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OP:E:EO:T:3

Employer Identification Number: [REDACTED] OCT 27 1998

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 under the laws of [REDACTED] on [REDACTED]. The information furnished shows that you have now redomesticated to [REDACTED].

The information furnished shows that your sole shareholder is [REDACTED]. The vehicle service contracts reinsured by you are sold by [REDACTED]. All of the above dealerships are owned by [REDACTED].

You state that you are a reinsurance company which currently reinsures vehicle service contracts and credit life and credit disability insurance contracts.

The information furnished shows that a customer who purchases a vehicle service contract is covered to the extent of the terms of such contract.

The information shows that the dealerships market the [REDACTED] (hereafter Program) that warrant coverage for new and used cars to their customers. The customers who participate in the Program sign the [REDACTED] (hereafter Agreement). The Agreements provide that the dealerships are responsible for repair. The dealer's obligation under the service contracts is insured by [REDACTED]. [REDACTED] requires the dealerships to collect certain amounts from customers and invest and retain such amounts as reserves to handle claims.

The Program is administered by [REDACTED]. The amounts placed in reserve are directed by [REDACTED] to [REDACTED], one of its

Subsidiaries. reinsures its risks under the Program with you.

You entered into a reinsurance contract with [redacted], effective [redacted]. Under this contract, [redacted] reinsures with you 100% of vehicle service contracts issued by the dealerships.

The information furnished shows that the credit direct writer is [redacted]. You entered into a reinsurance agreement with [redacted], covering combined credit life and credit [redacted] policies issued on or after [redacted]. [redacted] agrees to reinsure [redacted] % of the credit life agreements produced by the dealerships and you.

[redacted] does not consider a combined credit life and credit [redacted] contract to be a life product.

The financial information furnished shows the following:

Premium Income:	[redacted]	[redacted]
Life	\$ [redacted]	\$ [redacted]
A&H	[redacted]	[redacted]
Vehicle Service	[redacted]	[redacted]
Reserves:		
Life	\$ [redacted]	\$ [redacted]
A&H	-0-	-0-
Vehicle Service	[redacted]	[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 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 56.

Your sole business is indemnifying the risks of your owner's automobile dealership(s) under service contracts on which the dealership(s) are 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 accordingly, do not meet the statutory requirements for exemption under section 501(c)(15) of the Code.

Further, excluding the income attributed to the warranty service contracts from your premium reserves in [redacted] and [redacted] leaves you with predominantly life premium reserves. Therefore, since your unearned premium reserves consists of [redacted] life premium reserves in [redacted] and [redacted], we conclude that you were a life insurance company. Thus, you do not qualify for recognition of exemption under section 501(c)(15) of the Code, because you were a life insurance company and, accordingly, did not meet the statutory requirements for exemption under section 501(c)(15) of the Code.

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

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Date 2-24-99

[REDACTED]  
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 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 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 status should be addressed to that office.

Thank you for your cooperation.

Sincerely yours,

[Signed] Edward K. Karcher

Edward K. Karcher  
Chief, Exempt Organizations  
Technical Branch 3

cc: [REDACTED]

OP:E:EO:T:3  
[REDACTED] OP:G:EO:T:3  
[REDACTED]