Release Number: **201517018**
Release Date: 4/24/2015

INTERNAL REVENUE SERVICE

TE/GE TECHNICAL ADVICE MEMORANDUM

Area Manager –

Date: January 26, 2015

Taxpayer's Name:
Taxpayer's Address

Taxpayer's Identification Number:

Years Involved:

Conference Held: N/A

Uniform Issue List

501.15-00
831.00-00

LEGEND:

Taxpayer =
State =
Z =
B =
C =
D =
E =
F =
G =
H =
J =
K =
L =
N =
O =
P =
Q =
R =
S =
Property 1 =
Property 2 =
Property 3 =
Date 1 =
Date 2 =
Date 3 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =

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<u>Year 5</u> =
<u>a</u> =
<u>b</u> =
<u>c</u> =
<u>d</u> =
<u>e</u> =
<u>f</u> =
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<u>ss</u> =
<u>tt</u> =
<u>uu</u> =
<u>vv</u> =

Xxxxxxx Xxxxxxx

<u>ww</u> =
<u>xx</u> =
<u>yy</u> =
<u>zz</u> =
<u>ux</u> =
<u>zy</u> =
<u>xw</u> =
<u>xy</u> =
<u>ab</u> =
<u>cd</u> =
<u>ef</u> =
<u>gh</u> =
<u>kh</u> =

ISSUE:

1. Whether Taxpayer qualified as an insurance company under § 501(c)(15) of the Internal Revenue Code for tax years ending December 31 of Year 3, Year 4 and Year 5.

2. Whether Taxpayer is entitled to relief pursuant to § 7805(b).

FACTS:

Taxpayer incorporated itself on Date1 in Z. Taxpayer made the election under § 953(d) for treatment as a U.S. corporation for federal income tax purposes. Taxpayer also applied for tax-exempt status under § 501(c)(15). On Date 3, IRS granted Taxpayer tax-exempt status. Accordingly, for the tax years Year 3, Year 4, and Year 5, Taxpayer filed a Form 990, Return of Organization Exempt from Income Tax. The IRS audited Taxpayer's Year 3, Year 4, and Year 5 tax years and concluded that IRS should revoke Taxpayer's tax-exempt status retroactively to include the tax years Year 3, Year 4, and Year 5. Thereafter, Taxpayer requested a technical advice memorandum.

Facts as Presented on Form 1024 and Supplements

Taxpayer submitted its Form 1024, Application for Recognition of Exemption under § 501(a) ("Form 1024") in the middle of Year 3 with Taxpayer's business plan enclosed. D signed the Form 1024.

According to Taxpayer's Memorandum of Association, Taxpayer was established "to engage in the business of an insurance and reinsurance company, to act as insurance agents, intermediaries and consultants, to accept risks and to settle claims on its own behalf and on behalf of others." Under A's laws, Taxpayer was licensed to engage in the general insurance business with respect to fire, theft, business interruption, legal liability, property & casualty insurance, and credit life and credit disability reinsurance.

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Taxpayer's principal office is located in State. On Date 2, Taxpayer received its insurance license from A's Government and employed B to manage Taxpayer's insurance activities.

Taxpayer revenue for Year 3 totaled $ab. For Years 3, Taxpayer's premium revenue was less than 2% of Taxpayer's aggregate revenue, 1.36% for Year 3. Net gain from sale of non-inventory assets was over 90% of Taxpayer's aggregate revenue for Year 3, 95.3% for Year 3.

Pursuant to Taxpayer Form 1024, in the first half of Year 3, Taxpayer wrote direct insurance that totaled $gh and reinsurance that totaled $kh.

Total direct insurance Taxpayer wrote in Year 3 sum up $tt. One contract provided "Administrative Actions" coverage, to F for $h, while the other policy provided "Employment Practices Liability" coverage to L for $i.

