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SEP 9 1998

Employer Identification Number: [REDACTED]

Dear Taxpayer:

This refers to your application for recognition of exemption from federal income tax as an organization described in section 501(c)(15) of the Internal Revenue Code.

The information furnished shows that you were incorporated on [REDACTED] under the laws of [REDACTED]. No risks other than vehicle service contracts are reinsured by you.

The information furnished shows that your shareholder is [REDACTED]. The service contracts reinsured by you are sold by [REDACTED]. [REDACTED] also owns 100% of [REDACTED].

The dealership markets the "[REDACTED]" for warranty coverage to the customers of [REDACTED]. You advise that the program provides specifically that the dealerships are liable for repairs, that [REDACTED] is the Administrator and that proceeds from the customer must be used to purchase insurance to indemnify the cost of repairs.

[REDACTED] requires that the dealership collect from the listed customers specific amounts to handle anticipated claims, and that these amounts be invested and maintained as reserves to handle claims. [REDACTED] directs these reserves for anticipated claims.

Under a reinsurance contract entered into between you and [REDACTED] dated [REDACTED], [REDACTED] cedes and you accept as reinsurance one hundred percent of [REDACTED] liability under vehicle service contracts written by [REDACTED] on or after the effective date of the agreement.

The financial information furnished shows that you had net written premium income of [REDACTED] in [REDACTED] and \$[REDACTED] in [REDACTED]. Your capital and surplus for [REDACTED] was [REDACTED].

Section 501(c)(15) provides that "[i]nsurance companies or associations other than life" are exempt from taxation under § 501(a) if "net written

[REDACTED]

premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000." § 501(c)(15)(A).

The principal test for what constitutes "insurance" for federal income tax purposes is set out in Helvering v. Le Gierse, 312 U.S. 531 (1941). In that case, the Supreme Court stated that "[h]istorically and commonly insurance involves risk-shifting and risk-distributing." Id. at 539. Further, the Court stated that this risk must be an "insurance risk" as opposed to an "investment risk." Id. at 542. In Allied Fidelity Corp. v. Commissioner, 66 T.C. 1068, 1074 (1976), aff'd, 572 F.2d 1190 (7th Cir. 1978), the Tax Court wrote that this risk is a risk of "a direct or indirect economic loss arising from a defined contingency," so that an "essential feature of insurance is the assumption of another's risk of economic loss."

Rev. Rul. 77-316, 1977-2 C.B. 53, addressed three situations in which a domestic corporation and its domestic subsidiaries paid amounts, designated as insurance premiums, directly or indirectly to the parent's wholly owned foreign "insurance" subsidiary. In Situation 1, the parent and its subsidiaries paid amounts directly to the insurance subsidiary. In Situation 2, the parent and its subsidiaries paid amounts to M, an unrelated domestic insurance company, under a contractual arrangement providing that M would remain as the primary insurer but immediately "reinsure" 95 percent of the risks received with the parent's insurance subsidiary. In Situation 3, the parent and its subsidiaries paid amounts directly to the insurance subsidiary, but the insurance subsidiary then transferred 90% of the risks to W, an unrelated insurance company, in a reinsurance transaction. In no situation did the insurance subsidiary accept risks from parties other than the parent and its domestic subsidiaries.

Rev. Rul. 77-316 concluded that the arrangements in each of these situations under which the insurance subsidiary assumed "a portion of the risks" of the parent and its domestic subsidiaries were "not insurance under the standards set forth in Le Gierse." Id. at 55. It held that the subsidiaries were "not insurance companies ... because their primary and predominant business activity [was] not the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by other insurance companies." Id. at 55.

Your sole business is indemnifying the risks of your owner's automobile dealership under service contracts on which the dealership is liable. There is no substantial difference between your activities and those of the "insurance" subsidiary in Situation 2 of Rev. Rul. 77-316. We find that you are not an insurance company or association other than life, and your request for recognition of exemption under § 501(c)(15) is denied.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days of the date of this letter. You also have a right to a conference in this office after your statement is

[REDACTED]

submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need you to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

You will expedite our receipt of your protest statement by using the following address on the envelope:

OP:E:EO:T:3, Room 6137
Internal Revenue Service
1111 Constitution Ave.
Washington, D.C. 20224

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the Southeast key District Office, which is located in Baltimore, Maryland. Thereafter, any question about your federal income tax status should be addressed to that office. Thank you for your cooperation.

Enclosure
Key District List

Sincerely yours,

 "Signed - Edward K. Karcher"

Edward K. Karcher
Chief, Exempt Organizations
Technical Branch 3