



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

March 27, 2007

Number: **200809034**

Release Date: 2/29/2008

Legend

ORG = Organization name

Address = address

XX = Date

UIL: 501.15-00

ORG

Address

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

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 January 1, 20XX.

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. They explain appeal rights and the procedure for obtaining technical advice.

Both technical advice and appeals procedures require a minimum of 180 days remaining on the statute of limitations. In order to take advantage of appeal rights or technical advice procedures, a taxpayer might be asked to execute a consent to extend the statute of limitations to permit Appeals consideration or submission of a request for

technical advice. That was the situation in this case. Internal Revenue agents discussed with you the possible referral of this matter for technical advice. You declined that option. Internal Revenue agents also requested statute extensions. You elected not to extend the applicable statutes. As you are aware, the time remaining on the statutes does not allow for usual appeal procedures or submission of the case for technical advice.

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:

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



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE
678 Front Street, Suite 200
Grand Rapids, MI 49504-5335

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

December 16, 2005

Legend

ORG = Organization name Address = address XX = Date

ORG
Address

Taxpayer Identification Number:

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

Marsha A. Ramirez
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		Year/Period Ended 12/31/20XX

Legend

ORG = Organization name Address = address XX = Date XYZ = State City = city
 Founders = founders Country 1 = 1st country Country 2 = 2nd country
 Country 3 = 3rd country Country 4 = 4th country Employee = employee
 CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7, CO-8, CO-9, CO-10, CO-11, CO-12, CO-13,
 CO-14, CO-15, CO-16, CO-17, CO-18, CO-19, CO-20, CO-21, CO-22, CO-23, CO-24, CO-
 25, CO-26, CO-27, CO-28, CO-29, CO-30, CO-31, CO-32, CO-33 = 1ST THRU 33RD
 Companies IN-1, IN-2, IN-3, IN-4, IN-5, IN-6, IN-7, IN-8, IN-9, IN-10, IN-11,
 IN-12, IN-13, IN -14, IN-15, IN-16, IN-17, IN-18, IN-19, IN-20, IN-21, IN-22, IN-
 23, IN-24, IN-25, IN-26, IN-27, IN-28, IN-29, IN-30, IN-31, IN-32, IN-33, IN-34,
 IN-35, IN-36, IN-37, IN-38, IN-39 = 1ST THRU 39TH Individuals.

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 20XX?
3. Is ORG's 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 (ORG) was formed on September 1, 19XX in the Country 1, by Founders and Founders. 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 100,000 shares with par value of \$ each. Founders and Founders each own % of the stock of this organization.

On June 20, 20XX, 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 incorporated on September 1, 19XX 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 ORG were transacted with unrelated third parties, unrelated insurance companies. The initial insured's were consumers spread throughout the Country 4. Founders were

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

listed as the President and Director while Founders was listed as Secretary and Director. Total assets and liabilities reported for year ending December 31, 19XX were \$ and \$ respectively.

Submitted with the application form was a copy of a coinsurance contract that ORG entered into with CO-1 of the Country 1. The contract was effective from January 1, 19XX through December 31, 19XX. The contract was for credit disability and credit involuntary unemployment. A breakdown of the coinsurance follows:

- Credit Disability Insurance \$per month
- Credit Involuntary Unemployment \$per month
- Maximum Total Premium \$for duration of contract

Reinsurance Commissions consisted of the following:

- Credit Disability Insurance % of reinsurance premiums
- Credit Involuntary Unemployment % of reinsurance premiums

Also submitted with the application form was a coinsurance contract with CO-2. This contract was effective from January 1, 19XX through December 31, 19XX. This contract was also for Credit Disability Insurance and Credit Involuntary Unemployment Insurance. A breakdown of the coinsurance percentages follows:

- Credit Disability Insurance .
- Credit involuntary Unemployment .

Reinsurance Commissions consisted of the following:

- Credit Disability Insurance % of reinsurance premiums
- Credit Involuntary Unemployment % of reinsurance premiums

Based on the information provided in its application form, and the attachments submitted, ORG was issued a favorable determination letter granting tax exempt status under section 501(c)(15) of the Code, on January 10, 20XX.

According to the exemption letter, ORG did file its 953(d) election. Further research determined that the election was filed but was never approved. A request was made to ORG to submit an "Income/Assets Statement" but none was ever provided.

Form 990 for year ending December 31, 20XX was selected for an examination. In review of the books and records during the examination it was determined that the operations of ORG had changed since its application form was filed and exemption was granted. The organization was now issuing

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

insurance policies directly. There were no reinsurance agreements in 20XX. The types of insurance issued included residential property, interruption of business, and commercial general liability insurance.