F's business operation consisted of (a) owning/retailing petroleum facilities primarily in State and a neighboring state, (b) real estate speculation and development in State, and (c) private and public equity investments. F devotes 75% of its business to real estate speculation. As of the beginning of Year 3, D's brother owned 97% of F and 63.83% by the end of Year 3.

L devotes 80% of its business operation to owning and retailing petroleum in State and 20% consist of real estate speculation and development in State. D, Taxpayer's officer/director, is also L's director.

Policies covering "administrative actions" indemnified insureds for a broad variety of actions, including disciplinary proceedings or governmental actions taken against the insured pertaining to the business, trade or profession of the insured. Disciplinary proceedings included any professional review action against the insured by a voluntary or mandatory trade association or professional organization with which the insured had privileges, membership or any similar association, which action had the potential to affect adversely said privileges, membership, or association.

Policies covering "employment practices liability" include a severance pay insurance coverage that include an event that causes a liability pertaining to the business, trade or profession of the Insured resulting from the termination of an employee and the granting of a severance package in accordance with the business, trade or profession of the Insured.

In Year 3, Taxpayer and O entered into reinsurance arrangement contracts. Taxpayer assumed from O during Year 3 1.01% pro-rata shares of group disability insurance and related claims. Both agreed there would be no guarantees to limit Taxpayer's losses. Total reinsurance for Year 3 was $g.

On October 19, of Year 3, IRS approved Taxpayer's Form 1024 tax-exempt status application under § 501(c)(15).

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Facts as Developed by Agent during the Examination Process

Taxpayer, by common ownership and/or control, has interest in a group of businesses that includes F, G, H, L, J, and K (collectively, the "Companies"). Companies except L, are located at the same address/location as Taxpayer, however, Taxpayer's director, D, is one of L's director and minority owner.

Pursuant to Taxpayer's business plan, Taxpayer will provide non-traditional insurance coverage to the Companies. 50 percent or more of Taxpayer's business will consists of providing insurance services to the Companies. The remaining balance of Taxpayer's business will consists of reinsurance business of unrelated, licensed insurance companies. Taxpayer represents that it will cover risks not covered by traditional insurance companies.

Taxpayer revenue for Year 4 and Year 5 total $cd and $ef respectively. For Year 4, Taxpayer's premium revenue was less than 2% of Taxpayer's aggregate revenue, 1.41% for Year 4. Net gain from sale of non-inventory assets was over 90% of Taxpayer's aggregate revenue for Year 4, 93.24% for Year 4.

In Year 5, premium revenue accounted for 24% of Taxpayer's total revenue, the remaining consisted of other investments (58.26%) and net gain from non-securities sales (18.67%).

Taxpayer's Form 990s reported net gains from sale of non-inventory assets as follows; $ii for Year 3, $jj for Year 4 and $kk for Year 5.

Pursuant to minutes from Taxpayer's Board meeting, Taxpayer's total asset for Year 4 was $ll compared to $mm for Year 3, this increase was mainly because of sale of Property 3.

Because of real property sales transactions in Year 4, Taxpayer net income for Year 4 was $nn. However, because there was no real property sale transactions in Year 5, Taxpayer had a net loss of $oo.

Year 4 total investment income was $pp compared to $qq for Year 5. Year 4 premium income was $rr compared to $ss for Year 5.

Taxpayer's business plan also noted that Taxpayer wrote most of Taxpayer's direct-written policies to Companies, companies owned/controlled by D, E and their families.

In Year 4, Taxpayer wrote two direct contracts that total $uu. One direct contract provided "Administrative Actions" coverage to F for $j, while the other policy provided "Employment Practices Liability" coverage to L for $k. For Year 4, there is no event maximum amount or annual maximum amount deductible for L and F.

In Year 5, Taxpayer wrote five direct contracts, one direct contract provided "Administrative Actions" coverage to F for $l. Another policy provided "Employment Practices Liabilities" coverage to L for $m. The remaining three provided "Commercial Excess General Liability" coverage in respective amounts of $n to P, $o to Q and $p to R.

