LEGEND -

Org – Name of Organization
Num – EIN Number
Date1 – Effective Date
Date2 – Year End after Effective Date
Person to contact/phone - Agent

Department of the Treasury
Internal Revenue Service

Release Number: 200715012
Release Date: 4/13/07
Date: January 11, 2007
UIL Code: 501.15-01
Org

Taxpayer Identification Number:
Num
Form:
990
Tax Year(s) Ended:
Date 2
Person to Contact/ID Number:
Agent
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,

R. C. Johnson
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 Org, Num		Year/Period Ended Date2

Legend:

Org – Name of Organization	State – State of	Child2 – Sibling2	Borrower 1 – N/R 1
Org2 – Related party/company	Date3 – Formation date	Child3 – Sibling3	Borrower 2 – N/R 2
Org3 – Related Foreign company	Country 1 – Territory	Child4 – Sibling4	Borrower 3 - "
Org4 – LLC Company	Founder – President F	Child5 – Sibling5	Borrower 4 – "
Org5 – Investment LLC	Founder2 – Secretary	ABCCorp – C Corp	Borrower 5 – "
Num – EIN Number	XYZ – Family Lastname	GCorp – Unrelated Corp	Borrower 6 – "
Date1 – Effective Date	Dad – Primary Firstname	HCorp – Unrel.Corp2	LegalCorp - Firm
Date2 – Year End after Effective Date	Mom - Spouse	Sole Proprietor-Company	Related Org – Family org
Person to contact/phone - Agent	Child1 – Sibling1	N/R – Note Recipient	

ISSUES:

1. Is Org providing insurance to its policyholders?
2. Is Org an insurance company exempt from Federal tax as an Organization described under Internal Revenue Code (IRC) section 501(c)(15) for taxable years Date2?
3. Is Org primary and predominant activity that of insurance or investment activity?
4. Can Org rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to IRC § 501(c)(15)?
5. Is Org entitled to relief pursuant to IRC § 7805(b)?
6. If Org cannot rely on its determination letter, what is the effective date of revocation?.

FACTS

Org was formed on Date3, in the territory of the Country1, by Founder. In its Memorandum of Association filed on that date, Org indicated as one of its objectives was to carry on the business of insurance, captive insurance and reinsurance, to act as agents and/or brokers for insurance companies and syndicates, to accept risks, settle claims, solicit insurance business, and all other matters incidental thereto. Both the Memorandum of Association and Articles of Association filed authorized capital of $ comprising of shares with par value of $ each. Founder owned % of the stock of this Organization.

On June 16, 1999, ORG filed Application Form 1024, Application for Recognition of Exemption Under Section 501(a), with the Internal Revenue Service, seeking tax exempt status under Internal Revenue Code section 501(c)(15). ORG indicated that it was licensed on xx/xx/xx as a Property and Casualty Insurance company. Also that the company had entered into reinsurance contracts and did not insure or reinsure any related party insurance. All insurance and reinsurance contracts entered into by the Company were transacted with unrelated third parties, unrelated insurance companies. The initial insured's are consumers spread throughout the United States. Founder was listed as the President and Director while Founder2 was listed as Secretary and Director. Total assets and liabilities reported for year ending December 31, 1998 were $ and $ respectively.

ORG indicated that they had entered into a reinsurance agreement with Org2 on January 2, 1998, where ORG assumed credit disability insurance and credit involuntary unemployment insurance produced by Insurance Company.

ORG provided a copy (unsigned), during the application process, of the 953(d) election it made.

Based on the information provided in its application form and attachments, ORG was issued a favorable determination letter granting tax exempt status under section 501(c)(15) of the Code, on Date1.

On August 1, 2001, a Reorganization Plan and Agreement was executed between ORG, Org3, a Foreign company and Founder. It stated that Org3 wished to acquire all of ORG's assets in a transaction which would qualify as a reorganization under section 368(a)(1)(D) of the Internal Revenue Code of 1986. ORG wished to transfer all of its assets to ORG3and then Founder wished to sell all of his shares in Org to an unrelated party in a transaction which would qualify as a reorganization under section 368(a)(1)(D) of the Code.

As part of the Agreement, ORG3 was to issue to Founder 100,000 shares of common stock of ORG3 representing % of the issued and outstanding shares of the ORG3 immediately after the issuance of such shares.

A Bill of Sale and Assignment of Assets was signed effective August 1, 2001 by Founder, President of Org and by Related, President of Org2.

An Assignment of Assets and Assumption of Liabilities were executed on December 11, 2001. Org3 granted, conveyed, transferred and assigned to Org4 ("Org4") a State limited liability company all of its rights, title and interest in the assets received or to be received by ORG3 from ORG pursuant to the Reorganization Plan and Agreement dated August 1, 2001. As consideration of the assignment, ORG3received a ninety-nine percent (%) membership interest in Org4.

Also executed on December 11, 2001 was a Stock Purchase Agreement between Founder as the selling shareholder of Org and Org5, LLC, a Foreign limited liability company. Org5 desired to purchase the 2,000,000 shares of Org from Founder. The purchase price was $.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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Org5 is owned % by the XYZ family. A breakdown of ownership follows:

- Dad and Mom XYZ %
- Child1 XYZ %
- Child2 XYZ %
- Child3 XYZ %
- Child4 %
- Child5 %
- Child6 XYZ %

Dad XYZ owns % of the stock in ABC CORP, Inc., (a "C" Corporation). Child3 XYZ and Child5 own % in XYZ, Inc. (a "C" Corporation).

In October 2001, the XYZ Family formed XYZ Related ORG, LLC. Each XYZ Family member contributed real estate in exchange for membership. On January 2002 each XYZ Family member contributed his/her share of XYZ Related ORG, LLC to Org5, LLC. In return, Org5, LLC contributed its membership share in XYZ Related ORG, LLC to ORG, thereby making XYZ Related ORG, LLC a % subsidiary of ORG.