The founder, Founders was born in what is now the Country 2. He immigrated to Country 3 and later to the Country 4. ORG is currently selling insurance in the Country 2 and Country 3, as well as insuring residential property in XYZ. A breakdown of the policies in effect during 20XX, 20XX & 20XX follows:

Policies

- Founders & Employee
 - Residential Property Earthquake Insurance Policy- Address, City, XYZ
 - 1/1/XX – 12/31/XX
 - Dwelling or Real Property- \$
 - Other Structure- \$
 - Personal Property- \$
 - Premium- \$
 - Renewed in 20XX & 20XX
 - Limits- Dwelling- \$; Other- \$; Personal- \$; Loss Use- \$
 - Premium \$
 - % insured by ORG and % insured by CO-14

- CO-3
 - Interruption of Business
 - 1/1/XX - 12/31/XX
 - \$ aggregate
 - \$ deductible
 - Premium- \$
 - Renewed in 20XX & 20XX
 - Limit \$
 - Premium- \$

- Founders
 - Residential Property Earthquake Insurance Policy- Address, City, XYZ
 - 1/1/XX - 12/31/XX
 - Dwelling or Real Property- \$
 - Other Structure- \$
 - Personal Property- \$
 - Premium- \$
 - Renewed in 20XX & 20XX
 - Limit- Dwellings- \$; Other- \$; Personal- \$
 - Premium- \$

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

- CO-4
 - 1/1/XX – 12/31/XX
 - Interruption of Business
 - \$ aggregate
 - \$ deductible
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$ & \$ respectively
 - Premium - \$

- CO-5
 - 1/1/XX – 12/31/XX
 - Interruption of Business
 - \$ aggregate
 - \$ deductible
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$
 - Premium- \$

- CO-6
 - 1/1/XX – 12/31/XX
 - Interruption of Business
 - \$ aggregate
 - \$ deductible
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$
 - Premium- \$

- CO-4
 - Commercial General Liability Coverage
 - 1/1/XX – 12/31/XX
 - Limit- \$
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$
 - Premium- \$ & \$ respectively

- CO-5

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

- Commercial General Liability Coverage
 - 1/1/XX – 12/31/XX
 - Limit- \$
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$
 - Premium- \$

- CO-6
 - Commercial General Liability Coverage
 - 1/1/XX – 12/31/XX
 - Limit- \$
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$
 - Premium- \$

- CO-3
 - Commercial General Liability Coverage
 - 1/1/XX – 12/31/XX
 - Limit- \$
 - Premium \$
 - Renewed in 20XX & 20XX
 - Limit- \$
 - Premium- \$

- Employee/CO-7
 - Contingency Liability
 - 1/1/20XX – 12/31/20XX
 - Limit- \$ (% of \$ life policy on Policy 1 issued by CO-9, Policy No.)
 - Premium- \$
 - Not renewed for 20XX

- Employee/CO-7
 - Contingency Liability
 - 1/1/20XX – 12/31/20XX
 - Limit- \$ (% of \$ life policy on Policy 2 issued by CO-10, Policy No.)
 - Premium- \$
 - Not renewed for 20XX

- Employee/CO-7

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

- Contingency Liability
- 1/1/20XX – 12/31/20XX
- Limit- \$ (% of \$ life policy on Policy 3 issued by CO-11, Policy No.)
- Premium- \$
 - Not renewed in 20XX

- CO-12
 - Contractual Liability
 - 1/1/20XX – 12/31/20XX
 - Limit- \$
 - Premium- \$
 - Reinsurance Premium- \$
 - Not renewed in 20XX

- Founder
 - CO-13 Tax Audit- CO-13 Pool 20XX
 - 1/1/20XX – 12/31/20XX
 - ORG CO-2- Reinsurance
 - CO-2 has issued policies of insurance to CO-13
 - Purchased insurance from CO-13
 - ORG desires to reinsure this insurance based on participants percentage of premiums
 - Limit- 3x premiums
 - Premium- \$
 - Reinsurance Premium- \$
 - Ceding fee, excise- \$
 - Renewed in 20XX- same

- Founder
 - CO-13 Litigation Policy- CO-13 Pool 20XX
 - 1/1/20XX – 12/31/20XX
 - ORG CO-2- Reinsurance
 - CO-2 has issued policies of insurance to CO-13
 - Purchased insurance from CO-13
 - ORG desires to reinsure this insurance based on participants percentage of premiums
 - Limit- 3x premiums
 - Premium- \$
 - Reinsurance Premium- \$
 - Ceding fee, excise- \$
 - Renewed in 20XX- same