P, Q and R, devote 80% of their activities towards owning/operating retail petroleum facilities located mainly in State and 20% towards real estate speculation/development in State.

Taxpayer wrote direct-written insurance contract that totaled $yy for Year 5. Similar to Year 4, Taxpayer did not maintain a reserve for policy loss, and did not use actuarial information to asses the risks Taxpayer insured against for L and F in Year 5.

In Year 4 and Year 5, Taxpayer and O entered into reinsurance arrangement contracts. During Year 4 and Year 5, Taxpayer assumed from O 1.01% and 0.88%, respectively, pro-rata share of group disability insurance and related claims. Both agreed there would be no guarantees to limit Taxpayer's losses. Total revenue from reinsurance premium for Year 4 was $r, $s for Year 5.

Taxpayer concluded that no reserves were necessary for unpaid losses whenever a contract period closes with no open-ended claims. Consistent with its business plan, Taxpayer expected numbers of claims to be low and dealt with claims on an ad hoc basis. Because Taxpayer deemed itself financially able to meets its claims obligations, Taxpayers neither reinsured its direct-written policies nor limited its losses through guarantees, indemnification, or hold harmless agreements.

For Year 5, Taxpayer's Form 990 reported reserve for policy losses and loss-related expenses of $ww however Taxpayer was unable to locate the documentation to substantiate this liability claim.

For Year 3, Taxpayer reported a management fee of $xx, 99% of this fee was for real estate related transactions. Taxpayer paid more than 70% of this fee to G for real estate management services. Family members of D and E indirectly own G.

For Year 4, Taxpayer reported a management fee of $yy. Taxpayer paid 100% of this fee to G to manage a real estate property. Family members of D and E indirectly own this G.

For Year 5, Taxpayer reported a management fee of $zz. More than 90% of this fee was for asset management however, Taxpayer did not explain what specific assets management services Taxpayer received to justify the fee.

In Year 3, Taxpayer reported incurred claims of $uv from three transactions arising from O's quarterly retrocession computations.

In Year 4, Taxpayer incurred and paid claims of $zy. Of this amount, Taxpayer paid $xw to F, a claim based on the Year 3 policy Taxpayer wrote to F. However, documentations show that this claim was a portion of an expense that originated from an EPA clean-up expenses associated with two real properties. Documentation also show the EPA clean-up occurred in a different state other than the states covered in the policy written to F. The EPA clean-up also occurred on a date prior to the date Taxpayer wrote F the Year 3 policy. Taxpayer paid the remaining amount as retrocession claims and experience refunds.

In Year 5, Taxpayer reported incurred claims of $xy to O which consisted of quarterly retrocession computations.

In the year following Year 5, Taxpayer decided not to write any more direct policies. Taxpayer also stated its intension to liquidate Taxpayer within 2 years after Year 5.

Facts as Developed from the Revised Joint Statement of Pertinent Facts between Taxpayer and Internal Revenue Service

Information the IRS gather from the documents Taxpayer submitted indicate Taxpayer incorporated itself on Date 1. The authorities of Z will regulate Taxpayer. The Government of Z also granted Taxpayer its insurance license. Taxpayer's business consists of insurance and reinsurance.

Taxpayer's Year 1 Form 990 includes a copy of Taxpayer's Foreign Insurance Company Election under § 953(d). Taxpayer elected treatment as a domestic corporation for federal income tax purposes.

A day after Taxpayer incorporated itself; Taxpayer's Board of Directors passed a resolution to accept the subscription of 30,000 shares of the authorized capital of Cambridge and issued 30,000 shares, 10,000 shares each to F, H, and K.

In Year 2, F and K transferred their shares to H. As of the first days of Year 3, Year 4 and Year 5, D and E owned 97%, 64.38% and 44.99% of H respectively.

N, H's general partner, owned 3% of H. From Year 3 through Year 5, D and E owned 49% of N, and D and E's children during the same periods owned not more than 6.38% of N.

At the time of Taxpayer's formation, Taxpayer had capital, $a, United States currency.