A breakdown of the financial activity of XYZ Related ORG, LLC for & follows:

FINANCIAL INFORMATION		
Rental Income		
Interest Income		
Misc. Income- Easement		
Royalty Income		
Service Charge Income		
Total Income		
Maintenance/Repairs		
Bad Debt		

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Accounting/Legal Fees		
Bank Charges		
Fees, dues, Subscriptions		
Insurance		
Office Expenses		
Outside Services		
Travel & Entertainment		
Utilities		
Taxes- Property		
Total Expenses		
Total Income		

The amount reported as Total Income above is the amount recognized as income from a disregarded entity by ORG on its Forms 990 for &

As indicated above, ORG entered into a reinsurance agreement with GCorp Insurance Company Limited. They assumed credit disability insurance and credit involuntary unemployment insurance, produced by HCorp Insurance Company. Coinsurance percentages for each type of insurance were . %. The reinsurance commissions for Credit disability insurance was % of reinsurance premiums and for Credit involuntary unemployment insurance was % of reinsurance premiums. The Organization's determination letter was based on this agreement.

Since the reorganization and stock purchase described above, ORG had no longer been involved in reinsurance agreements but has issued insurance directly. The types of insurance issued directly included, Individual Disability Insurance coverage; Property Insurance coverage; Director's & Officer's coverage; Business Owners Coverage, and Commercial General Liability Coverage. A breakdown of the policies issued during & are as follows:

- Individual Disability Insurance Policy
    - 1/1/02 – 12/31/02
    - Maximum Monthly amount- $
    - Premium- $ per year
    - Coverage- % of last 12 months compensation for 10 years
    - issued Child4, Child5, Child6 XYZ, Child2 XYZ, Child3 XYZ, Child1 XYZ
    - other policies issued to Dad XYZ and Mom XYZ
        - Renewed for
            - XYZ- Limit $; Premium $
            - Mom XYZ- Limit $; Premium $
            - Child1 XYZ- Limit ; Premium $
              Child3 XYZ- Limit $; Premium $
            - Child2 XYZ- Limit $; Premium $
              Child6 XYZ- Limit $; Premium $
            - Child5- Limit $; Premium $
            - Child4- Limit $; Premium $

- Property Insurance
    - 1/1/02 – 12/31/02
    - Limit of Liability- $
    - Premium $
    - issued to Child2 and Othdau1 XYZ, Child6 and Othdau2 XYZ
        - Renewed for for each
        - Premium $

- Commercial General Liability Coverage
    - 1/1/02 – 12/31/02
    - Limit of Liability $
    - Premium $
    - issued to ABC CORP, Inc.
        - 1/1/2003 – 12/31/2003
        - Limit of Liability $
        - Premium $
        - Issued to ABC CORP, Inc.
        - Limit of Liability $
        - Premium $ & $
        - Issued to XYZ, Inc. and Sole proprietor Plumbing

- Businessowners Coverage
    - 1/1/02 – 12/31/02
      Property- $

- Property in Transit- $
- Tools and Equipment- $
- Non-owned Tools and Equipment- $
- Total premium $
- Issued to XYZ, Inc.
  - Renewed for
  - Premium $
- another policy issued to XYZ Contractors, $ premiums
  - Renewed for
  - Premium $

- Directors & Officers policy issued to ABC CORP, Inc., $
  - Premiums $
    - Renewed in
    - Premiums $

- Employment-Related Practices Liability Insurance
  - January 1, 2003 – December 31, 2003
  - Issued to XYZ, Inc.
  - Limits: $ each one insured event; total policy limit
  - Premium $

At the end of & , the maximum exposure of these policies was $ & $ respectively

Since the reorganization and stock purchase described above, ORG had no longer been involved in reinsurance agreements but had issued insurance directly. In , ORG entered into two reinsurance agreements with GCorp Insurance Company Limited. A breakdown of each agreement follows:

- GCorp Insurance Company
  - 1/1/2003 – 12/31/2003
  - GCorp issued policies to Name1 Business League
  - Company related to Org has purchased or intends to purchase such insurance from Name1
  - GCorp will reinsure with Org
  - based on percentage of company's premium to total premiums
  - UBL Tax Audit Expense and UBL D&O Liability
  - Policy limits- three times premiums
  - ceding fee % plus % premium tax

- GCorp Insurance Company
  - 1/1/2003 – 12/31/2003
  - Company related to Org has purchased or intends to purchase such insurance from Name1
  - GCorp will reinsure with Org
  - UBL Special-Punitive Damages
  - Policies/Premiums
    - ORG2003-05 $
    - ORG2003-06 $
  - ceding fee %; premium tax %

Policies that were issued under these two reinsurance agreements included the following:

- XYZ, Inc.
  - QS: Special – Punitive Damages
  - ORG2003-05
  - Coverage 1,000,000
  - Premium- $
- ABC CORP, Inc.
  - QS: Special – Punitive Damages
  - ORG2003-06
  - Coverage 1,000,000
  - Premium- $
- XYZ, Inc.
  - UBL Tax Audit
  - UBL Pool
  - Coverage- $
  - Premium- $
- XYZ, Inc.
  - UBL D&O
  - UBL Pool

    Coverage- $

    Premium $

Maximum exposure of these four policies was $, bringing the total maximum exposure for to $.

During there were two notes receivable created. A breakdown of each note follows:

- Borrower 1- FSS Non-Revocable Children's Trust
  - August 20, 2002
  - $
  - % interest
  - $ interest due 2/20/03 (semi-annual)
  - principal and interest due 2/20/04

- Borrower 2 Franchises
  - purchased receivables from Borrower 2 Franchises face value $
  - installments are for 5 years
  - Purchase price $
  - non-interest bearing note
  - collected $; cost balance $ 6

Other notes outstanding at the end of included the following:

- Otherdau3 XYZ
  - Amount $
  - no interest rate or number of months listed

- Borrower 3
  Amount $
  - interest rate %
  - 11 months

- Borrower 4
  - Amount $
  - interest rate %
  - 8 months

- Borrower 5
  - Amount $
  - interest rate %
  - 5 months

A breakdown of the notes receivable reported by ORG for & 3 follows:

NAME	ISSUED	12/31/02 BAL.	INT. RATE	PYMNTS	LOANS	PYMNTS	12/31/03 BAL.