- Founder
 - CO-13 Tax D & O Liability- CO-13 Pool 20XX

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

- 1/1/20XX – 12/31/20XX
- ORG CO-2- Reinsurance
- CO-2 has issued policies of insurance to CO-13
- Purchased insurance from CO-13
- ORG desires to reinsure this insurance based on participants percentage of premiums
- Limit- 3x premiums
- Premium- \$
- Reinsurance Premium- \$
- Ceding fee, excise- \$
 - Renewed in 20XX- same

Total policies issued: 20XX2- 10; 20XX- 17; 20XX- 13

ORG promoted its products through direct contacts with Prospective clients. ORG's agents in Country 3 and the Country 2 were Agent 1 and Agent 2.

Founders and Founders have no ownership, control or employment or such relationship with the companies mentioned above. Only relationship is ORG selling insurance to these companies.

In response to Question #2, Information Document Request #3, pertaining to how many companies were offered insurance by this organization, whether purchased or declined, ORG responded with the following information:

20XX COUNTRY 3 COMPANIES

CO-3 CO-17
CO-5 CO-18
CO-6 CO-19
CO-15 CO-21
CO-16 CO-20
CO-22

20XX COUNTRY 3 COMPANIES

CO-3 CO-17
CO-5 CO-18
CO-6 CO-19
CO-15 CO-21
CO-16 CO-20
CO-22 CO-23
CO-24 CO-25
CO-26

20XX COUNTRY 3 COMPANIES

CO-3 CO-17
CO-5 CO-18
CO-6 CO-19
CO-15 CO-21

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

CO-16 CO-24
CO-22

**20XX COUNTRY 3
INDIVIDUALS**

IN-1 IN-5
IN-2 IN-6
IN-3 IN-7
IN-4 IN-8

**20XX COUNTRY 3
INDIVIDUALS**

IN-9 IN-5
IN-2 IN-6
IN-3 IN-7
IN-4 IN-8
IN-10 IN-14
IN-11 IN-15
IN-12 IN-16
IN-13 IN-17

**20XX COUNTRY 3
INDIVIDUALS**

IN-9 IN-5
IN-2 IN-6
IN-3 IN-7
IN-4 IN-8
IN-10 IN-14
IN-11 IN-15
IN-12 IN-16
IN-13 IN-17
IN-18 IN-19
IN-20

**20XX
COMPANIES**

CO-27 CO-28

**20XX
COMPANIES**

CO-4P CO-28
CO-33

**20XX
COMPANIES**

CO-27 CO-28
CO-29 CO-30
CO-31 CO-33

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

CO-32

**20XX
INDIVIDUALS**

IN-21 IN-26
IN-22 IN-27
IN-23 IN-28
IN-24 IN-29
IN-25

**20XX
INDIVIDUALS**

IN-21 IN-26
IN-30 IN-33
IN-31 IN-34
IN-27 IN-35
IN-23 IN-36
IN-24 IN-29
IN-32 IN-25

**20XX
INDIVIDUALS**

IN-21 IN-26
IN-37 IN-22
IN-31 IN-34
IN-27 IN-35
IN-23 IN-36
IN-29 IN-24
IN-25 IN-32
IN-38 IN-39

ORG stated that the focus on Country 3 was on residential burglary insurance due to the high crime rates and Founders's and his agent's security background) and then on business insurance.

ORG also stated that they explored reinsuring a portion of boat insurance written in the XYZ, XYZ, XYZ and XYZ markets but decided against taking the risk. Also explored were reinsuring small business owners and a portion of contractor's liability insurance.

As stated above, during 20XX there were no reinsurance agreements. In 20XX & 20XX, ORG entered into reinsurance agreements with ORG CO-2 Company (). would sell insurance to ORG Business League. This insurance included CO-13 Tax Audit Expense, CO-13 Legal Audit Expense, and CO-13 Director & Officer Liability.