In the last month of Year 2, H contributed one-third interests in two properties, Property 1 and Property 2 to Taxpayer. H's basis in these two properties was $b. From the middle of Year 3 to the end of Year 3, Taxpayer sold its interests in Property 1 and Property 2 to 5 different buyers for a net gain of $c.

Two other insurance companies owned the remaining two-thirds interests in Property 1 and Property 2 and they sold their interests in Year 3.

On December 31 of Year 3, H contributed one-third interest in Property 3 to Taxpayer. H's basis in Property 3 was $d. In the third quarter of Year 4, Taxpayer sold its interest in Property 3 at a gain of $e.

In Year 2, Taxpayer's acquisition targets required cash equity of $f. In Year 4, it required $g.

During Year 2, Taxpayer and S entered into reinsurance arrangement contracts. S and Taxpayer agreed there would be no guarantees to limit Taxpayer's losses.

In Year 3, Taxpayer and O entered into reinsurance arrangement contracts. Taxpayer assumed from O pro-rata share of group disability insurance and related claims, 1.01% during Year 3 and Year 4 and 0.88% during Year 5. Taxpayer and O agreed there would be no guarantees to limit Taxpayer's losses.

Total direct written and reinsurance premiums Taxpayer issued in Year 3 were $z ($aa of reinsurance premium); for Year 4, it was $bb ($cc of reinsurance premium); and for Year 5, it was $dd ($ee of reinsurance premium).

In Year 4, Taxpayer wrote two direct contracts. One direct contract provided "Administrative Actions" coverage to F, while the other policy provided "Employment Practices Liability" coverage to L.

In Year 5, Taxpayer wrote five direct contracts, one direct contract provided "Administrative Actions" coverage to F. Another policy provided "Employment Practices Liabilities" coverage to L. The remaining three provided "Commercial Excess General Liability" coverage to P, Q and R.

Taxpayer consulted various law firms and risk management firms that advised Taxpayer regarding Taxpayer's direct written contracts drafting, pricing, risks management and actuarial matters. Taxpayer also retained an independent auditor to prepare Taxpayer's financial statements.

Pursuant to Taxpayer's Form 990s, Taxpayer's total assets for Year 3 was $t; for Year 4, it was $u; and for Year 5, it was $v.

Pursuant to Taxpayer's Form 990s, Taxpayer's total liabilities for Year 3 was $w; for Year 4, it was $x; and for Year 5, it was $y.

Total expenses reported, $ff for Year 3; $gg for Year 4; and $hh for Year 5.

IRS began its examination of Taxpayer in the middle of the year following Year 5, and concluded the examination the following year. IRS recommended that Taxpayer's tax-exempt status under § 501(c)(15) be revoked.

LAW AND ANALYSIS:

Neither § 501(c)(15) nor its corresponding regulations define an "insurance company" for federal tax purposes. Generally, the definitions under Subchapter L apply in addressing whether a company qualifies as an "insurance company" for purposes of § 501(c)(15). See Rev. Rul. 74-196, 1974-1 C.B. 140 (applying Subchapter L rules in the context of determining whether a company is an insurance company under § 501(c)(15)). For the years at issue, Treas. Reg. § 1.831-3(a) applies. Treas. Reg. § 1.831-3(a) defines "insurance company" as a company whose primary and predominant business activity is issuing insurance or annuity contracts and or reinsuring risks underwritten by such contracts. The determination of whether an arrangement constitutes insurance is made on a yearly basis and thus, each year must be considered independently. Cardinal Life

Insurance Co. v. United States, 300 F.Supp 387, 392 (N.D. Tex. 1968), rev'd on other grounds, 425 F.2d 1328 (5th Cir. 1970).

Regulations provide that though the company's name, charter powers, and subjection to state insurance laws are significant in determining the business that a company is authorized and intends to carry on, it is the character of the business actually done in the taxable year that determines whether the company is taxable as an insurance company. Treas. Reg. § 1.801-3(a)(1); see also Bowers v. Lawyers Mortgage Co., 285 U.S. 182, 188 (1932) (to the same effect as the regulation).