Otherdau3 XYZ			%				
Borrower 1			%				
Borrower 2		3	%				
Borrower 3			%				
Borrower 4			%				
Borrower 5			%				0
XYZ Ent.							
Borrower 6							
TOTALS				0	2		

As can be seen by the chart above, no interest payments had been made and only one payment by Borrower 2 on principal had been made.

ORG reported the following income on its Forms 990 for the taxable year & :

FORM 990 INFORMATION		
Premiums		
Total Investment Income		
Gain on Sales of Property	0	0
Other Income- Disregarded		
Total Revenue		

A breakdown of the premium income to total revenue, including the number of policies issued is below:

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REVENUE		
Premiums		
Total Revenue		
Percentage- Total Premiums to Total Revenue	%	%
Number of Policies Issued/Reinsured	14	21

ORG held investments worth approximately $ million in and $ million in , to cover anticipated insurance claims. A majority of these assets were held in the investment of XYZ Related ORG, LLC; a disregarded entity. In , $ and in , $ was held. A majority of the income received by ORG came from this investment. Other assets included the notes outstanding and a small amount of marketable securities.

In , the XYZ Family contacted A Professional Corporation, to review their current Organizational structure and assist in providing recommendations in regards to asset protection and tax issues. After reviewing the current Organizational structure and tax matters, it became apparent that a restructuring of the Organizational structure was required.

With assistance from the XYZ Family, the following restructuring plan was designed to retro-actively comply with all tax laws and to provide maximum asset protection:

- Retro-actively rescind the transfer of XYZ Related ORG, LLC to Org5 and subsequently to ORG
- Prepare and file Partnership tax returns (Federal 1065 for XYZ Related ORG, LCC for
- Prepare and file amended Forms 990 returns for ORG. Prepare without XYZ Related ORG, LLC assets and income, for
- Prepare and file amended returns for the XYZ Family taking into account K-1 income from XYZ Related ORG, LLC
- Wrap-up insurance activities of Org by November 2005
- Prepare and file the Form 990 for Org
- Dissolve Org as of
- Dissolve Org5, LLC by

After the restructuring plan, the ownership structure will be as follows:

- XYZ Family Members – together owns % of XYZ Related ORG,
- XYZ Related ORG, LLC – Owns real estate

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Upon further review of the restructuring plan by the Organization's attorneys, it was determined to not amend Forms 990 and proceed with dissolving the Organization by . Reasons for dissolving the Organization included:

- Consolidation of all enterprises into central location
- No longer wish to be involved in offshore enterprises
- Decision to terminate professional relationship with Attorney and Accountant who set up and managed ORG.

All assets (after any taxes) will be distributed to ORG's sole shareholder, Org5, LLC.

All assets (after any taxes) will be distributed by Org5, LLC to each member based upon membership interests.

ORG had no employees, no sales or clericalstaff. No effort had been made by anyone to solicit new business. There was no intent to sell policies to any unrelated companies.

LAW & ANALYSIS

1. Is ORG providing insurance to its policyholders?

The first issue is whether ORG is providing insurance. Determining whether this qualifies as insurance will assist in determining whether ORG can qualify for exemption pursuant to IRC § 501(c)(15).

Neither the Internal Revenue Code nor the Regulations specifically define the term "insurance contract." The courts have generally required that a transaction involve both risk shifting (from the insured's perspective) and risk distribution (from the insurer's perspective) in order to be characterized as insurance. Helvering v. LeGierse, 312 U.S. 531, 539 (1941); Gulf Oil Corp. v. Commissioner, 914 F.2d 396, 411 (3rd Cir. 1990).

Risk shifting occurs when a person facing the possibility of a loss transfers some or all of the financial consequences of the loss to the insurer. Rev. Rul. 88-72, 1988-2 C.B. 31, clarified by Rev. Rul. 89-61, 1989-1 C.B. 75. The risk transferred pursuant to an insurance contract must be a risk of economic loss. Allied Fidelity Corp. v. Commissioner, 66 T.C. 1068 (1976), aff'd., 572 F.2d 1190 (7th Cir. 1978), cert. denied, 439 U.S. 835 (1978).

Risk shifting issues frequently arise in the case of captives. In Clougherty Packing Co. v. Commissioner, 811 F.2d 1297 (9th Cir. 1987), the court defined a "captive" in footnote 1 on page 1298 as,

> a corporation Organized for the purpose of insuring the liabilities of its owner. At one extreme is the case presented here, where the insured is both the sole shareholder and only customer of the captive. There may be other permutations involving less than 100% ownership or more than a single customer, although at some point the term "captive" is no longer appropriate.

Risk distribution refers to the operation of the statistical phenomenon known as the "the law of large numbers." When additional statistically independent risk exposure units are insured, although the potential total losses increase, there is also an increase in the predictability of average loss. This increase in the predictability of the average loss decreases the amount of the capital that an insurance company needs per risk unit to remain at a given solvency level. See Rev. Rul. 89-61, 1989-1 C.B. 75.

The Courts have not spent a great deal of time explaining what they mean by risk distribution. No court has squarely held that there can be no risk distribution if there is only one, or a few, insureds. A fair reading of the court opinions addressing the issue, however, supports the IRS's position. See Barnes v. United States, 801 F.2d 984, 985 (7th Cir. 1986) ("Risk distributing is the spreading of the risk of loss among the participants in an insurance program."). See also, Commissioner v. Treganowan, 183 F.2d 288 , 291 (2nd Cir. 1950). Such spreading is effectuated by pooling among unrelated insureds. " [R]isk distribution means that the party assuming the risk distributes his potential liability, in part, among others." Beech Aircraft Corp. v. United States, 797 F.2d 920, 922 (10th Cir. 1986). Risk distribution is accomplished where the risk is distributed among insureds other than the entity that incurred the loss. See Ross v. Odem, 401 F.2d 464 (5th Cir. 1968).

