Internal Revenue Service
Appeals Office
One Cleveland Center-Suite 815
1375 East Ninth Street
Cleveland, OH 44114-1739

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:
Fax:
Refer Reply to:
AP:FE:
In Re:
EO Examination
Tax Period(s) Ended:
and
EIN:
C
UIC: 501.15-00

Date: DEC 3 0 2008

Number: 200913069
Release Date: 3/27/2009

A
B

LEGEND:
A -
B -

C -

CERTIFIED MAIL

Dear :

This is a Final Adverse Determination as to your exempt status under section 501(c)(15) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

Your organization fails to meet the requirements for exemption under IRC section 501(c)(15) for the periods ended December 31, and December 31, IRC section 501(c)(15) provides for the exemption of certain insurance companies if their gross receipts for the taxable year do not exceed $600,000 and if more than 50 percent of such gross receipts consist of premiums.

A recent examination of your organization's activities and Forms 990 determined that your organization's gross receipts exceeded the limits set forth in IRC section 501(c)(15)(A)(i) as described above.

Based on the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(15) of the Internal Revenue Code effective January 1,

You are required to file converted Forms 1120-PC, U.S. Corporation Income Tax Return, for any years which are still open under the statute of limitations beginning with the year ending December 31, You should file any returns due for the periods ending December 31, and December 31, with the Internal Revenue Service TEGE: EO:
These returns should be filed within 60

days of the date of this letter. Forms 1120 for tax periods beginning on and after January 1, , should be filed with the Service Center, in a timely manner.

You have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can call the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"* for Taxpayer Advocate telephone numbers and addresses.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax 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.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Douglas H. Schulman
Commissioner
By

Charles F. Fisher
Appeals Team Manager

Enclosure:
Notice 1214 Helpful Contacts for your "Notice of Deficiency"

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

January 28, 2008

LEGEND
ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
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 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 December 31, 20XX December 31, 20XX

LEGEND
ORG = Organization name XX = Date XYZ = State EMP-1 = 1st employee
Treasurer = treasurer CO-1, CO-2, CO-3 & Co-4 = 1st company, 2nd company, 3rd company & 4th company

ISSUES

1. Does ORG qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15), for the years ending December 31, 20XX & 20XX?

2. If ORG does not qualify for tax exempt status for years ending December, 31, 20XX & 20XX, what are the tax consequences?

3. If the tax exempt status is revoked, how will it affect future years?

FACTS

ORG (ORG) was formed in the State of XYZ on March 9, 20XX.
The Articles of Incorporation for ORG states the purpose of the organization as follows:

- Purpose- to administer and operate, on a cooperative basis, the production or furnishing of goods, services or facilities; to provide health and wellness and related educational services in order to advance and promote the business interests of the Members of the Corporation; to assist the Members of the Corporation and the organizations with which they may be associated in the performance of health and wellness promotional activities; and to act as a group insurance policyholder.

The Bylaws of the organization discuss that there would be between 3-8 directors in charge of the organization. It also states the following regarding members:

- Section 2.1 Qualification. Membership status may be bestowed in accor ce with Section 2.2 of this Article II on any person or entity that qualifies for membership pursuant to the By-laws or any membership rules promulgated by the Board of Directors pursuant to Section 2.4 of this Article II. Members will be qualified and selected persons or entities.

- Section 2.2 Membership Selection and Organization. The Membership Chairman may bestow membership status on any qualifying person or entity in accor ce with the Membership Rules promulgated by the Board of Directors pursuant to Section 2.4 of this Article II. Membership status may not be assigned by a Member to any other person or entity.

- Section 2.3. Voting. Members will have no power to vote on any matter except as will be expressly granted by resolution of the Board of Directors. If allowed to vote, Members will be entitled to vote only at special meetings called by the President or Board of Directors on such matters that affect the members' benefits and that are presented to Members for vote by the Board of Directors, within its sole discretion. When Members are entitled to vote on specified matters, the procedures governing such voting will be as set forth in the membership rules established by the Board of Directors pursuant to Section 2.4 hereof. There will be no annual meeting of Members entitled to vote.