Neither the Code nor the regulations define the terms "insurance" or "insurance contract." The standard for evaluating whether an arrangement constitutes insurance is Helvering v. LeGierse, 312 U.S. 531 (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 "involv[ing] a contract, whereby, for adequate consideration, one party agrees to indemnify another against loss arising from certain specified contingencies or perils. Epmeir v. United States, 199 F.2d 508, 509-10 (7th Cir. 1952). Insurance is contractual security against possible anticipated loss. Id. 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. 1978). The risk must contemplate the fortuitous occurrence of a stated contingency, Commissioner v. Treganowan, 183 F.2d 288, 290-91 (2d Cir. 1950), and must not be merely an investment or business 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 a payment from the insurer. See Rev. Rul. 60-275, 1960-2 C.B. 43 (risk shifting not present where subscribers, all subject to the same flood risk, agreed to coverage under a reciprocal flood insurance exchange).

Risk distribution incorporates the statistical phenomenon known as the law of large numbers. The concept of risk distribution "emphasizes the pooling aspect of insurance: that it is the nature of an insurance contract to be part of a larger collection of coverages, combined to distribute risks between insureds." AMERCO and Subsidiaries v. Commissioner, 96 T.C. 18, 41 (1991), aff'd, 979 F.2d 162 (9th Cir. 1992). In Treganowan, 183 F.2d at 291, the court quoting Note, The New York Stock Exchange Gratuity Fund: Insurance That Isn't Insurance, 59 Yale L.J. 780, 784 (1950), explained that "[b]y diffusing the risks through a mass of separate risk shifting contracts, the insurer casts his lot with the law of averages. The process of risk distribution, therefore, is the very essence of insurance." See also Beech Aircraft Corp. v. United States, 797 F.2d 920, 922 (10th Cir. 1986), (risk distribution "means that the party assuming the risk distributes his potential liability, in part, among others"); Ocean Drilling & Exploration Co. v. United States, 988 F.2d 1135, 1153 (Fed. Cir. 1993) ("[r]isk distribution involves spreading the risk of loss among policyholders").

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 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). Risk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks. See Humana, Inc. v. Commissioner, 881 F.2d 247, 257 (6th Cir. 1989).

The principal concern with Taxpayer's activities is whether Taxpayer's primary and predominant business during each of the taxable years is insurance as required. Pursuant to Taxpayer's Form 990s, Taxpayer's total asset for Year 3 was $t, $u for Year 4, and $v for Year 5. Of Taxpayer's total business for the taxable years Year 3, Year 4 and Year 5, only 1.36%, 1.41% and 24%, respectively, were related to its purported insurance activities. Thus, it is clear that the majority of Taxpayer's business for the tax years at issue was related to business other than insurance and, therefore, Taxpayer does not qualify as an insurance company for these years.

As for risk distribution, Taxpayer's "insurance" activities for Year 2, Year 3, and Year 4 can be characterized as follows:

Year 2

| | "Insured" name | Type of policy | Premium | % of insurance business for tax year (rounded) |
|---|---|---|---|---|
| | F | Administrative actions | $h | 27% |
| | L | Employment Practices Liabilities" | $i | 28% |
| | O | Special risk/medical | $g | 45% |
| Total | | | $z | |

Year 3

| | "Insured" name | Type of policy | Premium | % of insurance business for tax year (rounded) |
|---|---|---|---|---|
| | F | Administrative actions | $j | 31% |
| | L | Employment Practices | $k | 23% |

| | | | | |
|---|---|---|---|---|
| | | Liabilities" | | |
| | O | Special risk/medical | $r | 46% |
| Total | | | $bb | |

