Internal Revenue Service

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November 10, 2008

In Re: .

Legend

Company =

Lead Company =

Foreign Country M =

2 =

Individual A =

Individual B =

Individual C =

Individual D =

Date A =

Year C =

E =

F =

Insured Corporation 1 =

Insured Corporation 2 =

Insured Partnership 1 =

Insured Partnership 2 =

Insured Partnership 3 =

Insured Partnership 4 =

Insured Partnership 5 =

Corporation Q =

Partnership R =

Corporation S =

Partnership T =

Partnership U =

Partnership V =

Corporation W =

Corporation X =

Partnership Y =

Independent Insurer 1 =

Independent Insurer 2 =

Independent Insurer 3 =

Independent Insurer 4 =

Independent Insurer 5 =

Z =

Number a =

Number b =

Number c =

Number d =

Number e =

Number f =

Number g =

Number h =

Number i =

Number j =

Number k =

Number l =

Number m =

Number n =

Dear :

This is in response to the letter submitted by Company dated May 12, 2008, primarily requesting a ruling under § 831 relating to Company's status as an insurance company for federal income tax purposes.

FACTS

Company was incorporated in Foreign Country M on Date A. Company has been licensed by the Insurance Regulators of Foreign County M as a Class 2 Association Insurance Company effective for Year C. Also effective for Year C, Company has made an election under § 953(d) to be taxed as a domestic corporation. All of the stock of Company is owned by Individual A.

Insured Corporation 1 is a domestic corporation engaged the E extraction business. The stock of Insured Corporation is Number m % owned by Trusts for the benefit of Individual B and Number m % owned by Trusts for the benefit of Individual C.

Insured Corporation 2 is a domestic corporation engaged in the E transportation and processing business. All of the stock of Insured Corporation 2 is owned by Insured Corporation 1.

Insured Partnership 1 is a limited partnership, which is engaged in the E transportation business. Corporation Q is the general partner of Insured Partnership 1 and has a Number d % ownership interest in Insured Partnership 1. Partnership R, Individual D, Corporation S, Partnership T and Partnership U, own, respectively, a Number a %, Number b %, Number h %, Number k %, and a Number f % interest in Insured Partnership 1.

Insured Partnership 2 is a limited partnership, which is engaged in a business, in part, related to E extraction activities. Partnership V is the general partner of Insured Partnership 2 and it has a Number a % interest in Insured Partnership 2. The remaining ownership in Insured Partnership 2 is in the hands of Partnership T with a Number n % interest and Partnership U with a Number i % interest.

Insured Partnership 3 is a limited partnership engaged in the business of the extraction of F. Corporation V is the general partner of Operating Partnership 3 with a Number a % ownership interest. The remaining ownership in Insured Partnership 3 is held Number l % each by Partnership T and Partnership U.

Insured Partnership 4 is a limited partnership engaged in the business of E extraction and processing. Corporation X is the general partner of Operating Partnership 4 with a Number a % ownership interest. The remaining ownership in Insured Partnership 4 is Number l % each owned by Partnership T and Partnership Y.

Insured Partnership 5 is a limited partnership, which is engaged in the business of E waste disposal. Partnership Y, (a partnership) is the general partner of Insured Partnership with a Number a % interest, the remaining interests are owned by Individual

D with a Number e % interest and Partnership T and Partnership U each with a Number j % interest.

Neither Individual B nor Individual C own or control more than 50% percent of any of the Company's direct insureds (Insured Corporations 1 and 2, and the Insured Partnerships 1 through 5). Further, Individual C, the 100% owner of Company, also does not possess a 50% ownership or control of any of Company's insureds.

Company offers to its direct insureds (Insured Corporations 1 and 2 and Insured Partnerships 1 through 5) policies which comprise the following four types of contracts: (1) Z policy, (2) employment related practices liability policy, (3) executive liability policy, and (4) commercial crime policy.

