DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201101029**
Release Date: 1/7/11
Date: October 15, 2010

UIL:501.15-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(15).

We made this determination for the following reason(s):

There is an insufficient number of insureds to provide for an adequate premium-pooling base. In addition, your risk is too heavily concentrated in two insureds. As a result, your business lacks one of the principal elements of insurance, risk distribution. Thus, because you do not qualify as an insurance company, you do not meet the statutory requirement for exemption under section 501(c)(15) of the Code.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose,* and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: July 20, 2009

Contact Person:

Identification Number:

UIL:501.15-00

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

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Dear

We have considered your application for recognition of exemption from Federal income tax under section 501(a) of the Internal Revenue Code ("Code"). Based on the information provided, we have concluded that you do not qualify for exemption under section 501(c)(15) of the Code. The basis for our conclusion is set forth below.

Facts:

You were incorporated on U as a V non-stock corporation. You were formed to provide auto damage and liability coverage for your members which are taxicab companies.

You are structured on a mutual basis with six members, A, B, C, D, F and G. G provides services to you with respect to claims administration.

A, C, and D are corporations solely owned by H. G is a corporation owned by H (52%), I, H's nephew, (20.5%) and each of H's five daughters, J, K, L, M and N (5.5%). F is owned equally by each of the daughters (20%). B is owned by H's daughter, J (52%), and O (48%) which is owned equally by each of H's daughters (9.6%).

You provided automobile damage and liability policies to A,B,C and D, the insureds. The insureds have operated on a self-insured basis where, depending on the company, risk of $25,000 to $50,000 was retained for each occurrence. Losses over and above that amount have been covered by reinsurance provided by R. You then provided reimbursement to the insureds for losses they incurred as a result of the risks they retained.

In 2007, you received W in premiums from these four insureds. A paid X (41.7%) of your total premiums. B paid Y (32%) of your total premiums. C paid Z (13.1%) of your total premiums. D paid ZZ (13.2%) of your total premiums. These percentages represent the percentages of total risk insured by you on behalf of each of these entities.

Each of the six member-companies is operated on a strictly independent basis with profits of each company being shared only with the shareholders of that company. Similarly, the retained risk of accidents is borne solely by the company experiencing the loss. Each of the companies has determined that it is in its best interest to shift risk away from itself individually to you through a mutual insurance arrangement that you manage.

Law and Analysis:

The issue presented is whether you qualify as an insurance company for federal income tax purposes under section 501(c)(15) of the Code.

Section 501(c)(15) of the Code provides that insurance companies (as defined in section 816(a)) other than life (including interinsurers and reciprocal underwriters) are exempt for all tax years beginning before January 1, 2004, when your net written premiums (or, if greater, direct written premiums) do not exceed $350,000.

It also provides that, for tax years beginning on or after January 1, 2004, insurance companies (as defined in section 816(a)) other than life (including interinsurers and reciprocal underwriters) are exempt if (a) the gross receipts for the taxable year do not exceed $600,000, and (b) more than 50 percent of such gross receipts for the taxable year consists of premiums. See section 501(c)(15)(A)(i) of the Code. For purposes of these tests, amounts received by entities affiliated with you are taken into account if the entities are members of your controlled group. See section 501(c)(15)(C).

Neither the Code nor the regulations thereunder define the terms "insurance" or "insurance contract." The bedrock for evaluating whether an arrangement constitutes insurance is

Helvering v. LeGierse, 312 U.S. 531, 539 (1941), in which the Court stated that "historically and commonly insurance involves risk-shifting and risk-distributing in a transaction which involve[s] an actual 'insurance risk' at the time the transaction was executed." Insurance has been described as "involve[ing] a contract, whereby, for adequate consideration, one party agrees to indemnify another against loss arising from certain specified contingencies or perils ... [I]t is contractual security against possible anticipated loss." Epmeier v. United States, 199 F.2d 508, 509-10 (7th Cir. 1952). Cases analyzing "captive insurance" arrangements have distilled the concept of "insurance" for federal income tax purposes to three elements, applied consistently with principles of federal income taxation: (1) involvement of an insurance risk; (2) shifting and distribution of that risk; and (3) insurance in its commonly accepted sense. See, e.g., AMERCO, Inc. v. Commissioner, 979 F.2d 162, 164-65 (9th Cir. 1992), aff'g. 96 T.C. 18 (1991).

The risk transferred must be risk of economic loss. Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190, 1193 (7th Cir.), cert. denied, 439 U.S. 835 (1978). The risk must contemplate the fortuitous occurrence of a stated contingency, Commissioner v. Treganowan, 183 F.2d 288, 290-91 (2d Cir.), cert. denied, 340 U.S. 853 (1950) and must not be merely an investment risk. LeGierse, 312 U.S. at 542; Rev. Rul. 89-96, 1989-2 C.B. 114.

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 the insurance payment. 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 a claim. 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).

Rev. Rul. 2005-40, 2005-2 C.B. 4, considered X, a domestic corporation, which operated a courier transport business under the following situations, (1) its own name (i.e., as a sole proprietorship), (2) [omitted], (3) through 12 LLCs of which X is a single member and which were disregarded as entities separate from X under the Procedure and Administration Regulations, or (4) through 12 LLCs of which X is a single member and which had elected to be classified as associations. In each situation, X (or the LLCs) entered into an arrangement with Y to cover an insurance risk; the arrangement was Y's only such arrangement. In situations (3) and (4), none of the LLCs accounts for less than 5%, or more than 15%, of the total risk assumed by Y. The ruling holds that, where X conducted the business in its own name or through the disregarded LLCs, the arrangement did not constitute insurance for federal income tax purposes for lack of risk distribution; the arrangement did constitute insurance for federal income tax purposes in the situation where X conducted the business through LLCs which had elected to be classified as associations because the LLCs could now be treated as separate insureds resulting in risk distribution.

In 2007, you provided insurance coverage for four insureds. A paid 41.7% of total premiums received by you. B paid 32% of total premiums received by you. These percentages represent the percentages of total risk insured by you on behalf of each of these entities. As such, these two insureds each have liability coverage for more than 15% of the total risk insured by you. Therefore, you are not similar to the organization described in Situation 4 of Rev. Rul. 2005-40.

Accordingly, the requisite risk shifting and risk distribution have not occurred. As such, your activities do not constitute insurance for federal income tax purposes as described in Rev. Rul. 2005-40.

Conclusion:

Therefore, you are not recognized as an organization exempt under section 501(c)(15) of the Code for any of the years in which you seek exemption.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

> *Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative,* if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney.* All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
SE:T:EO:RA:T:3, PE-3L7
Attn:
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Director, Exempt Organizations
Rulings & Agreements