Year 4

| | "Insured" name | Type of policy | Premium | % of insurance business for tax year (rounded) |
|---|---|---|---|---|
| | F | Administrative actions | $l | 17% |
| | L | Employment Practices Liabilities" | $m | 11% |
| | Plan | Commercial excess liability | $n | 13% |
| | Q | Commercial excess liability | $o | 15% |
| | R | Commercial excess liability | $p | 12% |
| | O | Special risk/medical | $s | 32% |
| Total | | | $dd | |

Risk distribution requires a sufficient number of insureds such that the Taxpayer achieves an adequate pooling of premiums and incorporates the statistical phenomenon known as the law of large numbers. See AMERCO, 96 T.C. 18 at 41. Here, it also appears that the various risks "insured" are not homogeneous and thus must be separated from one another and analyzed separately as to whether there is risk distribution as to that risk. See Rev. Rul. 2002-89, 2002-2 C.B. 984; see also Rev. Rul. 2005-40, 2005-2 C.B. 4.

The Service has taken the following positions with respect to risk distribution. In Situation 1 of Rev. Rul. 2002-89, supra, S a wholly owned subsidiary of P, a domestic parent corporation, entered into an annual arrangement with P whereby S provided coverage for P's professional liability risks. The liability coverage S provided to P accounted for 90% of the total risks borne by S. Under the facts of Situation 1, the Service concluded that insurance did not exist for federal income tax purposes. On the other hand, in Situation 2 of Rev. Rul. 2002-89, supra, the premiums that S received from the arrangement with P constituted less than 50% of S's total premiums for the year. Under the facts of Situation 2, the Service reasoned that the premiums and risks of P were pooled with those of unrelated insureds and thus the requisite risk shifting and risk distribution were present. Accordingly, under Situation 2, the arrangement between P and S constituted insurance for federal income tax purposes.

In Rev. Rul. 2002-90, 2002-2 C.B. 985, S a wholly owned insurance subsidiary of P, directly insured the professional liability risks of 12 operating subsidiaries of its parent. S was adequately capitalized and there were no related guarantees of any kind in favor of

S. Most importantly, S and the insured operating subsidiaries conducted themselves in a manner consistent with the standards applicable to an insurance arrangement between unrelated parties. Together, the 12 operating subsidiaries had a significant volume of independent, homogeneous risks. Under the facts presented, the ruling concludes the arrangement between S and each of the 12 operating subsidiaries of S's parent constitute insurance for federal income tax purposes.

Situation 1 of Rev. Rul. 2005-40, supra, describes a scenario where a domestic corporation operated a large fleet of automotive vehicles in its courier transport business covering a large portion of the United States. This represented a significant volume of independent, homogeneous risks. For valid non-tax business purposes, the transport company entered into an insurance arrangement with an unrelated domestic corporation, whereby in exchange for an agreed amount of "premiums," the domestic carrier "insured" the transport company against the risk of loss arising out of the operation of its fleet in the conduct of its courier business. The unrelated carrier received arm's length premiums, was adequately capitalized, received no guarantees from the courier transport company and was not involved in any loans of funds back to the transport company. The transport company was the carrier's only "insured." While the requisite risk-shifting was seemingly present, the risks assumed by the carrier were not distributed among other insured's or policyholders. Therefore, the arrangement between the carrier and the transport company did not constitute insurance for federal income tax purposes.

The facts in Situation 2 of Rev. Rul. 2005-40, supra, mirror the facts of Situation 1 except that in addition to its arrangement with the transport company, the carrier entered into a second arrangement with another unrelated domestic company. In the second arrangement, the carrier agreed that in exchange for "premiums," it would "insure" the second company against its risk of loss associated with the operation of its own transport fleet. The amount that the carrier received from the second agreement constituted 10% of the total amounts it received during the tax year on a gross and net basis. Thus, 90% of the carrier's business remained with one insured. The revenue ruling concluded that the first arrangement still lacked the requisite risk distribution to constitute insurance even though the scenario involved multiple insureds.

In Situation 4 of Rev. Rul. 2005-40, supra, 12 LLCs elected classification as associations, each contributing between five and 15% of the insurer's total risks. The Service concluded that this transaction constituted insurance for federal income tax purposes.