- Section 2.4. Membership Rules. The Board of Directors, within its sole discretion, will establish membership rules to govern qualifications for membership, membership rights and privileges, termination of membership status and rights or any other matter affecting the members or membership. The Board of Directors, within its sole discretion, may amend or revoke such rules or adopt new rules at any time. Members will have only those rights and privileges that are expressly granted to them in these By-laws or in the membership rules established by the Board of Directors pursuant to this Section 2.4.

A rough draft Membership Rules was provided by ORG for this examination. The draft stated that to become a member, each person or entity must apply for membership on an application form. The application must contain a statement that it is the applicant's understanding that membership does not guarantee that the applicant is or will be insurable by insurance companies. The Membership Chairman may, at his or her discretion, accept any qualified applicant as a member.

Application Form 1024 was filed with the Service on March 17, 20XX. Its purpose, as stated in the application form was as follows:

- The applicant organization, "ORG" was formed solely to provide for a mechanism to collect a monthly aggregate sum from members, and then in one lump sum pay a monthly health insurance premium to the insurance provider. These are the sole duties involved in the organization. The organization facilitates the members by a) simplifying the health insurance enrollment process b) streamlining the administrative relationship between the members and the insurance provider and c) reducing or helping to control the ever-escalating health insurance costs by providing better pricing and services for members of the organization. This is the sole past, present and planned purpose of the applicant organization.

- The only other costs involved include a) some minor bank service fees, and b) some minor administrative fees including postage, copies, etc. EMP-1 receives the monthly lump sum and pays the monthly premium to the insurance provider. EMP-1 also handles legal issues related to the organization. The Treasurer and board member Treasurer provides accounting services including reconciling the bank statements and provides tax preparation services, including preparing this 1024 document as well as the annual 990 form. EMP-2 oversees and coordinates the insurance services and the relationship between the members and the applicant organization. Each officer's duties comprise approximately 33.3% of the total time involved in managing the organization's affairs and provide said services at each of their respective offices.

The application form also states that the organization does not ever expect any financial support other than the sole source of income from the monthly membership payment issued to pay the monthly insurance premium. As for dissolution, the organization made the statement that there is no accumulation of assets ever expected.

In a letter dated January 8, 20XX, to the Service from the organization, ORG states the following: "In general, members are who clear their through CO-1. The rights that ORG focuses on are the ability for members to obtain health and disability insurance at group rates."

After more correspondence between ORG and the Service, the organization received a determination letter dated September 12, 20XX, granting exemption under IRC 501(c)(15). In the letter it states the new requirements under this code section, for years beginning on or after January 1, 20XX.

In a letter dated November 13, 20XX, from EMP-1, as President of ORG, in response to the first Information Document Request (IDR), and phone conversations with ORG, ORG provided the following information:

- "As I think I explained to you on the telephone, ORG does not directly provide insurance to anyone. Rather, it acts as a group insurance policyholder, and assists individual members who wish to obtain both group health and disability insurance. Accordingly, every month, ORG collects premium amounts for individual members, and, based on the total collected, pays the monthly premiums for 1) the members' health insurance, and 2) the members' disability insurance."

- In summary, ORG acts as a group policyholder for a number of involved in the XYZ . Since ORG is not an employer group, the group

Incorporated to attract health and disability insurers and demonstrate that there is unity of interest for insurers providing group coverage. ORG neither sells a product nor provides a service. It is a self-contained group, consisting at times of 100+ which are managed by a three-person board of directors/officers. The board and officers are charged primarily with ensuring that monthly premiums are paid to the referenced insurers.

