

Modification of Exemption From Tax for Small Property and Casualty Insurance Companies

Notice 2004-64

This notice alerts taxpayers to recent amendments to § 501(c)(15) of the Internal Revenue Code. These amendments may affect the qualification of entities as

tax-exempt property and casualty insurance companies described in § 501(c)(15). This notice advises taxpayers that the Service will continue to scrutinize the eligibility of entities claiming to be tax-exempt property and casualty insurance companies. See Notice 2003-35, 2003-1 C.B. 992.

BACKGROUND AND PRIOR LAW

Section 501(a) provides that an organization described in § 501(c) is exempt from federal income tax. Prior to the recent amendments, former § 501(c)(15)(A) provided that an insurance company, other than a life insurance company, was tax-exempt if its net written premiums (or, if greater, its direct written premiums) did not exceed \$350,000. For purposes of determining whether the insurance company met the \$350,000 premium test for the taxable year, the premiums received in that taxable year by all companies or associations in the same controlled group (as defined in § 831(b)(2)(B)(ii) of the Code) as the insurance company were treated as though received by the insurance company.

PENSION FUNDING EQUITY ACT OF 2004

The Pension Funding Equity Act, P.L. 108-218, (the “Act”) was enacted on April 10, 2004. Section 206 of the Act made several changes to § 501(c)(15) that, in general, are effective for taxable years beginning after December 31, 2003. Specifically, the Act amended § 501(c)(15) to provide that a property and casualty insurance company is eligible to be exempt from federal income tax if (a) its gross receipts for the taxable year do not exceed \$600,000, and (b) more than 50 percent of its gross receipts for the taxable year consist of premiums. See § 501(c)(15)(A)(i). For purposes of these tests, amounts received by all members of the insurance company’s controlled group (including foreign and tax-exempt companies) are taken into account. See § 501(c)(15)(C). Alternative gross receipts and premium tests apply to small mutual insurance companies. See § 501(c)(15)(A)(ii).

The Act clarifies that, for purposes of § 501(c)(15), the term “insurance company” has the same meaning as in § 816(a)

of the Code, which provides that a company is an insurance company if more than half of its business during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

The recent amendments to § 501(c)(15) may affect the qualification of some insurance companies under § 501(c)(15) for taxable years beginning after December 31, 2003.

For example, a non-life stock insurance company with \$650,000 of gross receipts in a taxable year would have been eligible to be exempt from federal income tax before the recent amendments to § 501(c)(15) if the company's written 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 § 501(c)(15), as amended by the Act, because the \$600,000 gross receipts test will not be met.

Conversely, a non-life stock 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 § 501(c)(15) if the company's written premiums for the year 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 from tax under § 501(c)(15), as amended by the Act. Nonetheless, if the same company is a member of a controlled group (as defined in § 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.

As previously described in Notice 2003-35, 2003-1 C.B. 992, the Service will continue to challenge the exemption of any entity that claims to be described in § 501(c)(15), but that does not meet the requirements of that section, regardless of whether the exemption is claimed pursuant to an existing determination letter or on a return filed with the Service. The Service will challenge the qualification of an entity under former § 501(c)(15) for any open taxable year beginning prior to January 1, 2004. The Service will chal-

lenge the qualification of an entity under § 501(c)(15), as amended by the Act, for taxable years beginning after December 31, 2003.

EFFECTIVE DATE OF AMENDMENTS

The amendments to § 501(c)(15) of the Code generally are effective for taxable years beginning after December 31, 2003. A special transition rule applies with respect to certain insurance companies in receivership or liquidation.

DRAFTING INFORMATION

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