activity involves administering claims.

A. The State Insurance Commissioner or other appointed receiver takes over the management of insurance companies in liquidation, or rehabilitation. The rehabilitation and/or liquidation process, involves the gathering of assets and paying claimants. During the rehabilitation period the insurance company is prohibited from issuing new insurance contracts.

B. In Bowers v. Lawyers Mortgage Co ., 285 U.S. 182 (1932), the Supreme Court held that a company was not an insurance company where its premium income constituted only about 35 percent of its total income. If less than half of a company's business is not properly characterized as insurance, it is not an insurance company.

2. The Service has taken the position that insurance companies in liquidation that do not issue insurance contracts, but only administer claims, may qualify as insurance companies. However, when such company's investment activity generates more income than necessary to pay its claims, the "excess" investment activity is non-insurance business. If over one-half of a company's business is excess investment activity, the company is not an insurance company.

3. "Return premium income" is premium income returned by third-party reinsurance companies and is considered premium income for both the premium income and gross receipts tests under IRC 501(c)(15). However, when insurance companies in liquidation no longer receive substantial premiums and their main source of income is investment income, they may qualify under IRC 501(c)(15), even though they may have millions of dollars in annual investment income. See Rev. Rul. 67–80, 1967–1 C.B. 143.

4. Section 206(e)(2) of the 2004 Act provided a transition rule for insurance companies in receivership or liquidation. For the taxable year which includes April 1, 2004, and that met the requirements of IRC 501(c)(15)(A), as in effect for the last taxable year beginning before January 1, 2004. If such a company was, in a receivership, liquidation, or similar proceeding under the supervision of a State court on April 1, 2004, , the 2004 Act amendments to IRC 501(c)(15) apply to taxable years beginning after the earlier of the date such proceeding ends or December 31, 2007."

7.25.15.4.1 (09-26-2013)
Annualization

1. If an organization has a short tax year, then its premiums should be annualized (i.e., dividing the premiums by the number of months in the short tax year and multiplying by 12) to determine whether it meets the premium income and gross receipts tests.

7.25.15.4.2 (09-26-2013)
IRC 845

1. IRC 845(b) authorizes the Service to make proper adjustments, in the case of any reinsurance contract having a significant tax avoidance effect, with respect to a party to the contract to eliminate the tax avoidance effect.

2. In Trans City Life Insurance Company v. Commissioner, 106 T.C. 274 (1996), the Tax Court ruled that IRC 845(b) is not unconstitutionally vague and that the Service may rely upon IRC 845(b) prior to the issuance of regulations. IRC 845(b) permits the Secretary to make proper adjustments in a reinsurance contract that has a significant tax avoidance effect.

3. In Trans City Life, supra, the Tax Court cited the seven factors set out in the conference report of the Deficit Reduction Act of 1984 (DEFRA) (H.R. Conf. Rep. No. 861, 98th Cong., 1st Sess. 1062 (1984), 1984–3 C.B. 316). Additionally, the Tax Court discussed an eighth factor, "risk transferred versus tax benefits derived," and a ninth factor, "state determinations."

4. The DEFRA conference report stated that "tax avoidance effect must be significant to one or both of the parties to a reinsurance agreement in order for the Commissioner to exercise her authority to make adjustments under IRC 845(b)." Further, the DEFRA conference report stated that a tax avoidance effect is significant "if the transaction is designed so that the tax benefits enjoyed by one or both parties to the contract are disproportionate to the risk transferred between the parties." The DEFRA conference report then set forth seven factors that help determine an agreement’s economic substance. These factors include the following:

   A. the age of the business reinsured (reinsurance of a new block of insurance contracts has more economic substance than an old block);

   B. the character of the business reinsured (reinsurance of long-term insurance has more economic substance than short-term);

   C. the structure for determining the potential profits of each of the parties, and any experience rating;

   D. the duration of the reinsurance agreement;

   E. the parties’ rights to terminate the reinsurance agreement, and the consequences of a termination;

   F. the relative tax positions of the parties; and

   G. the general financial situations of the parties.

5. The conference report also lists certain types of reinsurance transactions which generally will be respected. In addition, the report advises that a tax avoidance effect is "significant " if the transaction is designed so that the tax benefits enjoyed by one or both parties to the contract are disproportionate to the risk transferred between the parties.