During the course of the examination, this agent secured copies of insurance policies in effect during audit years. The policies were group policies, issued by the insurance companies. ORG was listed as the policyholder. ORG did not sell any of the insurance to the members. Their only activity was the collection of the premiums from the members and submitting those premiums to the respective insurance companies. A breakdown of each policy follows:

CO-2

- Name of Policyholder- ORG
- Type of Coverage- Group Long Term Disability
- Policy Issued In- State of XYZ
- Effective Date- May 1, 20XX
- Policy Amendment #1 August 18, 20XX
    - Policy owner- CO-1
    - Employer- CO-1; ORG
    - Member- any active Owner-Employee or employee of the Employer; citizen or resident of the Country or Country; regularly works 30 or more hours per week
    - Benefit date- 91st day of Disability in the first 120 days after date you become disabled
    - Maximum Benefit- 60% of your predisability earnings not to exceed a monthly amount of $.
    - Minimum Benefit- $
    - Maximum Benefit Period- determined by age
- Notice- 4/26/20XX. Added employer- CO-1.

CO-3

- Policyholder- Trustee of Employers Health Insurance Benefits Trust
- Participating Employer- ORG
- Effective Date- 7/1/20XX

- Group Health Insurance Contract
- Through 6/30/20XX

CO-4

- Policyholder- ORG
- Effective Date, July 1, 20XX
- Group Health Insurance Contract
- Payment of premiums- monthly
- Premium Rider- Core Plan & Buy-Up Plan

Form 990 was filed for the 20XX & 20XX tax years. The following is a breakdown of the Gross Receipts received by ORG for the years ending December 31, 20XX & 20XX, and the percentage of Gross Premiums to Gross Receipts for the same years.

ORG	20XX	20XX
Premiums Earned		
Other Investment Income		
Total Gross Receipts		
Percentage- Gross Premium/Reinsurance Income to Gross Receipts		

LAW AND ANALYSIS

1. **Does qualify for tax exempt status under Internal Revenue Code (IRC) Section 501(c)(15) for the years ending December 31, & ?**

Internal Revenue Code section 501(c)(15)(A) exempts from Federal income tax insurance companies (as defined in section 816(a)) other than life (including interinsurers and reciprocal underwriters) if-

(i.) (I) the gross receipts for the taxable year do not exceed $600,000, and
(II) more than 50 percent of such gross receipts consist of premiums, or

(ii.) in the case of a mutual insurance company-

(I) the gross receipts of which for the taxable year do not exceed $150,000 and,
(II) more than 35 percent of such gross receipts consist of premiums.

Clause (ii) shall not apply to a company if any employee of the company, or a member of the employee's family (as defined in section 2032(A)(e)(2). is an employee of another company exempt from taxation by reason of this paragraph (or would be so exempt but for this sentence).

Sec. 206, Clarification of Exemption from Tax for Small Property and Casualty Insurance Companies, of the Pension Funding Equity Act of 2004, P.L. 108-218, amended section 501(c)(15)(A) to change the definition of small property and casualty insurance companies (insurance companies other than life insurance companies) exempt from income taxes to: (1) a company whose gross receipts for the taxable year do not exceed $600,000, and over half such gross receipts consist of premiums (currently, whose net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $350,000); or (2) a mutual insurance company (a) whose gross receipts for the taxable year do not exceed $150,000 and more than 35 percent of which consist of premiums and (b) none of whose employees (or member of the employee's family) is an employee of another company exempt from tax under section 501(c)(15). These changes were applicable after December 31, 2003.

Notice 2006-42, IRB, 2006-19 provides guidance as to the meaning of "gross receipts" for purposes of section 501(c)(15)(A) of the Internal Revenue Code. This notice advises taxpayers that the Service will include amounts received from the following sources during the taxable year in "gross receipts" for purposes of § 501(c)(15)(A):

A. Premiums (including deposits and assessments), without reduction for return premiums or premiums paid for reinsurance;

B. Items described in § 834(b) (gross investment income of a non-life insurance company); and

C. Other items that are properly included in the taxpayer's gross income under subchapter B of chapter 1, subtitle A, of the Code.