The Sixth Circuit touched on the issue of risk distribution in Humana, Inc. v. Commissioner, 881 F.2d 247, 257 (6th Cir. 1989), noting that there was adequate risk distribution, "where the captive insures several separate corporations within an affiliated group and losses can be spread among the several distinct corporate entities." The Ninth Circuit has also measured risk distribution by explaining, "[i]nsuring many independent risks in return for numerous premiums serves to distribute risk. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smoothes out losses to match more closely its receipt of premiums." Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987)

In Revenue Ruling 2002-90, 2002-2 CB 985, the question was raised on whether a subsidiary's arrangement to provide liability insurance coverage to 12 of its parent company's subsidiaries constituted insurance contracts for federal tax purposes and thus, the amounts paid as premiums by each subsidiary were deductible as business expenses. Under the arrangement, the subsidiaries were charged arm's length premiums, according to customary industry ratings, and none had liability coverage of less than 5 percent or more than 15 percent, of the total risk insured by the subsidiary.

As a result, the professional liability risks of the 12 subsidiaries were shifted to the insurer subsidiary as required to constitute an insurance contract for federal tax purposes. The common ownership of the subsidiaries, including the insurer, by the parent, did not affect the determination that the arrangements constituted insurance contracts.

In comparing this Organization with the revenue ruling there are some similarities and differences. The similarities include not insuring any parent or subsidiary, constituting self-insurance. In the revenue ruling they were providing coverage for 12 of its parent's subsidiaries. Here they have issued 14 policies to individuals and companies of the XYZ Family in . The 14 policies were renewed for and three additional policies were issued.

The main difference is the type of policies issued. In the revenue ruling, all 12 policies were for liability insurance. In , ORG issued 5 different types of insurance; personal disability coverage (8 policies); corporate general liability coverage (1 policy); corporate business owners coverage (2 policies); personal property coverage (2 policies); and corporate directors and officers coverage (1 policy). In ORG renewed those policies and issued two commercial general liability policies and one employment related practices liability policy, for a total of 17 policies issued

It has been determined by the revenue ruling that liability insurance provided to 12 of the parent's subsidiaries constitutes insurance. In this revenue ruling, all the insurance issued was the same kind. The question is whether issuing different types of policies, with the largest group having only 8 policies issued, constitutes insurance. It is the Service belief that it does not constitute insurance because there is not adequate risk distribution.

As stated before, the courts have generally required that a transaction involve both risk shifting (from the insured's perspective) and risk distribution (from the insurer's perspective) in order to be characterized as insurance. In the present case, there is no risk distribution.

As stated in Revenue Ruling 89-61, 1989-1 C.B. 75, risk distribution refers to the operation of the statistical phenomenon known as the "the law of large numbers." When additional statistically independent risk exposure units are insured, although the potential total losses increase, there is also an increase in the predictability of average loss. This increase in the predictability of the average loss decreases the amount of the capital that an insurance company needs per risk unit to remain at a given solvency level.

In the present case, there is only one or a few policies issued for each type of insurance. As stated above, in ORG issued 5 different types of insurance; personal disability coverage (8 policies); corporate general liability coverage (1 policy); corporate business owners coverage (2 policies); personal property coverage (2 policies); and corporate directors and officers coverage (1 policy). There is no statistical phenomenon known as the "the law of large numbers." among each different type of insurance. There is no risk distribution of any of the five policies to help cover any claims that could be filed. The risks are not distributed among other insureds or policyholders. Adding the three additional policies in does not change the outcome.

If we consider each individual type of policy separate, because they are not homogeneous, it is the Service's position that there is not adequate risk distribution. There appears to be adequate risk shifting but without adequate risk distribution, the policies do not qualify as insurance.

As stated above, in ORG entered into two reinsurance agreements with GCorp Insurance Company. In response to Question #8 of IDR #3, ORG provided a worksheet showing all of the policies issued and enforced in . For the reinsurance agreements, there were only 4 policies issued by GCorp that were reinsured by ORG. Again, with only 4 policies insured, there is risk shifting but not adequate risk distribution.

2. Is ORG an insurance company exempt from Federal tax as an Organization described under Internal Revenue Code (IRC) section 501(c)(15) for taxable years & ?

The second issue is whether ORG is an insurance company exempt from tax pursuant to I.R.C. section 501(c)(15) for the taxable years & . I.R.C. section 501 provides that certain entities are exempt from taxation. Included in these entities are "[i]nsurance 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 $." I.R.C. section 501(c)(15)(A)[1].

a. Definition of an Insurance Company.

Neither I.R.C. 501(c)(15) nor its corresponding regulations define an "insurance company." Subchapter L of the Code (I.R.C. sections 801-848), however, addresses the taxation of insurance companies. The term "insurance company" has the same meaning under section 501(c)(15) as it does in Subchapter L. See H. Conf. Rep. No. 99-841, 99th Cong., 2nd Sess. (Vol. II) 370-71, reprinted in 1986-3 (Vol. 4) C.B. 370-71.

I.R.C. section 816 (formally I.R.C. section 801) defines a life insurance company. As part of this definition, I.R.C. section 816 provides, "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."

Treas. Reg. section 1.801-3(a)(1) defines an insurance company as,

> A company whose primary and predominant business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Thus, though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a company is authorized and intends to carry on, it is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Internal Revenue Code.

* * * *

[1] If an entity is part of a consolidated group, all net written premiums (or direct written premiums) of the members of the group are aggregated to determine whether the insurance company meets the requirements of I.R.C. section 501(c)(15)(A). I.R.C. 501(c)(15)(B). In this case, there are no other premiums to aggregate with the premiums ORG received during pursuant to I.R.C. 501(c)(15)(B).