7.25.15.4.3 (09-26-2013)
Brother-Sister Controlled Corporations Under IRC 1563

1. Constructive stock ownership rules under IRC 1563(a) must be applied to determine whether corporations are part of a brother-sister controlled group. A brother-sister controlled group consists of two or more corporations in which 5 or fewer persons (i.e., individuals, estates, or trusts), own more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation. The constructive ownership rules under IRC 1563(d)(2) and (e) are used to determine whether a person (who is an individual, estate, or trust) owns stock in the corporation.

2. An individual shall be considered as owning stock in a corporation owned directly or indirectly by or for his spouse, unless each of the following four conditions are met. See IRC 1563(e)(5).

   A. The individual does not, at any time during such taxable year, own directly any stock in such corporation;

   B. The individual is not a director or employee and does not participate in the management of such corporation at any time during such taxable year;

   C. Not more than 50 percent of such corporation's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities; and

   D. Such stock in such corporation is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such stock and which run in favor of the individual or his children who have not attained the age of 21 years.

3. Further, an individual shall be considered as owning stock owned directly or indirectly by or for his children who have not attained the age of 21 years, and if the individual has not attained the age of 21 years, the stock owned directly or indirectly by or for his parents. See IRC 1563(e)(6)(A).

4. Moreover, an individual who owns 50 percent or more of the shares of stock in a corporation shall be considered as owning the stock in such corporation owned directly, or indirectly by or for his parents, grandparents, grandchildren and children who have attained the age of 21 years. See IRC 1563(e)(6)(B).

7.25.15.4.4 (09-26-2013)
Miscellaneous IRC Provisions

1. IRC 953 applies special rules to certain controlled foreign corporations (CFC) who have United States shareholders holding 25 percent or more of the CFC's stock. Such CFCs may elect to be treated as domestic U.S. corporations by making the election provided by IRC 953(d).

2. IRC 1504(b)(1) provides that a corporation exempt from tax under IRC 501 may not file a consolidated return as a member of an affiliated group of taxable corporations. IRC 1504(e) provides an exception for tax-exempt organizations described in IRC 501(c)(2).

7.25.15.5 (09-26-2013)
Burial Associations

1. IRC 816 states that burial and funeral benefit insurance companies that provide benefits in the form of supplies and services are classified as insurance companies other than life, and may qualify for exemption under IRC 501(c)(15). (See Thompson v. White River Burial Association, 178 F.2d 954 (8th Cir. 1950). If benefits are paid in cash, the organization is deemed a life insurance company and exemption is considered under IRC 501(c)(12).