Thus, gross receipts include both tax-free interest and the gain (but not the entire amount realized) from the sale or exchange of capital assets, because those items are described in § 834(b). Gross receipts do not, however, include amounts other than premium income or gross investment income unless those amounts are otherwise included in gross income. Accordingly, the term gross receipts does not include contributions to capital excluded from gross income under § 118, or salvage or

reinsurance recovered accounted for as offsets to losses incurred under § 832(b)(5)(A)(i).

Section 834(b)(1)(D) of the Internal Revenue Code includes under gross receipts the gains from the sale or exchanges of capital assets to the extent provided in subchapter P (section 1201 and following, relating to capital gains and losses).

Section 834(c)(6) of the Internal Revenue Code allows a deduction for Capital Losses to the extent provided in subchapter P (section 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

Based on the changes in the limitations under Internal Revenue Code (IRC) Section 501(c)(15)(A), and the operation of during & , it was determined by the chart above, that did not qualify for tax exempt status during and was able to meet the 50% requirement of Gross Premiums to Gross Receipts ( ); however, was not able to meet the $600,000 gross receipts limitation ( ).

As a non-stock company, (mutual), did meet the requirement of over 35% premiums to gross receipts, but could not meet the limitations of under $150,000 in gross receipts.

To be qualified under IRC 501(c)(15), had to meet all requirements, either under IRC 501(c)(15)(A)(i) or (a)(ii). did not meet the requirements under either section of the code.

Section 206(e) of the Pension Funding Act of 2004, P.L. 118-218 provides the effective date of the new requirements for exemption under IRC 501(c)(15). It states:

EFFECTIVE DATE-

(1) **IN GENERAL**- Except as provided in paragraph (2), the amendments made by this section shall apply to **taxable years beginning after December 31, 2003.**

(2) **TRANSITION RULE FOR COMPANIES IN RECEIVERSHIP OR LIQUIDATION**- In the case of a company or association which--

(A) for the taxable year which includes April 1, 2004, meets the requirements of section 501(c)(15)(A) of the Internal Revenue

Code of 1986, as in effect for the last taxable year beginning before January 1, 2004, and
(B) on April 1, 2004, is in a receivership, liquidation, or similar proceeding under the supervision of a State court,
the amendments made by this section shall apply to taxable years beginning after the earlier of the date such proceeding ends or December 31, 2007.

was not involved in a court ordered liquidation during and . Therefore, Section 206(e) does not apply to this organization.

2. If does not qualify for tax exempt status for years ending December, 31, & , what are the tax consequences?

Since did not qualify for tax exempt status under IRC Section 501(c)(15) for the and years was required to file Form 1120/1120-PC for both years.

IRC 831 discusses tax on insurance companies other than life insurance companies.

IRC 831(a) states as a general rule, "Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company other than a life insurance company."

IRC 831(b) provides an alternative tax for certain small companies. It states in IRC 831(b)(1) that, in general, "In lieu of the tax otherwise applicable under subsection (a), there is hereby imposed for each taxable year on the income of every insurance company to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 11(b)."

IRC 831(b)(2) discusses the companies to which this subsection applies.

(A) In general. This subsection shall apply to every insurance company other than life (including interinsurers and reciprocal underwriters) if-
- (I) the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $1,200,000, and
- (ii) such company elects the application of this subsection for such taxable year.

The election under clause (ii) shall apply to the taxable year for which made and for all subsequent taxable years for which the requirements of clause (1) are met. Such election, once made, may be revoked only with the consent of the Secretary.

Regulations (Regs.) 301.9100-8(a)(2) discusses the time for making elections. Under (i) it states in general that except as otherwise provided in this section, the elections described in paragraph (a)(1) of this section, must be made by the later of-

(A) The due date (taking into account any extensions of time to file obtained by the taxpayer) of the tax return for the first taxable year for which the election is effective, or

(B) January 22, 1990 (in which case the election generally must be made by amended return)

Regs. 301.9100-8(a)(1) mentioned above includes IRC 831(b)(2)(A).