In 20XX & 20XX, Founders purchased one policy of each type of insurance and the policies were then reinsured by ORG. The premiums for each policy were \$ each. There were ceding fees and excise tax

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

expenses of \$ per policy. ORG reinsured no other policies sold by . Details of these policies are shown above with the listing of the other policies

Total premiums listed on Form 990 for December 31, 20XX was \$. This amount agrees to the premiums listed in the contracts. A breakdown of Form 990 for December 31, 20XX follows:

FORM 990 INFORMATION	20XX
Premiums	\$
Total Investment Income	\$
Sale of Marketable Securities	\$
Total Revenue	\$
Total Assets	\$
Total Liabilities	\$

For the years ending December 31, 20XX and 20XX, ORG filed Form 1120-PC. A breakdown of these forms follows:

FORM 1120-PC INFORMATION	20XX	20XX
Premiums	\$	**
Dividend Income	\$	\$
Interest Income	\$	\$
Capital Gain	\$	\$
Total Revenue	\$	***
Total Deductions	\$	***
Dividend Reduction	\$	\$
Taxable Income	\$	\$
Total Assets	\$	\$
Total Liabilities	\$	\$

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

** Amount reported in Statement 7 of the form indicated premium income to be \$. Also reported was Book to Tax Differences of \$.

*** Total Revenue and Deduction figures not available per copy of Form 1120-PC secured.

In 19XX, ORG issued two notes to Founders. In 20XX a note was issued to CO-3 one of the companies that had insurance through ORG. At the end of 20XX, no payments had been made. The amount of \$ reported in Part IV, Balance Sheets, of Form 990 for December 31, 20XX represented the \$ in notes and \$ in accrued interest. A breakdown of the notes follows:

- CO-3
 - July 17, 20XX
 - \$
 - % interest
 - payable within 30 days of written demand
- Founders
 - March 21, 19XX
 - \$
 - % interest
 - payable on demand
- Founder
 - February 19XX
 - \$
 - % interest
 - payable on demand

ORG had no employees, so sales or clerical staff. ORG did not employ anyone to solicit its insurance business. ORG relied on Founders and Founder to conduct its insurance activity.

LAW & ANALYSIS

1. Is ORG providing insurance to its policyholders?

The first issue is whether ORG was 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).

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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. Country 4, 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. Country 4, 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)

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In Revenue Ruling 20XX-90, 20XX-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.

The differences include the number of companies insured and the types of policies issued. In the revenue ruling there were 12 separate subsidiaries of the parent being insured. ORG insured only 4 entities; ; CO-4; CO-5; ; and its shareholders' two personal properties.

In the revenue ruling, all 12 policies were for liability insurance. ORG issued 3 different types of insurance; personal property (2 policies), Interruption of business (4 policies), and commercial general liability insurance (4 policies).

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 3 different types of policies to only four entities and its shareholders 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 are only 2 policies issued for personal property, 4 issued for interruption of business and 4 issued for general liability insurance. There is no statistical phenomenon known as the

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“the law of large numbers.” There is no risk distribution of any of the three types of policies to help cover any claims that could be filed. The risks are not distributed among other insured or policyholders.

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.

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 20XX?

The second issue is whether ORG was an insurance company exempt from tax pursuant to I.R.C. section 501(c)(15) for the taxable years 20XX. 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 \$350,000.” 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

* * * *

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 20XX pursuant to I.R.C. 501(c)(15)(B).

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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.

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

Prior to 20XX, 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 20XX, 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. Country 4 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.

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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 \$867.94, \$1,554.76, \$1,125.70, and \$1,421.98 during the taxable years 1958, 1959, 1960, and 1961 respectively. Inter-American, 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 \$35,988.21, \$31,195.60, \$36,436.04, and \$33,815.44 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. Country 4, 300 F. supp. 387 (N.D. Tex. 1969))

In Cardinal Life Ins. Co. v. Country 4, 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-American, 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

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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. Country 4, 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. Country 4, 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 20XX from its Investments

ORG should not be classified as an insurance company for tax purposes because its primary and predominant activity during the taxable year 20XX was not its insurance activity. This is evidenced by the sources of ORG's income during the year at issue. ORG reported the following income on its Forms 990 for the taxable year 20XX:

FORM 990 INFORMATION	20XX
Premiums	\$
Total Investment Income	\$
Sale of Marketable Securities	\$

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Total Revenue	\$
Total Assets	\$
Total Liabilities	\$

The majority of ORG's income during 20XX was attributable to its income from its investments and sales of marketable securities. As can be seen below, only a very small portion of the income was attributable to ORG's insurance activity.

REVENUE	20XX
Premiums	\$
Total Revenue	\$
Percentage- Total Premiums to Total Revenue	\$
Number of Policies Issued	

For the years ending December 31, 20XX and 20XX, ORG filed Form 1120-PC showing further the disparity between its premium income and total revenue. A breakdown of these forms follows:

FORM 1120-PC INFORMATION	20XX	20XX
Premiums	\$	**
Dividend Income	\$	\$
Interest Income	\$	\$
Capital Gain	\$	\$
Total Revenue	\$	***
Total Deductions	\$	***
Dividend Reduction	\$	\$
Taxable Income	\$	\$
Total Assets	\$	\$
Total Liabilities	\$	\$

** Amount reported in Statement 7 of the form indicated premium income to be \$. Also reported was Book to Tax Differences of \$.