Treas. Reg. section 1.801-3(a)(1)(emphasis added). See also Bowers v. Lawyers Mortgage Co., 285 U.S. 182 (1932).

Prior to , the Internal Revenue Service had not ruled on whether the more stringent "greater than half" test set forth in I.R.C. 816 applies to an insurance company other than a life insurance company. Instead, to determine whether a non-life insurance company qualifies as an insurance company for tax purposes, the "primary and predominant business activity" test set forth in Treas. Reg. 1.801-3(a)(1) applies. See Rev. Rul. 68-27, 1968-1 C.B. 315.

The courts and the IRS have also, at times, looked to whether the transaction has characteristics traditionally associated with insurance, and whether the company conducts business like an insurance company. In order for ORG to be considered an "insurance company" entitled to tax exempt status under I.R.C. 501(c)(15) for the taxable years & its primary and predominant business activity during that year must have been issuing insurance contracts or reinsuring insurance risks. See I.R.C. section 816; Treas. Reg. section 1.801-3(a)(1).

Several court cases have addressed the issue of whether a company qualifies as an insurance company based on the company's primary and predominant business activity. The seminal case addressing this issue is Bowers v. Layers Mortgage Co., 285 U.S. 182 (1932). In Bowers, the Supreme Court determined that the taxpayer was primarily engaged in "the lending of money on real-estate security, the sale of bonds and mortgages given by borrowers and use of the money received from purchasers to make additional loans similarly secured." Bowers, 285 U.S. at 188-89. Although the taxpayer in Bowers earned "premiums" that amounted to approximately one-third of its income for the taxable years at issue, these premiums were attributable to the excess of the interest paid to the taxpayer by borrowers over the amount the taxpayer paid the purchasers to whom it subsequently sold bonds and mortgages. Id. at 188 n.5. The premiums also included fees the taxpayer charged for guaranteeing mortgage loans which it did not make or sell. Id. at 186. The Court noted that the "premiums" the taxpayer earned included agency and other services provided by the taxpayer which were not generally provided under traditional insurance contracts. Id. at 189.

Because the taxpayer's premium income was incidental to its business of lending money, the Bowers Court held that the taxpayer was not an insurance company for tax purposes. Id. at 190. the Court explained, "[t]he lending fees, extension fees and accrued interest appertain to the business of lending money rather than to insurance, and may not reasonably be attributed to the subordinate element of guaranty in [taxpayer's] mortgage loan business." Id. at 189. Cf. United States v. Home Title Insurance Co., 285 U.S. 191 (1932) (holding that the taxpayer was insurance company where taxpayer derived over 75% of its income from the insurance of titles and guarantees of mortgages.

In Inter-American Life Ins. Co. v. Commissioner, 56 T.C. 497 (1971), aff'd per curiam, 469 F.2nd 697 (9th Cir. 1972), the taxpayer issued and reinsured 17, 280, 325 and 424 insurance policies earning premiums of $, $, $, and $ during the taxable years , , and respectively. Inter-AmChild6an, 56 T.C. at 507. Virtually all of the reinsurance contracts issued by the taxpayer came from another insurance company which was owned by the same two shareholders as the taxpayer. Id. Similarly, almost all of the directly written insurance policies issued by the taxpayer were issued to the same two shareholders of the taxpayer. Id. The taxpayer also engaged in the sale of real estate and stock, earned investment income totaling $, $, $, and $ over the four years at issue. Id.

In Inter-American, the Tax Court compared the taxpayer's income from other activities, and held that the taxpayer was not an insurance company. According to the Tax Court, the insurance premiums the taxpayer earned were de minimis, comprising less than 15% of the taxpayer's gross investment income. Id. In addition, the taxpayer had no sales force in place to sell insurance contracts. Id. The Tax Court concluded that, because the taxpayer's primary and predominant source of income was from its investments, and because the taxpayer did not focus its primary and predominant efforts in pursuit of its insurance business, it was not an insurance company. Id. at 508.

The Tax Court also acknowledged that it was cognizant of the "problems indigenous to new life insurance companies, in particular, that the initial years of a new life insurance company's operations are generally difficult because the initial expenses incurred in 'putting policies on the book' are greater than the premium received" Id. (citing S. Rept. No. 291, 86th Cong., 1st Sess. (1959), 1959-2 C.B. 779). The Court explained, however, that it was basing its decision on the fact that the taxpayer did not focus its "capital and efforts primarily" on its insurance business, not on the fact that the taxpayer's insurance business was not profitable. Id. (citing Cardinal Life Ins. Co. v. United States, 300 F. supp. 387 (N.D. Tex. 1969)

In Cardinal Life Ins. Co. v. United States, 300 F. Supp. 387 (N.D. Tex. 1969), rev'd on other grounds, 425 F.2d 1328 (5th Cir. 1970), the taxpayer earned no income from insurance in two of the five years under examination, and earned .66%, .87% and 9.11% of its total income from insurance during the remaining three taxable years at issue. Cardinal Life, 300 F. supp. at 389. Instead, the taxpayer earned a majority of its income from dividends, interest, rent and capital gains. Id. Like Inter-AmChild6an, the taxpayer in Cardinal Life failed to employ any brokers, solicitors, agents or salesmen. Id. It did, however pay an actuary on a fee basis to determine the amount of its premiums. Id. The Court noted that the taxpayer's income from insurance policies was "insignificant" compared to the total income earned by the taxpayer, explaining,

> While Plaintiff's insurance activities were insignificant, it was generating substantial income from dividends on stocks, rental income on real estate, rental income on trailers, interest income and capital gains upon disposal of real estate and stocks.

> These types of income constitute… personal holding company income which Congress has specifically stated is subject to a tax in addition to ordinary income tax. The Plaintiff is seeking to remove itself from the grasp of the personal holding company provisions by claiming life insurance company status through the issuance of a small and insignificant amount of insurance contracts.

Id. at 382.