Regs. 301.9100-8(a)(3) describes the manner of making elections. It states, " Except otherwise provided in this section, the elections described in paragraph (a)(1) of this section must be made by attaching a statement to the tax return for the first taxable year for which the election is to be effective."

Based on the Code and Regulation sections above, is not entitled to the relief under 831(b), for & , because it did not meet the requirements of Regs 301.9100-8(a)(2), and therefore would be required to report all income and expenses on Form 1120/1120-PC for each year. The election was not filed when required.

3. If the tax exempt status is revoked, how will it affect future years?

The tax exempt status is being revoked for the years ending December 31, , & Form 1120/1120-PC is required for each year. If meets the requirements under IRC 501(c)(15) in future years, it may be allowed to file the Form 990 for each year they qualify, as a self-declared entity. Otherwise, Form 1120/1120-PC would be required.

TAXPAYER'S POSITION

Unknown at the time of this writing.

SUMMARY

It is the Governments position, based on the above facts, law and analysis, that the tax exemption status of ORG for the years ending December 31, 20XX & 20XX should be revoked based on not meeting the qualifications for exemption under IRC 501(c)(15). Forms 1120/1120-PC would be required to be filed for years ending December 31, 20XX & 20XX without the relief under IRC 831(b) being applied.

ALTERNATIVE POSITION

If for some reason ORG meets the new requirements/limitations under IRC 501(c)(15), then there is an alternative position that ORG does not qualify under IRC 501(c)(15), because it is not an insurance company.

As stated above, ORG does not provide any insurance to the members. ORG acts as a mechanism to collect a monthly aggregate sum from members, and then in one lump sum pay a monthly health insurance premium to the insurance provider. These are the sole duties involved in the organization. The organization facilitates the members by a) simplifying the health insurance enrollment process b) streamlining the administrative relationship between the members and the insurance provider and c) reducing or helping to control the ever-escalating health insurance costs by providing better pricing and services for members of the organization. This is the sole past, present and planned purpose of the applicant organization.

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.

In this case, ORG's primary and predominant business activity is not the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. ORG does not do either or these two activities. Its sole purpose is to assist in the collection of premiums and payment of those premiums to the insurance companies on a monthly basis.

Another aspect to consider in this case is that there is no insurance contract that provides both risk shifting and risk distribution. In AMERCO & Subsidiaries, 96 T.C. 18 (1991), a case affirmed by the 9th Circuit, the Tax Court adopted a three-part test. The three parts consist of; (1) is the risk an insurance risk?; (2) is there risk shifting and risk distribution?; and (3) Is there insurance in its generally accepted sense?

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).

It is exam's position that risk distribution requires both a distribution of exposure units and a distribution of a pool of premiums. In addressing distribution courts have focused on one or the other, but no case has address both.

Risk distribution of exposure units 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)

ORG does not issue any policies. They act merely as a mechanism to collect premiums due the insurance companies from the actual policyholders and submitting those premiums to the insurance companies. Any risk shifting and risk distribution occurs between the insurance companies and the actual policyholders, the insurers. There is no risk shifting and risk distribution with ORG because ORG has no insurance policies.

Also, to show that ORG is not an insurance company is the lack of reserves to pay claims, and the payment of claims themselves. ORG is not liable to pay any claims. Any claims that are required to be paid are paid by the insurance companies to the policyholders. Therefore, ORG is not required to carry any reserves. The only assets maintained by ORG is the difference between what is collected in premiums and the amount submitted to the insurance companies. This amount is to pay for administrative fees that ORG incurs.

Therefore, as an alternative position, it is the Service's position that ORG does not qualify under IRC 501(c)(15), because it is not providing insurance and is not conducting itself as an insurance company.

IRC 7805(b)

If it is determined that ORG does not qualify for exemption based on the alternative position above, then the question arises whether they qualify for IRC 7805(b) relief.

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, 14.02 (cross-referencing 13.01 et seq.) 20XX-4 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, 13.02, 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. 20XX-4, 14.02 (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 14.02 (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. 20XX-4, 14.02. 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, 14.02(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).