*** Total Revenue and Deduction figures not available per copy of Form 1120-PC secured.

- ii. ORG Failed to Use its Capital and Efforts Primarily to Earn Income from its Insurance Activity.

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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 manner 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 20XX, 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 under capitalized; 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; and 4) ORG devoted little time to its insurance activities.

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 investment assets worth approximately \$, to cover anticipated insurance claims. A majority of these assets were held in savings and marketable securities. Other assets included the notes outstanding.

As stated above, the maximum exposure for 20XX was \$. A more in-depth review of the policies issued indicated an exposure per policy of between \$ and \$. With the filing of just one claim by one of these entities, there may not be enough assets to cover any other claims that could be filed. If the shareholders were to file a claim for one of its residential properties, there would not be enough assets to cover the claim itself, let alone any other claims filed.

Second, ORG devoted little time to developing and marketing its insurance products. There were a total of 10 policies issued in 3 different categories. In response to Question #2 of IDR #3, ORG provided a list of individuals and companies contacted in Country 3 and the Country 2 for 20XX, 20XX & 20XX (see above). According to ORG, all the contacts were made by Founders and . Many of the names on the list are the same from year to year. Even with all the contacts listed, the same policies were issued each year with no additional policies issued to the policyholders or to any of the individuals and companies contacted. There was no promotional material or advertising. All contacts were direct contacts. Very little was done to market the products.

Third, ORG did not employ anyone to solicit its insurance business. The only two individuals involved were Founders and . In both Cardinal Life and Inter-American Life, where the courts determined that the primary and predominant business of each company was not insurance,

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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 has no employees, no sales or clerical staff. They relied totally on Founders and All contacts were made directly without any promotional material or advertising.

Fourth, ORG spent an insignificant amount of time on its current insurance business. ORG issued the 10 policies in 20XX. 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 promotional material or adverting of the insurance product, only direct contact by Founders and . The amount of time spent on its current insurance business was insignificant.

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 policies, the primary and predominant activity during 20XX was its investments.

As shown in the charts above, ORG received very little premium income from its insurance agreements. A majority of its income came in the form of interest and income from the sales of marketable securities. The charts above also show that the percentage of premium income to total revenue was insignificant for the year. The primary and predominant activity conducted by ORG was its investment activity, not insurance 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)?

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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 20XX, 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 \$350,000.” [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 20XX. 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. 20XX-4, 14.XX (cross-referencing 13.01 et seq.) 20XX-1 C.B. 128. 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.XX, 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.

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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. 20XX-4, 14.XX (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. 20XX-4 14.XX (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 granted 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. 20XX-4, 14.XX. See also Rev. Proc. 20XX-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. 20XX-4, 14.XX(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;

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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 detriment.

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. Country 4, 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. First, the organization was formed for the purpose of conducting reinsurance business through CO-1 and ORG CO-2 Corporation Limited. Since receiving their exemption, ORG ceased the reinsurance activity and began issuing policies directly. In 20XX & 20XX, ORG did enter into reinsurance agreements, but all they reinsured were 3 policies issued to Founders.

Second, premium income reported for 19XX was \$ _____, or 22.6% of Total Revenue. By 20XX, premium income had decreased to \$ _____, or only 1.9% of total Revenue. ORG stated in its application form that it anticipated that its gross premiums will exceed \$350,000 within five years, as the company grows. Only in 20XX were gross premiums over \$350,000 due to the increase in number of policies. However, in 20XX the gross premiums decreased to only \$ _____ because of a decrease in the number of policies issued.

Third, when ORG filed its application form, there were two reinsurance agreements in effect, both providing risk distribution. Since exemption was granted, the amount of policies issued directly or through the reinsurance agreements provided no risk distribution. There was no risk distribution from policies issued directly and with only reinsuring 3 policies through the reinsurance agreement; there was also inadequate risk distribution.

The activities being conducted today are not the same as were indicated in the original application form. There is no indication that the organization ever informed the Service of these changes. What

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was presented in the application form was an organization that would reinsure many insurance policies through the reinsurance agreements. What has really happened is ORG providing insurance directly or through reinsurance agreements to a small amount of entities, some of which are Founders himself.

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, 20XX. This is the first year under examination.