7.25.15.6 (09-26-2013)
Applications for Recognition of Exemption

1. An organization applying for exemption under IRC 501(c)(15) must file its application on Form 1024.

7.25.15.7 (09-26-2013)
Digests of Published Rulings and Procedures

1. Democratic control by policyholders defined — Whether democratic control is in the policyholders of a mutual insurance company depends on the circumstances of each case and is determined by the control which the policyholders actually exercise, to the exclusion of any group other than policyholders, and not upon the unexercised power to control which such other group has by statute or otherwise. Rev. Rul. 55–240, 1955–1 C.B. 406, as clarified by Rev. Rul. 58–616, 1958–2 C.B. 928.
2. Democratic ownership required — In the absence of democratic ownership and control by the policy members, an insurance company may not qualify as a mutual insurance company. Rev. Rul. 55–240, 1955–1 C.B. 406, as clarified by Rev.Rul. 58–616, 1958–2 C.B. 928.
3. Gross income determination, inclusion of reinsurance or return premiums — In determining the gross amount (income) received by a mutual insurance company during the year for purposes of the limitation provided in IRC 501(c)(15), premiums written or received on insurance contracts during the taxable year are to be taken into account without deduction for amounts paid or incurred for reinsurance or for return premiums. Rev. Proc. v. Rul. 67–80, 1967–1 C.B. 143.
4. Economic Family Theory - In Rev. Rul. 77-316, 1977-2 C.B. 53, the Service ruled, in three situations, that the contractual arrangement between the domestic parent and subsidiaries and the insurance subsidiary did not qualify as insurance for federal income tax purposes. In Situation 1, a parent corporation and its subsidiaries paid amounts as insurance premiums directly to an insurance subsidiary. In Situation 2, the premiums were paid to an unrelated insurance company, and the parties agreed that the unrelated company would immediately transfer 95 percent of the risks under a reinsurance agreement to the insurance subsidiary. In Situation 3, the parent and subsidiaries paid premiums to the insurance subsidiary, with the understanding that it would transfer 90 percent of the risk through a reinsurance agreement to an unrelated insurance company. In each situation, the insurance subsidiary insured no other parties and was wholly owned by the parent. On June 25, 2001, Rev. Rul. 77-316 was obsolete by Rev. Rul. 2001-31.
5. Economic Family Theory Revoked - In Rev. Rul. 2001-31, 2001-1 C.B. 1348, the Service ruled that it would no longer invoke the economic family theory with respect to captive insurance transactions. The Service may, however, continue to challenge certain captive insurance transactions based on the facts and circumstances of each case.
6. In Rev. Rul. 2002-89, 2002-2 C.B.the Service provided guidance on whether arrangements between a parent and a subsidiary insurance company qualified as an insurance arrangement and whether premiums paid were deductible under section 162 of the Code

   A. Specifically, Situation 1 described a domestic corporation that entered into an annual arrangement with its wholly-owned insurance subsidiary. In doing so, the subsidiary either insures or reinsures the liability risks of the parent corporation. All business is maintained separately and the parent does not guarantee the subsidiary's risks. Also, 90 percent of the total premiums are received from the parent corporation on both a gross and net basis. The Service pointed out that when the total risk and liability coverage is more than 90 percent for the subsidiary, there is no risk shifting and risk distribution. Accordingly, the Service held that there was no insurance arrangement and that amounts paid by the parent to the subsidiary were not deductible under section 162.

   B. Situation 2 has the same fact pattern as Situation 1 except the premiums subsidiary earns from the arrangement with parent constitute less than 50 percent of subsidiary's total premiums earned during the taxpayer year on both a gross and net basis. The liability coverage the subsidiary provides to parent accounts for less than 50 percent of the total risks borne by subsidiary. The ruling stated in Situation 2, the arrangement between parent and subsidiary constitutes insurance for federal income tax purposes, and the amounts paid by parent to subsidiary pursuant to that arrangement are deductible as premiums under section 162 of the Code.

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7. Rev. Rul. 2002-90, 2002-2 I.R.B. 985, describes a holding company owning stock of 12 subsidiaries. The holding company formed a wholly-owned insurance subsidiary to directly insure the liability risks of the 12 subsidiaries of the holding company. The 12 subsidiaries are charged arms-length premiums, which are established according to customary industry rating formulas. None of the operating subsidiaries have liability coverage for less than 5 percent, nor more than 15 percent, of the total risk insured by the wholly-owned insurance subsidiary. There are no parental (or other related party) guarantees of any kind, nor does the insurance subsidiary loan any funds to the holding company or to the 12 operating subsidiaries. The liability risks of the 12 subsidiaries are pooled such that a loss by one operating subsidiary is borne, in substantial part, by the premiums paid by others. Therefore, the Service held that the arrangements between the insurance company and the 12 subsidiaries of the holding company constitute insurance.

8. Rev. Rul. 2002-91,, 2002-2 C.B. 991, describes a group captive (GC) formed by a small group of unrelated businesses involved in a highly concentrated industry to provide insurance coverage is an insurance company within the meaning of section 831 of the Code. GC was an entity separate from its owners and adequately capitalized. GC issues insurance contracts, charges premiums, and pays claims after investigating the validity of the claim. GC does not engage in any business other than insurance. The Service held that such arrangement constitutes insurance.

