

**F. Modify Qualification Rules for Tax-Exempt Property and Casualty Insurance Companies
(sec. 10 of the Senate amendment and secs. 501 and 831 of the Code)**

Present Law

A property and casualty insurance company generally is subject to tax on its taxable income (sec. 831(a)). The taxable income of a property and casualty insurance company is determined as the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions (sec. 832).

A property and casualty insurance company is eligible to be exempt from Federal income tax if its net written premiums or direct written premiums (whichever is greater) for the taxable year do not exceed \$350,000 (sec. 501(c)(15)).

A property and casualty insurance company may elect to be taxed only on taxable investment income if its net written premiums or direct written premiums (whichever is greater) for the taxable year exceed \$350,000, but do not exceed \$1.2 million (sec. 831(b)).

For purposes of determining the amount of a company's net written premiums or direct written premiums under these rules, premiums received by all members of a controlled group of corporations of which the company is a part are taken into account. For this purpose, a more-than-50-percent threshold applies under the vote and value requirements with respect to stock ownership for determining a controlled group, and rules treating a life insurance company as part of a separate controlled group or as an excluded member of a group do not apply (secs. 501(c)(15), 831(b)(2)(B) and 1563).

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the requirements for a property and casualty insurance company to be eligible for tax-exempt status, and to elect to be taxed only on taxable investment income.

Under the Senate amendment, 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) the premiums received for the taxable year are greater than 50 percent of its gross receipts. For purposes of determining gross receipts, the gross receipts of all members of a controlled group of corporations of which the company is a part are taken into account. The Senate amendment expands the present-law controlled group rule so that it also takes into account gross receipts of foreign and tax-exempt corporations.

A company that does not meet the definition of an insurance company is not eligible to be exempt from Federal income tax under the Senate amendment. For this purpose, 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 (sec. 816(a) and new sec. 831(c)). A company whose investment activities outweigh its insurance activities is not considered to be an insurance company for this purpose.³⁵ It is intended that IRS enforcement activities address the misuse of present-law section 501(c)(15).

The Senate amendment also provides that a property and casualty insurance company may elect to be taxed only on taxable investment income if its net written premiums or direct written premiums (whichever is greater) do not exceed \$1.2 million (without regard to whether such premiums exceed \$350,000) (sec. 831(b)). As under present law, for purposes of determining the amount of a company's net written premiums or direct written premiums under this rule, premiums received by all members of a controlled group of corporations (as defined in section 831(b)) of which the company is a part are taken into account.

It is intended that regulations or other Treasury guidance provide for anti-abuse rules so as to prevent improper use of the provision, including, for example, by attempts to characterize as premiums any income that is other than premium income.

Effective date.--The Senate amendment provisions are effective for taxable years beginning after December 31, 2003.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications.

Under the conference agreement, an additional special rule provides that a mutual property and casualty insurance company is eligible to be exempt from Federal income tax under the provision if (a) its gross receipts for the taxable year do not exceed \$150,000, and (b) the premiums received for the taxable year are greater than 35 percent of its gross receipts, provided certain requirements are met. The requirements are that no employee of the company or member of the employee's family is an employee of another company that is exempt from tax under section 501(c)(15). The limitation to mutual companies and the limitation on employees are intended to address the conferees' concern about the inappropriate use of tax-exempt insurance companies to shelter investment income, including in the case of companies with gross receipts under \$150,000. For example, it is intended that the provision not permit the use of small companies with common owners or employees to shelter investment income for the benefit of such owners or employees.

Effective date.--The provision generally is effective for taxable years beginning after December 31, 2003.

Under the conference agreement, a special transition rule applies with respect to certain companies. This transition rule applies in the case of a company that, (1) for its taxable year that includes April 1, 2004, meets the requirements of present-law section 501(c)(15)(A) (as in effect for the taxable year beginning before January 1, 2004), and (2) on April 1, 2004, is in a receivership, liquidation or similar proceeding under the supervision of a State court. Under the transition rule, in the case of such a company, the general rule of the provision in the conference agreement applies to taxable years beginning after the earlier of (1) the date the proceeding ends, or (2) December 31, 2007.

For such a company, present-law limitations on the carryover of net operating losses to or from years in which the company was not subject to tax (including section 831(b)(3)) continue to apply. A company that is not otherwise eligible for tax-exempt status under present-law section 501(c)(15) (e.g., a company that is or becomes a life insurance company, or a company with net (or, if greater, direct) written premiums exceeding \$350,000 for the taxable year) is not eligible for the transition rule.

³⁵ See, e.g., *Inter-American Life Insurance Co. v. Comm'r*, 56 T.C. 497, aff'd per curiam, 469 F.2d 697 (9th Cir. 1972).