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Reduced Rate – IRS Code Section 501(a)

The reduced rate does not apply to premiums from policies issued to plans which are exempt under Internal Revenue Code section 501(a) that are not pension or profit-sharing plans. Premiums from policies issued to such plans must be taxed at the full rate. Premiums from policies issued to plans meeting the two requirements of Revenue and Taxation Code section 12202 (pension or profit sharing plans that are exempt or qualified under the relevant Internal Revenue Code sections) qualify for the reduced rate even if the policy is not an annuity. Plans that come within the sections of the Internal Revenue Code listed in Revenue and Taxation Code section 12202, other than Internal Revenue Code section 501(a), virtually always qualify for the reduced rate.

Examples of premiums not meeting both tests under Revenue and Taxation Code section 12202 are: (i) premiums from policies issued to policyholders organized under Internal Revenue Code section 501(c)(3) and exempt under Internal Revenue Code section 501(a); or, (ii) premiums from policies issued to voluntary employees' beneficiary associations (VEBA) organized under Internal Revenue Code section 501(c)(9) and exempt under Internal Revenue Code section 501(a). 5/8/90. (Am. 2003-3).

Memorandum

To: Mr. Clarence E. Ward
Excise Tax Unit

Date: May 8, 1990

From: David H. Levine
Tax Counsel

Subject: (Redacted)
Section 12202

With your mini-memo dated April 9, 1990, you sent a copy of a petition for redetermination filed by (redacted) on the reduced rate issue (Rev. & Tax. Code § 12202). You cannot find a reference that this petition has been reviewed. You ask for my recommendation or comments.

As you know, there are two basic issues that have arisen in the reduced rate cases. First is whether the reduced rate applies to premiums from policies issued to plans which are exempt under IRC section 501(a) but which are not pension or profit-sharing plans (plans which come within the other IRC sections listed in section 12202 virtually always qualify for the reduced rate). We have concluded that premiums from policies issued to such plans must be taxed at the full rate. The second issue is whether premiums from policies issued to plans meeting the two requirements of section 12202 (pension or profit sharing and within a listed IRC section) qualify for the reduced rate if the policy is not an annuity contract. We have concluded that a policy is entitled to the reduced rate, even if not an annuity, if it meets the two requirements of section 12202.

(Redacted) states that the premiums listed first on page 2 of its petition were from policies issued to pension or profit-sharing plans that were exempt or qualified under the relevant IRC sections. If so, we would recommend granting this part of the petition. However, I note that these amounts apparently include premiums from policies issued to organizations within IRC section 501(c)(3) (such organizations are exempt under section 501(a)). Not all such organizations are pension or profit-sharing plans. We would recommend granting with respect to amounts from an organization under IRC section 501(c)(3) provided the organization is a pension or profit-sharing plan. We would recommend denial with respect to amounts from IRC section 501(c)(3) organizations which are not pension or profit-sharing plans.

We would recommend denial of the premiums listed second on page 2 of the petition because they do not appear to satisfy both elements of the reduced rate test. The most common premiums not meeting both tests which insurers claim as entitled to the reduced rate are premiums from policies issued to voluntary employees' beneficiary associations (VEBA), which are within IRC section 501(c)(9) and exempt under section 501(a). The premiums at issue here are apparently from section 501(c)(3) organizations and not from VEBAs. Nevertheless, as mentioned above, premiums from a section

501(c)(3) organization are not entitled to the reduced rate unless the organization is a pension or profit-sharing plan. (Redacted)'s argument on page 6 indicates that the organizations at issue were not pension or profit-sharing plans and that the premiums are therefore not entitled to the reduced rate. On the other hand, if (redacted) establishes that any were pension or profit-sharing plans, premiums from such plans would be entitled to the reduced rate.

I note that on page 4 of the petition, (redacted) states its "belief" that one of the plans included in the second listing on page 2 was actually a pension plan qualified under IRC section 401(a). If so, such premiums are entitled to the reduced rate.

We are currently in litigation on the reduced rate issue with respect to which we recommend denial. It is my understanding that the Excise Tax Division has held up claims for refund on this issue, whether we would recommend denial of all or part, pending resolution of the litigation. But it is also my understanding that Mr. E. V. Anderson has informed the Department of Finance that we would schedule matters in petition status for resolution. Based on this understanding, I believe it is appropriate to schedule this matter for a hearing, which (redacted) is entitled to and has requested, unless (redacted) wishes to pay the amount at issue, in which case we could hold it in paid-up status.

Please call me if you wish to discuss further.

David H. Levine

DHL:jb