The most significant policy is the Z policy. This policy is a package policy that contains coverage for buildings, business personal property, business income and extra expense, legal defense and other business related coverages. The employment-related practices liability policy provides coverage for liability arising out of claims for injury to an employee because of an employment-related offence, as well as a duty to defend. The executive liability coverage policy provides two coverages: one applies to liability arising out of claims for wrongful acts or interrelated wrongful acts committed by the named company's directors or officers, the other is a corporate reimbursement coverage that applies to claims for which the named company is legally obligated to indemnify its directors or officers when such claims involve wrongful acts or interrelated wrongful acts committed by them. The commercial crime policy covers business losses due to employee theft of money, securities, other property of the insured, including client's property on the client's premises.

In order to increase its overall risk distribution, Company participates in a reinsurance pool operated by Lead Company, an insurance company incorporated in Foreign Country M, consisting of Number c independent insurers in addition to Company. These other insurers and their insureds are unrelated to Company and Company's insureds (i.e., Insured Corporations 1 and 2 and Insured Partnerships 1 through 5).[1] Thus, while Company, as a direct writer, receives premiums from its insureds under Coinsurance Agreement A (an automatic pro rata indemnity reinsurance treaty) it cedes 100% of these directly written premiums on each line it insures to the reinsurance pool. Further, using Coinsurance Agreement B (another automatic pro rata indemnity reinsurance agreement), Company will then assume a quota share of the premiums from the reinsurance pool which is equivalent in dollar terms to the amount it ceded on each line of insurance.

The following applies to all of the insurers participating in the reinsurance pool:

[1] In additional to Company and Lead Company, the other pool members include Independent Insurers 1 through 5.

All insurers issue insurance contracts and charge premiums for the insurance coverage provided under their respective insurance contracts. All insureds use recognized actuarial techniques, based, in part, on commercial rates for similar coverage, to determine the premiums charged to an individual insured.[2]

Each of the insurers pools all the premiums it receives in its general funds and pays claims out of those funds. Each insurer investigates any claim made by any of the more than 12 independent policyholders to determine the validity of the claim prior to making any payment on such claim. Each insurer conducts no business other than the issuing and administering of insurance contracts.

No insured has any obligation to pay any insurer additional premiums if that insured's actual losses during any period of coverage exceed the premiums paid by that insured. Premiums paid by any insured may be used to satisfy claims of the other insureds. No insured that terminates its insurance coverage is required to make additional premium or capital payments to that insurer to cover losses in excess of its premiums paid. Company, Lead Company, or any of the other insurer members of the pool participating in the reinsurance pool are not related.

As a result of Company's participation in the reinsurance pool, the written premiums of Company will, generally, have the following characteristics on each line of coverage it insures: (1) Company will assume (in total) risks from the more than 12 independent policyholders with respect to insured businesses of these policyholders, and (2) no single insured will account for more than 15 % of the total risks assumed by Company through the reinsurance pool regardless of whether Insured Corporation 2 is counted as an insured separate from Insured Corporation 1. Also, it is represented that there are no guarantees of Company's obligations by Individuals A, B, C or any other related person. In addition, Company states that it is well capitalized.

LAW AND ANALYSIS

Section 831(a) of the Internal Revenue Code provides that taxes, computed as provided in § 11, are imposed for each taxable year on the taxable income of each insurance company other than a life insurance company. Section 831(c) provides that, for purposes of § 831, the term "insurance company" has the meaning given to such term by § 816(a). Under § 816(a), 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."

Neither the Code nor the regulations define the terms "insurance" or "insurance contract" in the context of property and casualty insurance. The Supreme Court of the

[2] More specifically, the pricing of the policies is based on an actuarial model that is published by the Insurance Services Office and the results of that model are compared with available market based pricing from other insurance companies.

United States has explained that in order for an arrangement to constitute insurance for federal income tax purposes, both risk shifting and risk distribution must be present. Helvering v. LeGierse, 312 U.S. 531 (1941). The risk transferred must be risk of economic loss. Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190, 1193 (7th Cir. 1978). The risk must contemplate the fortuitous occurrence of a stated contingency, Commissioner v. Treganowan, 183 F.2d 288, 290-291 (2d Cir. 1950), and must not be merely an investment or business risk. Rev. Rul. 2007-47, 2007-2 C.B. 127. In addition, the arrangement must constitute insurance in the commonly accepted sense. See, e.g., Ocean Drilling & Exploration Co. v. United States, 988 F.2d 1135, 1153 (Fed. Cir. 1993); AMERCO, Inc. v. Commissioner, 979 F.2d 162 (9th Cir. 1992).