With regard to the instant case, each year must be considered independently to determine whether adequate risk distribution is present. See Cardinal Life, 300 F.Supp 387 at 392.

Taxpayer's "insurance" activity for tax years Year 3 and Year 4 is almost identical in terms of number of insureds, types of coverage, and percentage of risk allocation among insureds. Therefore, these years can be considered together. The various risks "insured" during Year 3 and Year 4 are not homogeneous and thus must be separated from one another and analyzed separately as to whether there is risk distribution as to each risk. It appears that Taxpayer does not sufficiently distribute its risk among each type of coverage, i.e. Taxpayer maintained one administrative actions policy, one employment practices liability policy, and a pro-rata share of special risks/medical coverage. Therefore, Taxpayer has not adequately distributed its risk. Moreover, there appears to be too much concentration of risk among the two insureds and "reinsurance" arrangement. See Harper Group & Subsidiaries v. Commissioner, 96 T.C. 45 (1991), aff'd, 979 F.2d 1341 (9th Cir. 1992) (involving 13 related entities representing approximately 70% of the insurer's total risk); see also Rev. Rul. 2002-90, supra; Situation 4 of Rev. Rul. 2005-40, supra.

Taxpayer fails to achieve adequate risk distribution in Year 5 because it has an insufficient number of insureds in which risk is too concentrated. See Rev. Rul. 2002-90, supra; see also Situation 4 of Rev. Rul. 2005-40, supra. There is also insufficient distribution with respect to the coverage for administrative actions and employment practices liability.

Taxpayer raises Harper Group & Subsidiaries v. Commissioner, 96 T.C. 45 (1991), aff'd, 979 F.2d 1341 (9th Cir. 1992); Amerco & Subsidiaries supra at 96 T.C. 18, in support of its argument that it qualifies as an insurance company for the years at issue. In Harper Group, there were 13 entities making up nearly two thirds of the risk concentration in all of the years at issue.

Therefore, the court's analysis in Harper Group supports the Service's position that Taxpayer does not qualify as an insurance company.

Harper Group can also be distinguished on the basis that the risks involved in Harper Group were diverse and widespread—an extensive variety of cargo shipments throughout the world via a variety of means and vessels. In other words, the various risks insured were homogeneous and numerous such that risk distribution was accomplished with respect to each separate risk. See Rev. Rul. 2002-89, supra; see also Rev. Rul. 2005-40.

With respect to the instant case, no determination has been made as to whether all of the agreements at issue qualify as insurable risks. See Rev. Rul. 2007-47, 2007-30 I.R.B. 127, in part, holding that an arrangement that provides for the reimbursement of believed-to-be inevitable future cost does not involve the requisite insurance risk for purposes of determining whether the assuming entity may account for the arrangement as an "insurance contract" for purposes of Subchapter L of the Internal Revenue Code. Furthermore, business risk is not insurable. LeGierse, 312 U.S. at 542.

The Examiner notes that in Year 4, Taxpayer paid claims that total $zy. Of this amount and based on the Year 3 direct policy Taxpayer wrote to F, Taxpayer paid $xw to F. However, Taxpayer's records describes the $xw payment as payment for the "EPA clean-up" associated with two real estate properties. In addition, F incurred the "EPA clean-up" expense before Taxpayer wrote the Year 3 administrative action policy to F. This claim is questionable and appears to be a business costs for real estate development ventures. If so, such "risks" are not fortuitous and expenses for which the requisite insurance risk exists.

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CONCLUSION:

1. Taxpayer is not an insurance company exempt from tax pursuant to § 501(c)(15) of the Code as of Year 3, Year 4 and Year 5.

2. Taxpayer is entitled to relief pursuant to § 7805(b) as of Date 1

A copy of this technical advice memorandum is to be given to the taxpayer. § 6110(k)(3) provides that it may not be used or cited as precedent.

- END -