In Industrial Life Ins. Co. v. United States, 344 F. Supp. 870 (D.S.C. 1972), aff'd per curiam, 481 F.2d 609 (4th Cir. 1973), the Fourth Circuit rejected the taxpayer's claim that it was an insurance company where the taxpayer earned 20% of its income from selling credit life insurance and issuing life insurance policies to its officers, and the balance of its income from its investment portfolio and the sale and leasing of real estate. The court explained,

> It is obvious from the financial information … that the premium income from these years was small when compared with the income from real estate, mortgages and investment.
>
> It is also important to note that more than half of the premium income came from policies on the lives of the only officers and stockholders of the company.

Id. at 876. The Court likened the facts of Industrial Life to those of Cardinal Life. Id.

By contrast, in Service Life Ins. Co. v. United States, 189 F. supp. 282 (D. Neb. 1960), aff'd on other grounds, 293 F.2d 78 (8th Cir. 1961), the Court held that the taxpayer was an insurance company where it had "over $22,000,000 worth of life insurance on its books; over 70,000 individual policies in force; and approximately $1,675,000 in premium income" over a four year period. Id. at 286. The Service Life Court acknowledged that whether a company is considered an insurance company turns on the character of the business conducted by the company, not any percentage of income. Id. at 285-86. The Court did however; compare the taxpayer's premium income to its investment income to determine the business activity of the taxpayer. Id. at 286. Although the taxpayer also generated income from mortgage loans and investments, over half of the taxpayer's income was from its insurance premiums, and over half of its income producing assets was held for insurance policy reserves. Id.

i. ORG Earned a Substantial Amount of its Income During & from a Disregarded Entity

ORG should not be classified as an insurance company for tax purposes because its primary and predominant activity during the taxable year & was not its insurance activity.

This is evidenced by the sources of ORG's income during the years at issue. ORG reported the following income on its Forms 990 for the taxable year & :

FORM 990 INFORMATION		
Premiums		
Total Investment Income		
Gain on Sales of Property	0	0
Other Income- Disregarded		
Total Revenue		

The majority of ORG's income during & was attributable to its income from a disregarded entity. As can be seen below, only a very small portion of the income was attributable to ORG's insurance activity.

REVENUE		
Premiums		
Total Revenue		
Percentage- Total Premiums to Total Revenue	%	%
Number of Policies Issued/Reinsured	14	21

ii. <u>ORG Failed to Use its Capital and Efforts Primarily to Earn Income from its Insurance Activity.</u>

In addition to focusing on the sources of a company's income to determine if the company qualifies as an insurance company for tax purposes, courts have also considered the <u>manner</u> in which the company conducts its business activities. A taxpayer "must use its capital and efforts primarily in earning income from the issuance of contracts of insurance." Cardinal Life, 300 F. Supp. at 391.

During # & , ORG purported to operate as an insurance company, insuring contracts listed above. Based on the following, however, ORG has failed to demonstrate that it concentrated its capital and efforts primarily on its insurance business: 1) ORG was extremely overcapitalized; 2) ORG devoted little, if any, time to developing and marketing its insurance products; 3) ORG did not employ anyone to solicit insurance business, it had no employees; 4) ORG devoted little time to its insurance activities, and 5) ORG provided loans with little or no payments being made.

First, relying on Bowers, ORG asserts that it held passive investments to secure the risks it undertook through its insurance activities. Some investment income is undoubtedly required to support a company's insurance activities. See Bowers, 285 U.S. at 189 (explaining, "premiums' are characteristic of the business of insurance, and the creation of 'investment income' is generally, if not necessarily, essential to it."). In fact, one would expect an insurance company to have investment income attributable to investing its premiums while awaiting claims submitted by its policyholders.

The first issue is how much investment income did ORG require to support the risk it assumed by entering into its insurance contracts. ORG held investments worth approximately $ million in and $ million in , to cover anticipated insurance claims. A majority of these assets were held in the investment of XYZ Related ORG, LLC; a disregarded entity. In , $ and in , $ was held. A majority of the income received by ORG came from this investment. Other assets included the notes outstanding and a small amount of marketable securities.

As stated above, the maximum exposure for & 3 was $ & $ 000 respectively. The imbalance of assets to ORG's risk shows that ORG's primary and predominant business activity during & was not its insurance activity. The maximum amount ORG would have been liable for dwarfs in comparison to the amount of assets maintained. Therefore, ORG was extremely over-capitalized.

Second, ORG devoted little time to developing and marketing its insurance products. There were a total of 14 policies issued in 5 different categories in . Once these policies were issued, no policies were developed or marketed. The policies were issued only to members of the XYZ Family or corporations owned by family members. All of the policies were renewed in Only three new policies were issued in , and all those were issued to either family members or corporations owned by family members. No policies were promoted to unrelated parties. There was no intent to sell policies to any other parties, therefore there was no need to develop and market its insurance services.

ORG did enter into two reinsurance agreements during the year. However, only 4 policies issued by GCorp were issued to two companies owned by XYZ family members. These 4 policies were the only ones reinsured through the reinsurance agreement with GCorp. No other policies were reinsured and no other reinsurance agreements were signed in .

Third, ORG did not employ anyone to solicit its insurance business. In both Cardinal Life and Inter-American Life, where the courts determined that the primary and predominant business of each company was not insurance, neither company employed a sales force. In Cardinal Life, although the taxpayer sold some reinsurance contracts during the years at issue, the District Court noted,

> Plaintiff did not have an active sales force soliciting or selling insurance policies. Each of the insurance policies actually written by Plaintiff was as the result of reinsurance agreements wherein other companies ceded to Plaintiff certain amounts of insurance written by them. These reinsurance contracts were negotiated either by the president and sole stockholder of Plaintiff and/or the company's actuary who rendered services to Plaintiff on a fee basis. Plaintiff otherwise did not have any employees, brokers, agents or salesmen soliciting and selling insurance for it, and the only insurance written by Plaintiff was through insurance agreements.