Risk shifting occurs if a person facing the possibility of an economic loss transfers some or all of the financial consequences of the potential loss to the insurer such that a loss by the insured does not affect the insured because the loss is offset by a payment from the insurer. Risk distribution incorporates the statistical phenomenon known as the law of large numbers. Distributing risk allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as premiums and set aside for the payment of such as claim. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smooths out losses to match more closely its receipt of premiums. Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987).

Courts have recognized that risk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks. Humana, Inc. v. Commissioner, 881 F.2d 247, 257 (6th Cir. 1989). See also Ocean Drilling and Exploration Co., 988 F.2d at 1153 ("Risk distribution involves spreading the risk of loss among policyholders."); Beech Aircraft Corp. v United States, 797 F.2d 920, 922 (10th Cir. 1986) ("[R]isk distributing means that the party assuming the risk distributes his potential liability, in part, among others.")

In Rev. Rul. 2002-91, 2002-2 C.B. 991, the Internal Revenue Service considered a situation where a group of unrelated businesses in a concentrated industry that faced a significant liability hazard formed a group captive. No member of the group owned more than 15% of the group captive or had more than 15% of the vote on any corporate governance issue. In addition, no members' individual risk insured by the group captive exceeded 15% of the total risk insured by the group captive. Thus, no one member controls the group captive. The group captive was adequately capitalized and it used recognized actuarial techniques, based, in part, on commercial rates for similar coverage, to determine premiums to be charged to an individual member. Based upon all of the facts and circumstances described in the revenue ruling the Service concluded that the arrangement between the member/insured and the group captive constitutes insurance for federal income tax purposes and that the amounts paid as insurance premiums to the group captive are insurance premiums deductible as ordinary and necessary expenses. The revenue ruling also concluded that the group captive was in

the business of insurance and was treated as an insurance company taxable under § 831.

The present situation presented by Company has aspects to it that make it similar to Rev. Rul. 2002-91 at the directly written policy level. There are multiple insureds none of whom control Company and Company provides those insureds with coverage. The bulk of the insureds have a connection with the E industry and generally each has been issued identical policy forms. Thus, a sufficient level of risk distribution of homogeneous risks units has been achieved at the direct written policy level. In addition, as a matter of insurance practice and theory, Company's entry into the reinsurance pool allows it to assume a share of numerous relatively small, independent risks that occur randomly over time allowing it to smooth out losses to more closely match its receipt of premiums. Clougherty Packing Co. 811 F.2d at 1300. Accordingly, Company is functioning as an insurance company both as a direct writer and as a reinsurer. Thus, under the facts as presented Company is functioning as an insurance company in the traditional sense.

Section 162(a) of the Internal Revenue Code provides, in part, that there shall be allowed as a deduction all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-1(a) of the Income Tax Regulations provides, in part, that among the items included in business expenses are insurance premiums against fire, storms, theft, accident, or other similar losses in the case of a business.

CONCLUSION

Based solely on the information submitted and the representations made, and provided that Company is adequately capitalized, we conclude that the arrangement between the insureds and Company constitutes insurance for federal income tax purposes. This means that Company is in the business of issuing insurance and reinsurance contracts and will be treated as an insurance company taxable under § 831 so long as it meets the definition of § 831(c); and that the consideration made by the insureds to Company is eligible to meet the definition of insurance premiums as described in § 1.162-1(a) of the Regulations.

Except as expressly provided herein, no opinion is expressed in this letter ruling under the provisions of any other section of the Code or Regulations. No opinion is expressed as to whether or not the amount of premiums charged by Company has been calculated correctly or whether other requirements under § 162 have been met. See e.g., Rev. Rul. 2007-3, 2007-4 I.R B. 350. Further, no opinion has been requested and none has been expressed as to whether the reinsurance pool is an entity for federal income tax purposes. This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to any Federal income tax return to which it is relevant.

In accordance with the power of attorney on file in this office, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

/S/

JOHN E. GLOVER
Assistant to the Chief, Branch 4
Office of the Associate Chief Counsel
(Financial Institutions & Products)