9. Notice 2002-70, 2002-2 C.B. 765, describes many transactions designed to use a reinsurance arrangement to divert income properly attributable to taxpayer to taxpayer's wholly owned corporation to reinsure the policies sold by taxpayer. The wholly-owned company takes the position that it is entitled to exemption under IRC 501(c)(15). Taxpayer's wholly-owned reinsurance company then is subject to little or no federal income tax. The Service stated that it intends to challenge the purported tax benefits from these transactions on a number of grounds, specifically, whether the company whose primary and predominant business activity was that of issuing insurance. Taxpayers using these transactions that are the same as or similar to the transactions described in this Notice are required to register or list their transactions and who fail to do so may be subject to a penalty.

10. Notice 2004-65, 2004-2 C.B. 599, modifies Notice 2002-70 by removing or delisting the identification of transaction that are the same as, or substantially similar to, transactions described in Notice 2002-70 as transactions for purposes of section 1.6011-4(b)(2) of the Regulations and section 301.6111-2(b)(2) of the Procedure and Administration Regulations. The Service will, however, continue to scrutinize transactions described in Notice 2002-70 that are being used to shift income from taxpayers to related companies purported to be insurance companies that are subject to little or no U.S. federal income tax.

11. Notice 2003-35, 2003-1 C.B. 992, was published to remind taxpayers that an entity must be an insurance company for federal income tax purposes in order to qualify as exempt from federal income tax as an organization described in IRC 501(c)(15). For an entity to qualify as an insurance company, it must issue insurance contracts or reinsure risks underwritten by insurance companies as its primary and predominant business activity during the taxable year.

12. Notice 2004-64 alerts taxpayers to legislative amendments that may affect the qualification of some insurance companies under section 501(c)(15) for taxable years beginning after December 31, 2003. For example, an insurance company with $650,000 of gross receipts in a taxable year would have been eligible for exemption before the amendments to section 501(c)(15) if the company's premiums for the year were $350,000 or less. However, for taxable years beginning after December 31, 2003, an insurance company with $650,000 of gross receipts in a taxable year will not be eligible for exemption from tax under section 501(c)(15), as amended by the 2004 Act, because the $600,000 gross receipts test will not be met. Conversely, an insurance company with $500,000 of gross receipts in a taxable year would not have been eligible to be exempt from federal income tax under former section 501(c)(15) if the company's premiums were $375,000. However, for taxable years beginning after December 31, 2003, an insurance company with $500,000 of gross receipts in a taxable year, including $375,000 from premiums, will be eligible for

exemption under section 501(c)(15). Nonetheless, if the same company is a member of a controlled group (as defined in section 501(c)(15)(C)), it will not qualify if other members of the group have gross receipts in the taxable year in excess of $100,000 because the $600,000 gross receipts test will not be met.

13. Notice 2005-49 requests comments on additional guidance concerning the standards for determining whether an arrangement constitutes insurance for federal income tax purposes.

14. Rev. Rul. 2005-40, 2005-2 C.B. 4, describes certain arrangements and analyzes whether they constitute insurance for federal income tax purposes and, if so, whether the amounts paid to the insurer are deductible as insurance premiums and whether the insurer qualifies as an insurance company.

15. Notice 2006-42, 2006-1 C.B. 878, provides guidance on the definition of “gross receipts” under the IRC 501(c)(15) qualifying tests implemented by the legislative amendments provided in the 2004 Act. For the purpose of these tests, gross receipts include, premiums (including deposits and assessments), without reduction for return premiums paid for reinsurance, items described in section 834(b) (gross investment income of a non-life insurance company); and other items that are properly included in the taxpayer’s gross income under subchapter B of chapter 1, subtitle A, of the Code. Gross receipts include tax-free interest and the gain (but not the entire amount realized) from the sale or exchange of capital assets. Gross receipts do not include contributions to capital excluded from gross income under section 118, or salvage or reinsurance recovered accounted for as offsets to losses incurred under IRC 832(b)(5)(A)(i).

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