Cardinal Life, 300 F. supp. at 392. Similarly, in Inter-American Life, the Court considered the fact that the taxpayer did not "maintain an active sales staff soliciting or selling insurance policies" during the taxable years at issue as evidence of the taxpayer's "lack of concentrated effort" on the insurance business. Inter-American Life, 56 T.C. 497, 507 (1971).

ORG had no employees, no sales or clerical staff. No effort had been made by anyone to solicit new business. There was no intent to sell policies to any unrelated companies; therefore there was no need to have a sales force, brokers, agents, and clerical staff.

Fourth, ORG spent an insignificant amount of time on its current insurance business. ORG issued the 14 policies in and renewed them for . In , 3 additional policies were issued. All were issued to XYZ family members or corporations owned by XYZ family members. Only 4 policies were issued through the reinsurance agreements. There were no claims filed during this time. Once the policies were issued there was very little time spent on the insurance business. The only activity was the receiving of checks and making deposits. As stated above, there was no promoting or selling of the insurance services and there were no employees or sales staff. The amount of time spent on its current insurance business was insignificant.

Fifth, ORG provided various loans during the audited years. A breakdown of the notes receivable reported by ORG for & follows:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer Org, Num		Year/Period Ended Date2

NAME	ISSUED	12/31/02 BAL.	INT. RATE	PYMNTS	LOANS	PYMNTS	12/31/03 BAL.
Otherqtau3 XYZ			%				
Borrower 1			%				
Borrower 2			0%				
Borrower 3			%				
Borrower 4			%				
Borrower 5			%				
XYZ Ent.							3
Borrower 6							
TOTALS				0			

As can be seen by the chart above, no interest payments had been made and only one payment by Borrower 2 on principal had been made. Each entity has received a benefit by not making payments of interest and/or principal over the audited years. This further shows that the Organization was not operating an insurance company as its primary and predominant activity.

3. Is ORG's primary and predominant activity that of insurance or investment activity?

ORG generated a substantial amount of its income each year from its investments. Although ORG generated some premium income from its insurance and reinsurance activities, the primary and predominant activity during & was its investments.
As shown in the charts above, ORG received some premium income from its insurance agreements. However, a majority of its income came in the form of interest and income from a disregarded entity. The charts above also show that the percentage of premium income to total revenue was insignificant each year. The primary and predominant activity conducted by ORG was its investment activity, not insurance activity.

Form 886A	Department of the Treasury - Internal Revenue Service **Explanation of Items**	Schedule No. or Exhibit
Name of Taxpayer Org, Num		Year/Period Ended Date2

4. Can ORG rely on the determination letter granted by the Service allowing it to claim tax exempt status pursuant to IRC § 501(c)(15)?

Under section 501(a) of the Code, Organizations described in subsection 501(c) are exempt from federal income tax, unless such exemption is denied under section 502 or 503.

For taxable years prior to , I.R.C. § 501 provides that certain entities are exempt from taxation. Included in these entities are "[i]nsurance 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 $." [I.R.C. § 501(c)(15)(A)].

Section 501(c)(15)(B) of the Code provided that when an entity was part of a controlled group, all net written premiums (or direct written premiums) or net written premiums of the members of the group were aggregated to determine whether the insurance company met the requirements under section 501(c)(15)(A).

Neither section 501(c)(15) of the Code, nor the regulations under that section define an "insurance company". Accordingly, the term "insurance company" has the same meaning under section 501(c)(15) as it does in Subchapter L. See H. Conf. Rep. No. 99-841, 99th Cong., 2nd Sess. (Vol II) 370-71, reprinted in 1986-3 (Vol.4) C.B. 370-71.

Based on the facts presented above and the application of the law to those facts, it was determined that ORG was not an insurance company, therefore, ORG did not qualify for recognition of exemption from federal income tax under section 501(a) of the Code as an Organization described in section 501(c)(15) during 2002 and 2003. Not only was there no risk distribution of the policies issued, the majority of the Organization's activities was its investments. Therefore, ORG cannot rely on its determination letter granted by the Service allowing it to claim tax exempt status pursuant to IRC 501(c)(15).

5. Is ORG entitled to relief pursuant to IRC § 7805(b)?

An Organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Regulations 1.501(a)-1(a)(2); Rev. Proc. 2004-4, 14.01 (cross-referencing 13.01 et seq.) 2004-1 C.B. 514. An Organization may not rely on a favorable determination letter, however, if the Organization omitted or misstated a material fact, in its application or in supporting documents. In addition, an Organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the Organization's character, purposes, or methods of operation after the determination letter is issued. Regulations 601.201(n)(3)(ii); Rev. Proc. 90-27, 13.02, 1990-1 C.B. 514. Any such changes must be reported to the Service so that continuing recognition of exempt status can be evaluated.

The Commissioner may revoke a favorable determination letter for good cause. Regulations 1.501(a)-1(a)(2). A favorable determination letter may be revoked by written notice to the Organization to whom the determination originally was issued. Regulations 601.201(m) (cross-referencing Reg. 601.201(l)); Rev. Proc. 90-27, 14, 1990-1 C.B. 514, 518.

If the Commissioner revokes the tax exempt status of an Organization, the remaining question is whether the revocation should be applied prospectively or retroactively. Generally, revocation of a determination letter is prospective. Rev. Proc. 2004-4, 14.01 (cross-referencing 13.01 et seq.). Revocation of a determination letter may, however, be retroactive if the Organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Regulations 601.201(n)(6)(i); Rev. Proc. 90-27, 14.01; Rev. Proc. 2004-4 14.01 (cross-referencing 13.01 et seq.).

In cases where the Organization omitted or misstated a material fact, revocation may be retroactive to all open years under the statute. Regulations 601.201(l)(1). In cases where revocation is due to a material change, inconsistent with exempt status, in the character, the purpose, or the method of operation, revocation will ordinarily take effect as of the date of the material change. Regulations 601.201(n)(6)(i); Rev. Proc. 90-27. In any event, revocation will ordinarily take effect no later than the time at which the Organization received written notice that its exemption ruling or determination letter might be revoked. Regulations 601.201(n)(6)(i).

Under certain circumstances, however, the Commissioner may, in his discretion grant relief from retroactive revocation under I.R.C. 7805(b) of the Code. Section 7805(b)(8) of the Internal Revenue Code provides:

> APPLICATION TO RULINGS. The Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws, shall be applied without retroactive effect. Section 301.7805-1(b) of the regulations delegates authority grated by I.R.C. 7805(b) to the Commissioner (or the Commissioner's delegate).

To request I.R.C. 7805(b) relief, the Organization must submit a statement in support of this application of I.R.C. 7805(b), as described in Rev. Proc. 2004-4, 14.02. <u>See also</u> Rev. Proc. 2004-5, 19. The Organization's statement must expressly assert that the request is being made pursuant to I.R.C. 7805(b). The Organization's statement must also indicate the relief requested and give reasons and arguments in support of the relief requested. It must also be accompanied by any documents bearing on the request. The Organization's explanation and arguments should discuss the five factors bearing on retroactivity listed in Rev. Proc. 2004-4, 14.02(1) (cross-referencing 13.05), as they relate to the situation at issue. These five items are, in effect, the same as the factors provided in Regulations 601.201(l)(5) and 601.201(m), Statement of Procedural Rules, which states:

> Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such a ruling if:
>
> 1. there has been no misstatement or omission of material facts;
> 2. the facts at the time of the transaction are not materially different from the facts on which the [determination letter] was based;
> 3. there has been no change in applicable law;
> 4. the [determination letter] was originally issued for a proposed transaction; and
> 5. the taxpayer directly involved in the [determination letter] acted in good faith in reliance upon the [determination letter] and revoking or modifying the [determination letter] retroactively would be to the taxpayer's determinant.

If relief is granted under I.R.C. 7805(b), the effective date of revocation of a determination letter is no later than the date on which the Organization first received written notice that its exemption might be revoked. Regulations 601.201(n)(6)(i); Virginia Education Fund v. Commissioner, 85 T.C. 743, 7522-3 (1985), aff'd 799 F.2d 903 (4th Cir. 1986). This does not preclude the effective date of revocation being earlier than the date on which the Organization first received written notice that its exemption might be revoked. Virginia Education Fund v. Commissioner, 85 T.C. at 753.

The Supreme Court has held that the Commissioner has broad discretion under I.R.C. 7805(b) (and its predecessor) in deciding whether to revoke a ruling retroactively. Automobile Club of Michigan v. Commissioner, 353 U.S. 180, 184 (1957). See also Dixon v. United States, 381 U.S. 68, 74-75 (1965). The Commissioner's determination is reviewable by the courts only for abuse of that discretion. Virginia Education Fund v. Commissioner, 85 T.C. 743, 752 (1985).

In this case, the facts presented in its original application form are materially different to how ORG is operating today. The original application form indicated that ORG entered into a reinsurance contract with GCorp Insurance Corporation Limited., where ORG assumed credit disability insurance and credit involuntary unemployment insurance produced by HCorp Insurance Company

During & , ORG issued policies directly to members of the XYZ Family or corporations owned by family member. During , ORG did enter into two reinsurance agreements but only 4 policies sold by GCorp were reinsured by ORG.

Other changes that have been made since the application form was filed include the reorganization and sale of the Organization. ORG was originally formed by Founder. Since receiving exemption from the Service, a Reorganization Plan and Agreement was executed with Org2. On December 11, 2001, a Stock Purchase Agreement between Founder as shareholder and Org5, LLC was executed. Org5, LLC is owned % by the XYZ Family.

The activities being conducted today are not the same as were indicated in the original application form. ORG had stopped providing reinsurance business and started issuing direct policies. Not until did ORG sign reinsurance agreements but then only 4 policies through these reinsurance agreements were actually reinsured by ORG. ORG also sold its assets and reorganized since its exemption was granted. There is no indication that the ORG ever informed the Service of these changes.

Based on the information provided in its original application form and attachments, and the information gathered on the Organization's operations today, there have been material changes to the operations of the Organization. Therefore, it is appropriate for the Commissioner to deny relief from retroactive revocation of ORG's determination letter.

6. If ORG cannot rely on its determination letter, what is the effective date of revocation?

ORG is not entitled to relief under I.R.C. 7805(b). The effective date of revocation should be January 1, 2002. This is the first year under examination.

LEGEND -

Org – Name of Organization
Num – EIN Number
Date1 – Effective Date
Date2 – Year End after Effective Date

Taxpayer Identification Number: Num

Form: 990

Org

Tax Year(s) Ended: December 31, 20xx
Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

This is our final adverse determination letter as to your exempt status under I.R.C. § 501(c)(15) of the Internal Revenue Code. Our adverse determination was made because, for the year(s) of the examination, you were not operated as an "insurance company" within the meaning of I.R.C. § 501(c)(15) of the Internal Revenue Code. Your exempt status is revoked effective Date1.

We have enclosed a copy of our report of examination further 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. You agreed with examination report per your signature on Form 6018, dated April 12, 2006.

In our letter to you dated August 28, 2005, we advised of appeals procedures and asked you to respond within 30 days in the event you wanted to take advantage of those procedures. You did not respond to that 30-day letter.

Because this case involves exemption under I.R.C. § 501(c)(15), you cannot contest the adverse determination in a declaratory judgment action under I.R.C. § 7428. You can, however, contest the revocation of exempt status in the context of any related deficiency case involving adjustments that flow from the loss of exemption. Thus, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, from any deficiency notice issued in this case or a related case after satisfying procedural and jurisdictional requirements as described in Publications 3498 and 892.

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 the Ogden Service Center 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 prefer, you may contact your local Taxpayer Advocate at:

, International Taxpayer Advocate

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,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination