UNITED STATES TAX COURT

RESERVE MECHANICAL CORP F.K.A. RESERVE CASUALTY CORP,	)	
Petitioner,	)	
v.	)	Docket No. 14545-16
COMMISSIONER OF INTERNAL REVENUE,	)	Filed Electronically
Respondent.	)	Judge Kathleen Kerrigan

ANSWERING BRIEF FOR RESPONDENT

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PRELIMINARY STATEMENT

Respondent timely filed his opening brief on August 4, 2017. Petitioner filed its opening brief on August 5, 2017. The answering briefs are due on or before October 10, 2017.

This answering brief is confined to matters not previously discussed or requiring clarification. Respondent's opening brief adequately covers the relevant factual and legal arguments for the issues not discussed herein. Failure to address issues covered in respondent's opening brief does not constitute a concession or abandonment of those issues.

Capitalized terms and abbreviations have the same meaning as in respondent's opening brief.

RESPONDENT'S OBJECTIONS TO PETITIONER'S REQUESTS FOR FINDINGS OF FACT

1. and 2. No objection.

3. Objection. This request seeks a legal conclusion. Petitioner timely filed an election under section 953(d), but petitioner is not eligible to make an election under section 953(d) because petitioner is not an insurance company for federal income tax purposes.

4. Objection. This request is incomplete, misleading, and not supported by the record. While petitioner filed Forms 990 for the tax years at issue, this proposed finding is inconsistent with Zumbaum's testimony that Capstone was responsible for maintaining the books and records. RPFF ¶ 214.

5. through 11. No objection.

12. Objection. This request calls for a legal conclusion, is misleading and inaccurate. Petitioner was not engaged in the "foreign insurance business" because petitioner was not an insurance company.

13. through 17. No objection.

18. Objection. This request is misleading and not supported by the record. The evidence does not support the amount of repair work, if any, Premier received from Peak.

19. No objection.

20. Objection. This request is incomplete, misleading and unsupported by the record. The record is inconsistent with

respect to the percentage of Peak's total sales attributable to Stillwater Mining Company during the 2009 tax year. RPFF ¶¶ 237-240. Zumbaum stated it accounted for "about 30 percent" but provided no specificity as to when Stillwater represented that estimate. The Feasibility Study and Background Information provided no percentage of sales attributable to Stillwater either, even though it was listed for another customer. Ex. 16-J, RSV-0006014. Further, there is no evidence in the record to support due diligence in connection with the 2009 Claim relating to the amount of Peak's sales attributable to Stillwater.

21. through 34. No objection.

35. Objection. This request is incomplete. The portion of the record at Tr. 647:17-21 misconstrues Peak's business as manufacturing hoist conveyances, as opposed to solely the guide wheels for the hoist conveyances.

36. and 37. No objection.

38. Objection. This request is not in accordance with T.C. Rule 151(e)(3) because it is not a concise statement of essential facts, but rather a discussion relating to the law.

39. No objection.

40. Objection. This request is unsupported by the record. There is no evidence regarding the "age" or "complexity" of the Bunker Hill Superfund Site.

41. No objection.

42. Objection. This request is unsupported by the record. There is no evidence regarding mining operations starting in 1883, the extent of contamination, and the projected timeframe for cleanup efforts.

43. Objection. The proposed finding is not credible because it is based solely on Zumbaum's self-serving and uncorroborated testimony. The Feasibility Study makes no reference that Peak's facilities are located in an area designated as a floodplain by the U.S. Federal Emergency Management Agency. Ex. 16-J.

44. Objection. This request is misleading and unsupported by the record. There is no clear definition of what petitioner means by "Superfund liability" and it is undefined in the record.

45. Objection. This request is misleading and unsupported by the record. There is no clear definition of what petitioner means by "Superfund liability."

46. through 48. No objection.

49. Objection. This request is unsupported by the record. There is no evidence in the record that the EPA "closely scrutinizes" mining related activities at Peak's location.

50. Objection. This request is misleading, inaccurate, and contradicted by the record. There is no evidence in the record relating to the process or specific steps that Peak engaged in to attempt to secure pollution coverage from commercial

insurers. Further, Exhibit 16-J, at RSV-0006021, states specifically that Peak had "limited coverage provided as part of its commercial general liability and products liability policies" concerning a pollution event. Exhibit 16-J indicates that pollution coverage was available to Peak, in some capacity, from its commercial insurers and that Peak actually had limited pollution coverage in place under its commercial general liability and products liability policies.

51. Objection for the reasons set forth in paragraph 50, above. Moreover, there is no evidence in the record of any investigation or other efforts by Zumbaum to determine whether commercial insurers offered pollution coverage to companies like Peak.

52. Objection. This request is unsupported by the record. There is no evidence in the record relating to the "level of government scrutiny on companies like Peak."

53. through 59. No objection.

60. Objection. The proposed finding is not credible because it is based solely on Zumbaum's self-serving and uncorroborated testimony. The Feasibility Study makes no reference to any "negative experience" with an insurance company and further Peak continued to maintain coverage with that insurance company. Ex. 16-J; RPFF ¶ 30.

61. Objection. This request is misleading. EMC conducted an investigation of Peak's claim. After an appraisal by engineers and other professionals, EMC determined that the roof required repair at a cost of $2,000. The fact that Peak spent more is not relevant. RPFF ¶ 28.

62. Objection. This request is incomplete, misleading, inaccurate, and based solely on Zumbaum's self-serving testimony. Despite the alleged poor experience with Peak's commercial insurer, EMC, in connection with the snow damage to the roof, Peak never cancelled its insurance coverage with EMC. RPFF ¶¶ 28-30. Further, even after petitioner was formed, Peak did not maintain any comparable coverage for potential future snow damage to the roof with petitioner. RPFF ¶¶ 70, 82, 102. For the reasons explained in respondent's argument and supported by RPFF, Zumbaum formed petitioner solely for tax avoidance purposes.

63. Objection. This request is self-serving, uncorroborated and too general to support a meaningful determination as to its correctness. The term "numerous" is vague. There is no evidence in the record of a single example of an insurance company being sued to pay a claim. There is also no evidence in the record of Peak or any of its affiliates taking such action against any of its commercial insurers.

64. and 65. No objection.

66. Objection. This request is unsupported by the record. The testimony cited in footnote 6 was stricken from the record.

67. Objection. The proposed finding is not credible because it is based solely on Zumbaum's self-serving and uncorroborated testimony. RPFF ¶ 44. Further, Exhibit 16-J does not support the proposed finding.

68. No objection.

69. Objection. The proposed finding is not in accordance with T.C. Rule 151(e)(3) because it is not a concise statement of essential facts.

70. No objection.

71. Objection. This request is misleading and inaccurate. Snyder was not an independent consultant due to his role as one of two directors of PoolRe, which was, in turn, managed by Capstone, the transaction promoter. RPFF ¶¶ 188-197.

72. Objection. This request is inaccurate, misleading and incomplete. Snyder has experience in the healthcare insurance industry, but has no experience in the mining or manufacturing segment of the insurance industry. RPFF ¶¶ 62-65.

73. and 74. No objection.

75. Objection. This request is incomplete and misleading. First, the Feasibility Study contains numerous errors and was prepared by McNeel, a Capstone employee with no experience in the mining industry in Idaho or with any company located in an

EPA superfund site. RPFF ¶¶ 55, 59-67. Second, the Feasibility Study was not issued until August 2009 and includes information dated in December 2009. RPFF ¶¶ 86-87. Third, the Feasibility Study was signed by Snyder, who was one of two directors of PoolRe, the purported reinsurance entity involved in the transaction, and thus had an inherent conflict of interest. RPFF ¶¶ 62, 194.

76. and 77. No objection.

78. Objection. Although petitioner's purported direct written policy for the tax years at issue names Peak, RocQuest, and ZW as the insureds, there is no evidence that supports the fact that Peak was the primary insured.

79. Objection. This request is incomplete and misleading. Petitioner's purported direct written insurance policies provided no coverage as they did not meet the requirements of insurance in the commonly accepted sense and lacked economic substance.

80. Objection. This request is inaccurate, incomplete, and misleading. There is no evidence in the record to support, and petitioner did not have, any existing insurance coverages in place for its own operations. Further, assuming that the reference to "petitioner" in this request was meant to refer to Peak, the evidence does not support that the direct written policies were insurance and that Peak had gaps or a need for

supplemental coverages. RPFF ¶¶ 41-44, 93-99, 123, 219-221, entire record.

81. Objection. This request is incomplete, misleading, and unsupported by the record. The evidence in the record demonstrates that petitioner did not actually participate in the PoolRe arrangement. RPFF ¶ 221. First, there is no evidence that reinsurance premiums were paid to PoolRe by petitioner or by Peak, ZW, and RocQuest. While Peak may have made a payment to PoolRe during the taxable year 2010, petitioner's general ledger shows that the payment was funneled to petitioner in a circular flow of funds. Exs. 28-P, 29-P, and 30-P. Petitioner reports the same PoolRe quota share reinsurance premiums in income on its general ledger and Form 990, as those purportedly paid to PoolRe by Peak. Exs. 28-P, 29-P, and 30-P. Second, PoolRe did not have an insurance license at the time the 2008 and 2009 Stop Loss Endorsements were executed. Exs. 57-J and 58-J; PPFF ¶ 84.

82. Objection. This request is incomplete, misleading, and unsupported by the record. See respondent's objection to petitioner's proposed finding paragraph 81. Further, the evidence in the record demonstrates that petitioner actually reported as income the full amount of the purported direct written premiums, including the purported reinsurance premiums

under the PoolRe arrangement, for each of the taxable years at issue. Exs. 2-J, 3-J, and 4-J.

83. Objection. This request is misleading, conclusory, and unsupported by the record. There is no evidence in the record to support that PoolRe's owner was unrelated to petitioner. Further, PoolRe and Capstone were closely connected. RPFF ¶¶ 188-196. Additionally, there is no evidence to support that PoolRe was regulated or in good standing with the British Virgin Islands in 2008. Further, PoolRe was not a licensed insurer during the taxable year 2008 and for the period January 1, 2009 through April 14, 2009, which is the period in which the reinsurance contracts with petitioner were executed concerning the 2008 and 2009 policies. Exs. 57-J, 58-J.

84. No objection.

85. Objection. This request is misleading, inaccurate, and unsupported by the record. Petitioner's bank account does not reflect any receipt of premiums in the stated amounts from CreditRe. Exs. 31-J, 32-J, 33-J. There is no evidence in the record to establish the existence of any of the alleged vehicle service contracts; no underlying accounting support and no paperwork or other documents regarding the origination or ceding/transfer of the contracts and associated risk. While the Credit Reinsurance Agreement suggests a relationship involving petitioner, the document alone does not demonstrate that the

relationship was of reinsurance, or otherwise had economic substance. Exs. 52-J, 72-J, 87-J.

Further, the alleged PoolRe premiums were Peak's own money for the purported direct written premiums that were funneled through PoolRe and into petitioner, resulting in a circular flow of funds. Exs. 28-P, 29-P, 30-P. The money purportedly paid from PoolRe to petitioner was equal to the amount allegedly paid from Peak to PoolRe. Additionally, CreditRe, PoolRe, and petitioner are all affiliated through Capstone. RPFF ¶¶ 202-204. In fact, all participants in the PoolRe structure were interrelated through their creation and collective management by Capstone. However, the other PoolRe participants have not been identified and the nature of their associated policies has not been disclosed. Lastly, PoolRe was an unlicensed insurance company at the time these transactions occurred for the 2008 and 2009 tax years.

86. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

87. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

88. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

89. Objection. See respondent's objection to petitioner's proposed finding paragraph 85. Further, the amount on line (c.)

does not reflect the actual direct written premium amount shown on petitioner's purported insurance policies for the taxable years at issue. The correct amounts are $412,089.00, $448,127.00, and $445,314.00 for the taxable years 2008, 2009, and 2010, respectively.

90. Objection. See respondent's objection to petitioner's proposed finding paragraph 85. Further, the proposed finding is not credible because it is based on Feldman's self-serving and uncorroborated testimony.

91. Objection. This request is misleading and unsupported by the record. PoolRe held no risk during the taxable years at issue. RPFF ¶ 206.

92. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

93. Objection. See respondent's objection to petitioner's proposed finding paragraph 85. Further, the analysis allegedly conducted by Myron Steves & Co. ("Myron Steves") is implicitly biased. Ex. 96-J was signed by Snyder, a director of PoolRe, who also signed the Feasibility Study. Further, the letter does not offer an opinion on "its suitability for any individual insured or captive insurance company participant."

94. Objection. See respondent's objection to petitioner's proposed finding paragraph 85. Further, Exhibit 95-J references a previous final draft dated October 20, 2009 and does not

address how PoolRe should set premium rates; but instead focuses on how Capstone should be setting PoolRe's rates, as the documents are for "the sole and exclusive use of Capstone Associated Services, Ltd." There is no reference to petitioner in Glicksman's discussion.

95. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

96. Objection. See respondent's objection to petitioner's proposed finding paragraph 85. Further, the amounts paid to PoolRe as reflected on the Quota Share agreements do not draw anywhere near $30 million. According to the Quota Share agreements, the total amounts funneled through PoolRe to their respective captives were $5,626,711, $5,638,661, and $6,638,587, for the taxable years 2008, 2009, and 2010, respectively. Exs. 51-J, 71-J, 86-J.

97. Objection. See respondent's objection to petitioner's proposed finding paragraph 85. Further, Exhibit 134-P was not offered into evidence.

98. Objection. This request is unsupported by the record. Aside from the payments made with respect to the 2009 claim, petitioner's bank accounts do not reflect any payment of any losses during the taxable years at issue. RPFF ¶¶ 219, 220.

99. Objection. This request is unsupported by the record. There is no evidence in the record to demonstrate the percentage of Peak's total sales that were attributable to Stillwater.

100. Objection. This request is unsupported by the record. There is no evidence in the record to show how Peak's reduction in sales was investigated, verified or calculated so as to trigger a claim under the alleged coverage. Further, there is no evidence as to petitioner's due diligence prior to accepting or paying the claim, including whether petitioner verified if Peak terminated any agreement with Stillwater, if Peak made any attempts to replace or mitigate the alleged sales reduction, or if the alleged sales reduction was due to substantial non-compliance or other conduct by Peak.

101. Objection. While petitioner paid $150,000 on April 21, 2009 and $14,820 on May 27, 2009 to Peak, there is no evidence Peak and petitioner entered into an arrangement at arm's length regarding the payments. There is no evidence of negotiation or investigation regarding the alleged loss.

102. Objection. This request is misleading and unsupported by the record. There is no evidence in the record to support that additional losses existed or any due diligence or investigation of "further losses" to justify an additional payout under the policy.

103. Objection. This request is incomplete. While petitioner paid Peak $175,000 on September 10, 2009, there is no evidence that any loss from Stillwater occurred or that the claim was reopened beyond Zumbaum's self-serving and uncorroborated testimony. RPFF ¶¶ 237-240.

104. Objection. This request is incomplete. While petitioner and Peak signed an Addendum, there is no evidence beyond Zumbaum's self-serving and uncorroborated testimony that any loss from Stillwater occurred or that the Addendum was entered into at arm's length for the final payment. RPFF ¶¶ 237-240.

105. Objection. This request is misleading and based solely upon Zumbaum's self-serving testimony. Although presumptively available to petitioner, there is no documentary evidence in the record, such as Peak's federal income tax returns, to demonstrate that payments received from petitioner were reported in income by Peak for any taxable year.

106. Objection. This request is misleading and incomplete. There is no evidence in the record to support the services, if any, that Capstone provided to petitioner. The record is void of service agreements, contracts for services, or engagement letters between petitioner and Capstone as to services provided. RPFF ¶ 45.

107. Objection. This request is misleading and unsupported by the record. First, petitioner's owner did not recall any contractual agreement with Capstone. Tr. 134. Second, Myron Steves was not an independent organization as it acted through Snyder, who was also involved with Capstone in petitioner's Feasibility Study and with PoolRe as a director. RPFF ¶¶ 194-196. Third, there is no evidence in the record regarding the extent of involvement, if any, Lloyd, Willis, or HRH had with petitioner beyond the alleged work by Snyder on the Feasibility Study.

108. and 109. No objection.

110. Objection. This request is misleading and unsupported by the record. McNeel's testimony indicated that there were other, unnamed, individuals allegedly involved in developing premiums and never indicated he was the "primary person" responsible for developing premium amounts. RPFF ¶ 158.

111. Objection. The proposed finding is incomplete because McNeel's experience does not include the mining industry or businesses located in EPA Superfund sites. RPFF ¶ 60.

112. Objection. The proposed finding is not in accordance with T.C. Rule 151(e)(3) because it is not a concise statement of essential facts.

113. and 114. Objection. See respondent's objection to petitioner's proposed finding paragraph 111. Further, the

proposed findings are not in accordance with T.C. Rule 151(e)(3) requiring a concise statement of essential facts.

115. Objection. This request is misleading and unsupported by the record. There is no evidence beyond McNeel's self-serving and uncorroborated testimony as to when the pricing indication sheets were received. Further, the pricing indication sheets were not specific to coverages written by petitioner as they contain several not written by petitioner during the taxable years at issue, such as Cyber Risk for 2009 and 2010.

116. Objection. This request is unsupported by the record. There is no evidence in the record identifying any specific employees at Mid-Continent that were involved with petitioner, including their individual qualifications, and what pricing methodologies, if any, that were used to determine petitioner's premiums listed on the indication sheets.

117. Objection. This request is misleading and not supported by the transcript reference cited. Ex. 94-J does not specifically address petitioner's lines of coverage, but rather makes sweeping and general remarks about Capstone's program. Further, the testimony cited contains no references to the lack of market-based rating manuals for petitioner's coverages.

118. Objection. This request is unsupported by the record. There is no evidence that petitioner's purported direct written

policies generally provided for low frequency/high severity claims that were consistent with Lloyds.

119. Objection. This request is misleading. There is no evidence in the record to support the extent, if any, that Mid-Continent applied the general process in Ex. 94-J to petitioner.

120. Objection. This request is misleading and incomplete. The cited testimony describes a general process that may or may not have been applied to petitioner's pricing indications for any of the taxable years at issue and makes no reference to what details of petitioner's insureds' information was reviewed before determining a price indication for petitioner.

121. Objection. This request is incomplete and unsupported by the record. There is no evidence in the record to support what was considered in setting the premiums, what individuals were specifically relied upon, and how the downward adjustments were determined from the Mid-Continent pricing indications.

122. Objection. This request is unsupported by the record and misleading. The underlying documents used to create the "base rate averages" are not in the record and, therefore, the similarity of the policies to those issued by petitioner cannot be established. Further, petitioner introduced only one "rating sheet" for the 2010 taxable year, and there are no "rating sheets" for the 2008 and 2009 taxable years in the record.

123. Objection. This request is unsupported by the record. Nothing in the record supports that percentage of revenue is an appropriate methodology for determining premiums regardless of industry or risk exposure. McNeel was not qualified as an expert in the area of premium methodology or insurance.

124. Objection. This request is unsupported by the record. Nothing in the record supports that number of employees is an appropriate methodology for determining premiums regardless of industry or risk exposure. McNeel was not qualified as an expert in the area of premium methodology or insurance.

125. Objection. This request is incomplete and misleading. The cited testimony states that McNeel used an IRPM, but there is no evidence in the record to support how the IRPM was determined, what factors were considered, and how it would have been utilized in determining petitioner's premiums.

126. Objection. This request is misleading and unsupported by the record references cited. The "average pricing data" is only reflected on Ex. 110-P, which is only for the taxable year 2010. There is no "average pricing data" in the record for 2008 and 2009. Also, the premiums listed on the "Rating Worksheets" do not match the final premium amounts charged by petitioner.

127. Objection. This request is misleading and unsupported by the record references cited. The documents do not support when the Rating Worksheets were created and the only evidence

for when they were created is self-serving testimony. Further, the Rating Worksheets do not correspond with the premiums actually charged by petitioner.

128. Objection. This request is misleading, inaccurate and contradicted by other evidence in the record. The actuaries who testified at trial were not independent due to their pre-existing and ongoing relationship with Capstone. RPFF ¶¶ 136-137, 169, 261. Further, the actuaries solely relied upon data provided by Capstone, using only premium information from other Capstone-created captive insurance companies without any comparison to third party insurance premiums. RPFF ¶¶ 257-263. Additionally, there is no evidence in the record explaining how the final premiums for petitioner's purported direct written policies were determined. Also, the premiums were not reasonable in amount as shown by the fact that the total premiums for less than one month of coverage in 2008 were substantially equal to the annual premiums for 2009 and 2010. RPFF ¶¶ 70, 82, 102.

129. Objection. This request is incomplete and misleading. Petitioner's Feasibility Study states that Anguilla was picked since as "a younger captive domicile, the regulatory environment is more flexible." Ex. 16-J, RSV-0006031.

130. Objection. This request is misleading and inaccurate. This request is contrary to petitioner's analysis in their

Feasibility Study which specifically ruled out Delaware because domestic domiciles did not have the "flexible regulatory environment and reasonable capitalization" requirements petitioner sought, highlighting the differences between the domicile options. Ex. 16-J, RSV-0006030. Further, petitioner was concerned that domestic domiciles, including Delaware, would have "unfavorable or *tax implications* for a small captive insurer." Ex. 16-J, RSV-0006031 (emphasis added).

131. Objection. This request is misleading. The Feasibility Study indicates that Anguilla is "efficient in granting new licenses" to insurance companies. Ex. 16-J.

132. through 138. Objection. The proposed findings of fact are not in accordance with T.C. Rule 151(e)(3) because they are not a concise statement of essential facts.

139. No objection.

140. Objection. The proposed finding of fact is not in accordance with T.C. Rule 151(e)(3) because it is not a concise statement of essential fact.

141. No objection.

142. Objection. This request is misleading. The accounts with AmericanWest and D.A. Davidson & Co. were under Zumbaum's control on behalf of petitioner. RPFF ¶¶ 9, 231.

143. Objection. This request is misleading. Petitioner had minimal involvement with the preparation, maintenance, or

oversight of its books and records, as this was handled by Capstone. RPFF ¶ 214. Zumbaum, the CEO, President, and Assistant Treasurer of petitioner, had no knowledge of who created the general ledgers and offered conflicting information as to who was responsible for entries into the ledgers. Tr. 131-134.

144. Objection. This request is misleading. The waiver letter from Anguilla is incomplete and does not indicate the specific insurance companies to which it is applicable; the letter simply states that the "2008 audit requirement for the eleven companies listed" while providing no list of companies. Ex. 133-P.

145. No Objection.

146. Objection. This request is misleading. The financial statements allegedly filed with the Anguilla Regulator were filed after their due date for the taxable years at issue. See respondent's objection to petitioner's proposed finding paragraph 144.

147. Objection. This request is misleading. Liptz as a CPA was subject to peer review, however, there is no evidence in the record to support that the work conducted for petitioner was subject to peer review.

148. Objection. This request is misleading and unsupported by the transcript references cited. There is no testimony from

Liptz concerning how reinsurance premium income was verified, what documents were relied upon in making the verifications and audit determinations, and what audit procedures were followed or utilized.

149. No objection.

150. Objection. This request is misleading and unsupported by the record. While petitioner met the $100,000 solvency requirement of Anguillan law, there is nothing in the record to support what petitioner's "premium to surplus" ratio is, how it was determined, and what calculation was involved in determining it, and its relevance to the proceeding.

151. Objection. This request is incomplete, misleading, unsupported by the record and states a legal conclusion to the extent it concludes that petitioner is a "valid insurance company" for federal income tax purposes. This request is duplicative as it cites only to other paragraphs of petitioner's requested findings for support and does not cite directly to any portion of the record. Accordingly, respondent further objects to this request for the reasons set forth in each response to the requested findings paragraphs cited by petitioner.

152. No objection.

153. Objection. This request is misleading. Petitioner's Form 1024 describes a general process for the determination of

premiums, which was not utilized for the policies issued by petitioner for the taxable years at issue.

154. through 158. Objection. These proposed findings are misleading, irrelevant, and unsupported by the record. Petitioner voluntarily withdrew its application; thus, their Form 1024 application was never ruled on and is irrelevant. Further, a determination letter issued to another taxpayer cannot be used or cited as precedent. See I.R.C. § 6110(k)(3). Thus, any determination letters issued to other organizations are irrelevant.

159. Objection. This proposed finding is unsupported by the record. Petitioner is attempting to cite matters contained within an offer of proof to the Court and not admitted in the record. Furthermore, this proposed finding is inaccurate and misleading as it is not the IRS's position that it will never issue favorable a determination letter under section 501(c)(15). The applicant was informed that Petitioner's application would likely be denied based on the facts and circumstances of Petitioner's application.

160. Objection. This proposed finding is irrelevant. Furthermore, it is inaccurate and misleading as is not the IRS's position that it will never issue a favorable determination letter under section 501(c)(15). In addition, the facts and circumstances of any other application are irrelevant.

161. through 167. No objection.

168. through 175. Objection. This request is argumentative and violates the requirements of T.C. Rule 151(e)(3) as it is not a concise statement of essential facts but rather an argument related to law.

176. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

177. Objection. This request violates the requirements of T.C. Rule 151(e)(3) as it is not a concise statement of essential facts but rather an argument related to law.

178. through 180. Objection. See respondent's objection to petitioner's proposed finding paragraph 85.

181. through 183. Objection. See respondent's objection to petitioner's proposed finding paragraph 177.

184. Objection. This request is inaccurate and unsupported by the record. There is no evidence in the record to support that the payments made to petitioner were contributions to capital. Further, this request is inconsistent with petitioner's reporting of the payments as income on its Forms 990 for the taxable years at issue.

185. Objection. This request is irrelevant and unsupported by the record. There is no evidence in the record to indicate what deductions are unrelated to the alleged insurance business.

Further, the withholding tax under section 881(a) applies to the gross payment.

REPLY TO PETITIONER'S ARGUMENT

I. Introduction

The key to this case is clear. Courts consider "all of the facts and circumstances to determine whether an arrangement qualifies as insurance." Rent-A-Center, Inc. v. Commissioner, 142 T.C. 1, 13-14 (2014) (citing Harper Group v. Commissioner, 96 T.C. 45, 57 (1991), aff'd, 979 F.2d 1341 (9th Cir. 1992). A captive arrangement can constitute insurance for federal income tax purposes where the arrangement satisfies the following elements: (1) the arrangement is "insurance" in its commonly accepted sense; (2) there is risk distribution; (3) there is risk shifting; and (4) the arrangement involves the existence of "insurance risk." See Rent-A-Center, Inc., 142 T.C. at 13; Harper Group, 96 T.C. at 58. In looking at all of the facts and circumstances in this case, it is clearly evident that petitioner's purported captive insurance arrangement with Peak and its alleged reinsurance arrangement with PoolRe do not constitute insurance for federal income tax purposes. Further, since it failed to satisfy each of the four elements, petitioner's arrangements lack economic substance.

The story told by the facts of this case is comparable to that in the Tax Court's recent opinion in Avrahami v. Commissioner, 149 T.C. No. 7 (August 21, 2017). In Avrahami, the Court examined a microcaptive insurance arrangement and

found that the reinsurer in those transactions was not a *bona fide* insurance company due to "excessive premiums, an ultra-low probability of a claim ever being paid, and payments of a circular nature." Id. at 75. In so finding, the Court held that the captive's reinsurance arrangement with the reinsurer did not distribute risk. Id. The absence of risk distribution through the arrangement with the reinsurer was sufficient alone for the Court to determine that the captive's arrangement was not insurance for federal income tax purposes. Id. at 76. The Court also rejected petitioner's argument that the policies issued by the captive to three or four affiliated entities created sufficient risk distribution. Id. at 62-64. In addition, the Court held that the captive arrangement was not insurance in the commonly accepted sense as the captive "was not operated like an insurance company, it issued policies with unclear and contradictory terms, and it charged wholly unreasonable premiums." Id. at 86. Thus, the facts in this case are not just comparable, but strikingly similar, to those in Avrahami.

As in Avrahami, petitioner's alleged reinsurance arrangement with PoolRe does not distribute risk sufficient to constitute insurance for federal income tax purposes. First, there is no evidence to support that PoolRe is a *bona fide* insurance company. The planning, structure, and operation of

PoolRe demonstrate that it was likewise "part of a tax-reduction scheme papered to look like an entity engaged in insurance." See Avrahami, 149 T.C. No. 7, at 75. Second, even if PoolRe were deemed to be a legitimate insurer, there is no evidence of an actual premium payment made to PoolRe to support petitioner's participation in the quota share or the CreditRe credit coinsurance arrangements with PoolRe.

Moreover, petitioner's arrangement is not insurance in the commonly accepted sense, as PoolRe existed only for tax purposes and not to operate as a real insurance company. Therefore, petitioner's arrangement does not constitute "insurance" for federal income tax purposes. For many of the same reasons, including but not limited to the absence of evidence to support a *bona fide* insurance arrangement, petitioner's alleged captive insurance arrangement also lacks economic substance. As a result, petitioner is not exempt from taxation under section 501(a) as an "insurance company" described in section 501(c)(15). Finally, petitioner's experts should be accorded no weight as they are biased due to a pre-existing relationship with Capstone, the captive insurance arrangement's promoter.

II. Petitioner Cannot Rely Upon Its Purported Insurance Arrangements to Achieve Sufficient Risk Distribution to be Considered "Insurance" for Federal Income Tax Purposes

Petitioner cannot demonstrate sufficient risk distribution based upon its reinsurance arrangements with PoolRe and,

therefore, its purported captive insurance structure is not insurance for federal income tax purposes. Risk distribution occurs when an insurer pools a large enough collection of unrelated risks (i.e., risks that are generally unaffected by the same event or circumstance). Rent-A-Center, Inc., 142 T.C. at 24. The pooling of numerous relatively small, independent exposures allows an insurer to more accurately predict expected future losses and creates risk distribution. Securitas Holdings, Inc. v. Commissioner, T.C. Memo. 2014-225, at 27. In analyzing risk distribution "[t]he focus is broader and looks more to the insurer as to whether the risk insured against can be distributed over a larger group rather than the relationship between the insurer and any single insured." Humana Inc. v. Commissioner, 881 F.3d 247, 257 (6th Cir. 1989); see also Harper Group, 96 T.C. at 57.

"The idea is based upon the law of large numbers a statistical concept that theorizes that the average of a large number of independent losses will be close to the expected loss." Avrahami, 149 T.C. No. 7, at 60. Distributing risk allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as a premium and set aside for the payment of such a claim. Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987). The absence of risk distribution *alone* is sufficient for the court

to find that a captive arrangement does not constitute insurance for federal income tax purposes. Avrahami, 149 T.C. No. 7, at 76. "Risk transfer and risk distribution are two separate and distinct prongs of the test and both must be met to create an insurance contract." Humana, 881 F.2d at 257.

To support its claim of sufficient risk distribution, petitioner alleges that it received more than 30 percent of its total premiums for each taxable year from reinsuring third party risks through the arrangements with PoolRe referred to as the quota share program and the CreditRe credit coinsurance program. As a result of these two arrangements, petitioner claims it has achieved risk distribution consistent with the Tax Court's decision in Harper Group. However, in Harper Group, the approximately 30 percent of total premiums were received from more than 7,500 unrelated customers of the taxpayer's subsidiaries that purchased air waybill insurance or special cargo policies covering over 30,000 shipments. 96 T.C. at 51-52. The Tax Court explained "[w]e believe that when 30 percent of the captive insurer's income is received from a relatively large number of unrelated insureds, there is a sufficient pool for the occurrence of risk distribution." Id. at 60, n. 10; see also Rent-A-Center, Inc., 142 T.C. at 24 (finding risk distribution in 15 subsidiaries owning over 2,000 stores

operated in 50 states with over 14,000 employees and over 7,000 vehicles).

This case presents a very different fact pattern from Harper Group and Rent-A-Center, Inc., that is, one which utilized PoolRe to provide an *appearance* of risk distribution without actually distributing any risk.

A. Petitioner lacked the requisite number of insureds to distribute risk

Petitioner's insurance contracts for the taxable years at issue only listed Peak, RocQuest, and ZW Enterprises as the insured entities. On its face, petitioner fails to achieve risk distribution among its insureds, as three entities are an insufficient number to achieve risk distribution. See Avrahami, 149 T.C. No. 7, at 62-64 (rejecting petitioner's argument that sufficient risk distribution existed from policies issued by the captive to three or four affiliated entities). Therefore, petitioner's insurance policies issued to Peak and its affiliates did not distribute risk among its three insureds.

B. PoolRe was not a *bona fide* insurance company and, thus, petitioner's arrangements involving PoolRe did not distribute risk

Before considering whether an arrangement constitutes insurance, courts first consider whether the purported insurance company is legitimate. Rent-A-Center, Inc., 142 T.C. at 10-11. In Avrahami, the Tax Court set out various factors in examining

whether an entity (Pan America) was a *bona fide* insurance company. We will address each of these factors in turn:

- whether the reinsurer was created for legitimate nontax reasons;
- whether there was a circular flow of funds;
- whether the entity faced actual and insurable risk;
- whether the policies were arm's-length contracts;
- whether the reinsurer charged actuarially determined premiums;
- whether comparable coverage was more expensive or even available;
- whether the reinsurer was subject to regulatory control and met minimum statutory requirements;
- whether the reinsurer was adequately capitalized; and
- whether the reinsurer paid claims from a separately maintained account.

149 T.C. No. 7, at 66-67; see also Rent-A-Center, Inc., 142 T.C. at 10-13.

In Avraham, the entity (Pan American) received premiums from a small business and then transferred an equal amount as reinsurance premiums to the captive associated with the small business. The Court found this to "look suspiciously like a circular flow of funds." Id. at 68. Additionally, the Court observed that the premiums, calculated based upon a percentage

of the loss limit for all participants in the arrangement, were "grossly excessive." Id. at 69-71. Finally, the Court found an "ultra-low probability" that both a claim would occur under the terms of the contract and that a qualifying loss would be paid by an already thinly capitalized insurer that returned nearly all of the premiums to the captives. Id. at 72-73, 75. The Court focused on the circular flow of funds, the unreasonableness of the premiums, and the lack of arms-length contracts in holding that the entity was not a *bona fide* insurance company. 149 T.C. No. 7, at 75.

In applying the Avrahami factors to PoolRe, the conclusion is the same. The reinsurance arrangement in Avrahami bears striking similarities to the purported reinsurance arrangement between petitioner and PoolRe. Taken as a whole, it is clear that PoolRe is not a *bona fide* insurance company, but instead a "part of a tax-reduction scheme papered to look like an entity engaged in insurance." Avrahami, 149 T.C. No. 7, at 75.

Some of the Avrahami factors cannot be fully evaluated due to the absence of evidence in the record regarding PoolRe. However, this inures to the detriment of petitioner, as respondent made a full and complete effort to obtain the documents and information regarding PoolRe by a subpoena *duces tecum* served in this case on PoolRe's owner. The documents requested by the PoolRe subpoena consisted of contracts for

reinsurance, proofs of payment (e.g. cancelled checks, receipts, wire transfers) for monies both received by or paid to PoolRe from petitioner, claims received by petitioner, correspondence, and actuarial studies and/or reports. (See April 26, 2017 Motion Tr. 37:3-25). Both petitioner and PoolRe objected to respondent's subpoena and moved the Court to quash it.

During the motion hearing regarding the PoolRe subpoena, counsel for PoolRe stated:

> MR. LEIGHTMAN: Everything on [the subpoena duces tecum] has two sides to it. And I believe that anything that would be on this list has been obtained from Reserve or could have been obtained.
> (Motion Tr. 36:7-10).

PoolRe did not contend that the documents did not exist, but rather represented that the requested items in the subpoena was "information that Reserve has." (Motion Tr. 37:23-24). Thus, under PoolRe's view of its documents, petitioner had possession, custody or control of everything that PoolRe had or could have produced. However, the PoolRe documents were not introduced into evidence. Petitioner's failure to produce the PoolRe documents, which PoolRe contends petitioner has in its possession, supports an adverse inference against petitioner that such documents, if produced, would have been unfavorable. See Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158 (1946), aff'd, 162 F.2d 513 (10th Cir. 1947).

Yet, during the same motion hearing regarding the PoolRe subpoena, petitioner's counsel informed the Court that all documents in petitioner's possession relating to PoolRe were produced.

> THE COURT: I am asking, documents that would be in [petitioner's] possession related to PoolRe. Not anything in PoolRe's possession. Just documents that would have been in your client's possession?
> MR. ALBRIGHT: And you are saying, in Reserve Mechanical's possession?
> THE COURT: Yes.
> MR. ALBRIGHT: Yes, Your Honor.
> THE COURT: Reserve Mechanical's possession, related to PoolRe.
> MR. ALBRIGHT: *We have turned over everything to my knowledge that Reserve Mechanical Corporation [petitioner] has in its possession regarding PoolRe.*
> (Motion Tr. 35:9-22) (emphasis added).

In any event, irrespective of whether the requested PoolRe documents are in petitioner's possession or whether all the PoolRe documents were produced by petitioner, petitioner has failed to adduce any persuasive evidence that PoolRe was a *bona fide* insurance company. Petitioner bears the burden of proof to show that it is a genuine insurance company, including that its reinsurance arrangement with PoolRe distributed risk. T.C. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933). Based upon the evidence in this case, or more appropriately the lack of evidence regarding PoolRe or any documents relating to PoolRe's operations, petitioner cannot meet its burden of proof.

1. PoolRe was not created for legitimate nontax reasons

Petitioner's alleged captive insurance arrangement with PoolRe was created solely for tax purposes. PoolRe was a mere artifice that was layered onto the Capstone program to create an appearance of reinsurance. However, beneath the surface it is evident that tax, not insurance considerations are its focus.

The commonalities between PoolRe and Capstone indicate the entities worked in concert, rather than as independent, *bona fide*, businesses. Snyder, the individual signing off on feasibility studies in conjunction with Capstone, acts as one of two directors of PoolRe. While petitioner asserts that PoolRe is independent of Capstone, all of Snyder's PoolRe-related work is conducted in Capstone's physical office in Houston, Texas; down the hall from its sister entity, the Feldman Law Firm. (Tr. 41-42; 49-50). McNeel, a Capstone employee who conducts and writes the feasibility studies, corresponds with outside parties as to the amount of premiums that *PoolRe* should charge for all Capstone created captives. This does not reflect the operation of a *bona fide* insurance company, but rather, a device whose only function was to impart an appearance of legitimacy to a transaction wholly driven by tax considerations.

Moreover, petitioner's alleged captive insurance arrangement was not intended to more effectively or efficiently manage Peak's risks. At most, Peak only consulted with Capstone

on its potential captive insurance arrangement. (RPFF ¶ 44). From the on-site visit in August 2008 to December 2008 when petitioner was organized and the alleged excess insurance policies were put in place, Peak's insurance expenses skyrocketed. Peak's owner was aware that the premiums paid by Peak to petitioner would reduce Peak's federal income tax liability. (RPFF ¶ 130). Despite the sky-high premiums that Peak paid to petitioner, Peak always maintained its pre-existing commercial third party coverages. The focus of the entire arrangement was on taxes, not insurance.

2. **There was a circular flow of funds**

As shown by petitioner's general ledgers, the reinsurance premiums paid to PoolRe were ultimately funneled back to petitioner in the same amount, dollar for dollar, for each of the taxable years at issue. The direct written premiums paid to petitioner are reported in its general ledger account 40000 for affiliated direct written premiums. Petitioner's account on its general ledger for the PoolRe quota share reinsurance premium reports the same premium dollar amount for the twenty percent Peak purportedly paid to PoolRe as reflected in the insurance binders. This pattern continued, year after year. In 2008, Peak funneled $76,236 of reinsurance premiums through PoolRe, which then passed the exact same amount to petitioner's bank account. In 2009, the same occurred with the $82,903 of alleged

reinsurance premiums and again in 2010 with $88,617 of alleged reinsurance premiums. (Exs. 31-J, 32-J, 33-J). Petitioner attempted to paper its account to appear that there was genuine reinsurance, but ultimately all the money paid to PoolRe ended up under petitioner's control.

Furthermore, Peak's risks that were purportedly insured through petitioner with PoolRe were different than the risks that PoolRe reinsures with petitioner under the quota share arrangement. Yet, despite the diversity of insured individuals, exposures, policies, and industries involved, a flat rate was charged for both payments to and from PoolRe. This was not only logically counterintuitive, it reflected a complete lack of arms-length dealing, and that PoolRe's function was merely to return Peak's money to another Peak-related entity on a tax-free basis under the guise of reinsurance.

In sum, PoolRe was paying to petitioner what it should have received from Peak as direct written policy premiums. PoolRe retained no net insurance premiums. PoolRe was merely funneling the *same* exact premiums to petitioner, resulting in a circular flow of funds, while creating the appearance of a reinsurance arrangement. There was not a scintilla of non-tax validity to this arrangement.

3. PoolRe did not face actual risk

As Capstone's chief executive Stuart Feldman conceded, PoolRe bears no risk in the Capstone arrangement. (RPFF ¶ 206).

4. The reinsurance policies with PoolRe were not arm's-length contracts

PoolRe is comprised solely of Capstone-created captive insurance companies. (RPFF ¶ 188). The day-to-day operation and management, including administrative operations, of PoolRe have been delegated to Capstone, and Capstone maintains all books and records for PoolRe. (RPFF ¶¶ 191, 192). PoolRe has no employees; instead, PoolRe's directors are directed by Capstone as to what documents to sign and they conduct PoolRe-related business from Capstone's office. (RPFF ¶¶ 194-199). Capstone created the PoolRe reinsurance policies with petitioner and they were not arm's-length contracts.

This is apparent when examining the payments moving in and out of PoolRe. Under the Quota Share agreement, petitioner was allegedly ceding a portion of its risk to PoolRe and taking on a "blended" amount of risk from all the other entities involved in the PoolRe arrangement. This means that petitioner, insuring a mining manufacturing company in an EPA Superfund site, gave up a portion of that exposure in exchange for other alleged risks. However, there is one problem: there is no evidence as to what other parties were involved as counterparties to the reinsurance transaction, what their risks were, what amounts of exposure

existed, and what industries, locations, or operations they had. The Quota Share agreement only identifies the captive companies by a number. Unless all the companies involved in PoolRe were involved in mining manufacturing in an EPA Superfund site located in Idaho, petitioner would have the Court believe that it would be potentially exposed to a wide number of risks and industries without any due diligence. Any true arms-length negotiation would examine these risks and determine an appropriate pricing method, which is absent from the record in this case. Instead, petitioner blindly ran with a number that would ensure that 100 percent of its direct written premium amount would end up in its bank account. This is not how *bona fide* insurance companies operate.

The lack of arm's-length nature of the PoolRe arrangement is further evidenced by the letters from Myron Steves, an insurance consultancy, and Glicksman, an actuary. In the Myron Steves letter, there is no discussion about how the price was negotiated, but rather whether it was "reasonable." (Ex. 96-J). Regardless, the letter was drafted and signed by Snyder who would be an eventual director of PoolRe; hardly an arms-length negotiation. The Glicksman letter is addressed to Capstone and not PoolRe. (Ex. 95-J). The Glicksman letter demonstrates that Capstone, not PoolRe, is determining the amount of premiums. PoolRe, Capstone, and Snyder are so inextricably intertwined

that any dealing within the structure cannot be regarded as arm's-length.

5. Petitioner has failed to demonstrate that PoolRe charged actuarially determined premiums

There is no evidence to show how the reinsurance premiums were calculated by PoolRe. (RPFF ¶ 211). The documents petitioner offers in support of the PoolRe premiums are completely unreliable. Petitioner relies on a letter from Myron Steves to justify its PoolRe premiums for the 2008 and 2009 taxable years. Petitioner claims that Myron Steves is an independent organization and that its opinion formed the basis for the 18.5% flat rate. (PPFF ¶¶ 93, 107) The "independent" analysis for PoolRe, however, was conducted by Snyder, one of the eventual directors of PoolRe. (Ex. 96-J) Despite the inherent conflict of interest, Snyder, who is not an actuary, still determined that the premiums were reasonable for the entity he would one day be a director of and which would, in turn, offer "reinsurance" to companies he signed feasibility studies for on behalf of Capstone.

Moreover, at no point in the Myron Steves letter does it state what actuarial analysis, if any, was involved for the 2008 and 2009 tax years. Instead, the letter addresses the 2004 and 2005 years and further states that it is not opining on "its suitability for any individual insured or captive insurance company participant." (Ex. 96-J, RSV-0008953)

Petitioner also relies on a letter from Glicksman regarding the 2010 PoolRe premium. On its face, the Glicksman letter shows that PoolRe was not independently calculating actuarially sound premiums, as the letter was addressed to Capstone. The Glicksman letter also refers to a previous report that is not in evidence, and which therefore cannot be verified. Further, the Glicksman letter is dated January 31, 2012, which is after the taxable years at issue. It is nothing more than a belated attempt to document an appearance of compliance with the requirements of Harper Group. Petitioner has produced no evidence of any underlying actuarial analysis, underwriting, or due diligence in calculating the reinsurance premiums. Petitioner has failed to show how the reinsurance premiums were actually calculated. Lastly, as discussed above, the Glicksman letter supports that Capstone, not PoolRe, determined the premiums at a flat rate across the board for all the captives in its program regardless of what alleged risks were involved. As the Avrahami Court observed regarding the "one-size-fits-all rate for all of Clark's scores of clients", "[t]here are some rather obvious questions here". Avrahami, 149 T.C. No. 7, at 69.

6. Petitioner failed to establish that petitioner or Peak researched or evaluated the premiums or coverages provided

Petitioners adduced no evidence regarding how the premiums or coverages offered by PoolRe compared with those of legitimate third party insurers. What is clear, however, is that the captive arrangement enormously increased Peak's insurance costs relative to the cost of its pre-existing commercial insurance coverage. Further, since PoolRe "held no risk," it would be impossible for PoolRe to offer coverage of any sort, and its only purpose was to create the façade of a risk pool achieving risk distribution.

7. PoolRe was not a licensed insurer when the 2008 and 2009 policies were allegedly reinsured

Originally, PoolRe was domiciled in the British Virgin Islands with a third party acting as its management company. (RPFF ¶ 200). However, PoolRe was re-domiciled in Anguilla with its management company becoming a Capstone-related entity. (RPFF ¶ 201). Anguilla provided minimal statutory insurance requirements that could easily be met by PoolRe.

Irrespective of Anguilla's permissive insurance environment, it is undisputed that PoolRe did not hold an insurance license until April 15, 2009. (PPFF ¶ 84). Despite lacking this license, PoolRe issued contracts for reinsurance regarding petitioner's 2008 and 2009 policies.

8. Petitioner has failed to show that PoolRe was adequately capitalized

Petitioner failed to adduce any evidence showing that PoolRe was adequately capitalized, and consequently, such a determination cannot reasonably be made. Such a failure to show such evidence should be a mortal blow to petitioner's position.

9. Petitioner has failed to demonstrate that PoolRe paid claims

Petitioner has not proven the payment of any claims by PoolRe. However, there is evidence to show that petitioner did not pay any claims pursuant to its reinsurance agreement with PoolRe. (RPFF ¶ 212). If PoolRe had paid claims, petitioner would be responsible for payment of a pro rata portion of any such claim under the quota share reinsurance arrangement between petitioner and PoolRe. The fact that no claims were paid by petitioner under the PoolRe arrangement is supported by the lack of payments from their bank statements.

Based upon the foregoing, PoolRe is not a *bona fide* insurance company and, thus, petitioner's purported reinsurance arrangements with PoolRe did not distribute risk.

C. Petitioner has failed to establish its participation in the PoolRe quota share arrangement and, thus, cannot demonstrate risk distribution from the PoolRe reinsurance arrangement even if it is deemed to be a *bona fide* insurer

If the Court finds that PoolRe is an insurance company, then, as a factual matter, petitioner has failed to establish

its participation in the PoolRe quota share arrangement. As a result, petitioner cannot show any risk distribution from reinsurance in the PoolRe pool.

1. Reinsurance premiums were never paid to PoolRe

The quota share agreement between petitioner and PoolRe required the payment of premiums to PoolRe. There is nothing in petitioner's general ledger, its bank statements, or in the record in this case to support any payment from petitioner to PoolRe. There is also nothing in the record to show how the PoolRe reinsurance premiums were calculated. Nonetheless, the absence of reinsurance premiums paid by petitioner to PoolRe contradicts the existence of an actual reinsurance relationship between petitioner and PoolRe.

Due to the complete absence of reinsurance premium payments from petitioner to PoolRe, petitioner alleges that approximately 20 percent of direct written premiums were paid to PoolRe by petitioner's insured affiliates, meaning Peak. However, there is again a complete lack of evidence of any payment by Peak, along with Peak-affiliates 2W Enterprises and RocQuest, to PoolRe for the taxable years 2008 and 2009. The absence of actual reinsurance premiums paid by anyone to PoolRe in these taxable years refutes an actual reinsurance relationship.

2. Petitioner's general ledgers reflect a circular flow of reinsurance premiums through PoolRe back to petitioner

Petitioner claims that the reinsurance premiums for the quota share arrangement with PoolRe were paid by Peak directly, as opposed to petitioner. However, as discussed in greater detail above, petitioner's general ledgers show that the reinsurance premiums were transferred from Peak to PoolRe and then funneled to petitioner, in the exact same amount. Further, while there is evidence that Peak made a payment to PoolRe during the taxable year 2010, petitioner's general ledger shows that the payment was ultimately funneled to petitioner. (Exs. 28-P, 29-P, 30-P). Accordingly, any such reinsurance premiums paid by Peak to PoolRe were nothing more than Peak's funds flowing through PoolRe to petitioner.

As petitioner's expert Liptz testified, the direct written premiums paid to petitioner are reported in its general ledger account 40000 for affiliated direct written premium. Petitioner's direct written premium account 40000 reflects the premium amount paid by Peak to petitioner consistent with the insurance binders. However, petitioner's general ledger account for the PoolRe quota share reinsurance premium also reports the same premium amount, as also reflected in the insurance binders, that was allegedly paid to PoolRe.

As a result, petitioner is reporting as income in its general ledger for each taxable year the *same* PoolRe quota share reinsurance premiums that Peak purportedly paid to PoolRe for reinsurance premiums. These same amounts that were purportedly paid to PoolRe directly by Peak are also reported as income by petitioner on its Form 990. Petitioner is reporting the exact same dollar amount of that purported reinsurance premium as income for each taxable year.

Assuming *arguendo* that the reinsurance premiums were paid by Peak to PoolRe, the payments are inconsistent with the existence of an actual insurance arrangement because PoolRe is returning those *same* exact premiums to petitioner. PoolRe is paying back to petitioner what it would have received from Peak as reinsurance premium. PoolRe retains no net insurance premium. Thus, even under petitioner's view, the purported reinsurance premiums are paid by Peak to petitioner, and not retained by PoolRe. The expectation for PoolRe was not to hold risk, but only to create the façade of a risk pool achieving risk distribution.

Taken in total, PoolRe is a mere straw man in the purported insurance arrangement at issue. As noted above, based upon petitioner's general ledgers, PoolRe does not retain any net reinsurance premium. There is no evidence of any claims paid by PoolRe. PoolRe merely passes money it received from Peak on to

petitioner. PoolRe exists only to allow the appearance that petitioner has satisfied the Harper Group requirement of 30 percent risk distribution. After all, PoolRe is managed by Capstone, and all of the PoolRe participants are Capstone-related entities. Additionally, Snyder was both a director of PoolRe and signed the feasibility study for petitioner. PoolRe exists solely to create the appearance of risk distribution.

Petitioner has failed to establish that any reinsurance premiums were actually paid to PoolRe to support the alleged reinsurance relationship. In the absence of the PoolRe reinsurance arrangement, petitioner did not distribute any risk through the PoolRe pool and, accordingly, bore the entire risk from the direct written policies for each of the taxable years at issue.

3. PoolRe was not a licensed insurance company when Petitioner entered into the Quota Share Reinsurance Agreements regarding the 2008 and 2009 Policies

It is undisputed that a Class "B" Insurer's General License was issued to PoolRe by the Anguilla Regulator, which PoolRe held from April 15, 2009 through December 31, 2010. (PPFF ¶ 84). This, however, does not explain how petitioner was able to enter into reinsurance agreements with an unlicensed insurance company regarding the 2008 and 2009 policies. The quota share reinsurance agreement for 2008 was effective from January 1,

2008, to January 1, 2009, while the agreement for 2009 was effective from January 1, 2009, to January 1, 2010.

Petitioner has offered no explanation for why it allegedly has a valid and binding reinsurance agreement with a company unlicensed to conduct insurance business when the reinsurance contracts were executed with PoolRe in 2008 and 2009.

D. Petitioner has failed to establish its participation in the CreditRe credit coinsurance arrangement involving PoolRe and, thus, cannot demonstrate risk distribution through PoolRe even if deemed a *bona fide* insurer

Again assuming that PoolRe is deemed an insurance company by the Court, petitioner has nonetheless failed to establish its participation in the CreditRe credit coinsurance arrangement involving risks reinsured through PoolRe.

1. Petitioner has not established the CreditRe credit coinsurance arrangement involving PoolRe

As with the quota share arrangement with PoolRe, petitioner's bank records do not show that it received any premiums from PoolRe relative to the CreditRe credit coinsurance arrangement. Accordingly, petitioner cannot show, as a factual matter, its participation in the CreditRe arrangement and, consequently, any resulting risk distribution from reinsurance of the purported "thousands of unaffiliated insureds" that PoolRe reinsured from CreditRe.

Moreover, there is nothing beyond the credit reinsurance agreement to establish the credibility of the CreditRe

arrangement. In other words, the documents that an insurer would ordinarily maintain to support its reinsurance of "thousands of unaffiliated insureds" is completely absent. The record lacks even a single vehicle service contract underlying the CreditRe arrangement. Further, while CreditRe's owner testified that the underlying vehicle service contracts would result in claims, there is no evidence to support that petitioner *paid* any claims as a result of the arrangement. (RPFF ¶¶ 186, 187). Petitioner may point to the losses that appear in their general ledgers, but yet again, petitioner has failed to produce any documentation to support the entries in its ledgers. For the Peak loss, petitioner was able to produce documentation, but yet for the "losses" on petitioner's ledgers no such documents exist in the record. In any event, there is nothing to support petitioner's due diligence in the CreditRe reinsurance arrangement.

Petitioner has failed to establish that any reinsurance premiums were actually received from CreditRe to support the alleged CreditRe arrangement. Accordingly, in the absence of the CreditRe arrangement, petitioner's purported reinsurance arrangement did not distribute risk.

2. The CreditRe credit coinsurance arrangement involving PoolRe distributed *de minimis* risk

Even if the Court finds that petitioner actually participated in the CreditRe arrangement through PoolRe, the

amount of risk distribution under the arrangement was *de minimis*. While petitioner has not established the original size of the risk pool, PoolRe was allegedly ceded only 1.5 percent of the total vehicle service contracts. (RPFF ¶ 182). The risk of that 1.5 percent was then equally distributed between the roughly 50 Capstone participants in each year. The resulting risk to any of those 50 participants, including petitioner, for each of the taxable years was roughly .03 percent, which is clearly *de minimis*.

III. Petitioner's Insurance Arrangements are Not Insurance in the Commonly Accepted Sense so as to be Considered "Insurance" for Federal Income Tax Purposes

In determining whether an arrangement is insurance in the commonly accepted sense, the courts look to various factors. These factors include whether the premiums were reasonable and the result of an arms-length transaction; whether the policies were valid and binding; whether the insurer was adequately capitalized; and whether there was a legitimate business reason for acquiring insurance from the captive. Avrahami, 149 T.C. No. 7, at 76-77; see also Rent-A-Center, Inc., 142 T.C. at 24-25. In making the determination a court must look beyond the formalities and consider the reality of the transaction. Avrahami, 149 T.C. No. 7, at 78. The reality of the transactions here is that they were done solely for tax motivated purposes, not insurance purposes.

Petitioner argues that its arrangement satisfies each of the factors and is consistent with commonly accepted notions of insurance. In support, petitioner focuses on the reasonableness of its premiums. In so doing, petitioner points to 39 determination letters issued by respondent to other unrelated taxpayers concerning tax-exempt status under section 501(c)(15). Petitioner alleges that its process for setting the direct written policy premiums, which relied principally upon the advice of a Capstone employee, was the same in this case as it was in the 39 favorable determination letters issued by respondent.

First, a determination letter issued to another taxpayer cannot be used or cited as precedent. See I.R.C. § 6110(k)(3). Thus, the 39 determination letters issued to other organizations are not relevant. However, even if a determination letter could be relied on, the 39 determination letters are not sufficiently complete, in terms of their underlying facts and associated analysis, to compare their respective results to the present case. Additionally, while petitioner relies upon the 39 determination letters in its legal argument, its expert Snyder did not rely upon the 39 determination letters in reaching his opinion in the case. (Ex. 97-P, p. 4).

Petitioner was *not operated* as an insurance company. Instead, petitioner was organized solely for tax purposes. As

such, petitioner's alleged captive insurance arrangement is not insurance for federal income tax purposes.

A. Petitioner was created for tax purposes and not to operate as an insurance company

Petitioner was not operated like an insurance company. In stark contrast to the facts in Rent-A-Center, Inc., petitioner was not formed to reduce costs, did not provide greater accountability, and did not increase transparency in Peak's insurance program. Instead, the arrangement simply moved money in the form of premiums (and a single claim) for tax purposes.

The processing of the single claim in 2009 demonstrates that petitioner was not operated as an insurance company, but instead simply allowed money to move freely from Peak to petitioner and back to Peak whenever desired. The purported claim was for the lost business from Stillwater Mining Company, who was alleged to be a major customer of Peak. However, the only evidence of the claim is a single document without any detail showing how that customer met the requirements of a "major customer" under the 2009 policy. No investigation was conducted by petitioner or Capstone as to Peak's purported reduction in sales. Instead, an employee of Peak, who was wholly unaffiliated with petitioner, signed a series of checks drawn on petitioner's Idaho bank account in order to transfer money from petitioner to Peak. Further, a substantial portion of the claim was paid *before* a settlement agreement was

executed. (RPFF ¶¶ 241-246). In addition, another check was written after the settlement agreement was signed for almost double the amount of the initial payout. It was only several years after the final check was written that the amendment to the claim settlement agreement was made in order to justify petitioner's payout.[1] (RPFF ¶ 251). This is not how a legitimate insurance company does business.

Moreover, there is a blatant absence of evidence concerning how petitioner conducted its purported insurance business. Peak and its affiliates were issued subpoenas for extensive documentation concerning its operations and produced only copies of cancelled checks written by Peak in 2010 and 2011. (RPFF ¶¶ 119, 120). There is no evidence of meetings of petitioner's board of directors, only boilerplate waivers in lieu of a meeting. Petitioner's books and records were prepared by Capstone, the promoter of the transaction. (RPFF ¶¶ 36, 214). There is no evidence of due diligence conducted prior to the formation of petitioner. (RPFF ¶¶ 40-45). Finally, Zumbaum, who along with Weike' were the owners of both Peak and petitioner, stated that he was unfamiliar with and had no actual knowledge of what petitioner *actually did* in Anguilla. (RPFF ¶ 116). The evidence of petitioner's operations is wholly lacking

[1] The amendment to the 2009 Claim appeared to occur roughly around the same time petitioner was under audit for the 2009 tax year.

and insufficient to show that it operated as an insurance company.

1. Petitioner's premiums are unreasonable

Petitioner's premiums were determined by Capstone and approved by the two joint owners of Peak and petitioner. The premiums were calculated to maximize Peak's tax benefits, but the methodology, if any, for calculating the premiums remains a mystery. Surprisingly, and very telling, even petitioner's owner and director do not know how the premiums were determined for petitioner. (RPFF ¶ 126). Regardless of the methodology, the premiums are unreasonable.

Prior to petitioner's formation, Peak incurred insurance premium expense of $38,810, $95,828, and approximately $40,000, which skyrocketed to include an *additional* $412,089, $448,127 and $445,314 for the taxable years 2006, 2007, and 2008 for the excess direct written insurance with petitioner. Notably, the 2008 premium for one month of purported insurance coverage with petitioner was $412,089, while the annual 2009 and 2010 premiums for nearly identical coverage was $448,127 and $445,314. Though only roughly half of the 2008 policies issued by petitioner contained a "look-back" period, it was not discussed in the premium pricing methodology, in the feasibility study, or understood by Zumbaum, Peak's owner. The "look-back" period

simply does not justify the blatant attempt to generate a huge tax benefit before the 2008 tax year closed.

The fact remains that the premiums charged for less than one month of coverage in 2008 approximated the premiums charged for a full year of coverage for each of the years 2009 and 2010. The premiums charged by petitioner were unreasonable and the "methodology" utilized by Capstone to arrive at a high premium could only be intended to maximize the tax benefits.

There is no contemporaneous documentation to support petitioner's premium pricing methodology. Petitioner did not utilize historical loss data, though it is undisputedly the most accurate method to compute a premium. Petitioner did not look at comparable loss data within the industry. The "2010 Policy Rate Analysis Summary" document created by Capstone does not provide a methodology, but does reflect an average of all existing clients in the Capstone program without any comparison to third party insurance premiums. Likewise, Capstone's "rating worksheets" do not explain how the "premium" column is calculated, and there is no evidence to explain it in the record. Similarly, the indication sheets prepared by Mid-Continent do not evidence a premium methodology because there is no explanation in the record as to the methodology used, the assumptions made concerning coverages, and the underlying documents that were relied upon. In the end, nothing presented

by petitioner supports, or directly corresponds with, the final premium amounts in the insurance binders and as applied.

Petitioner's premiums were not determined at arm's-length and are unreasonable in relation to the risk of loss. There is no evidence of any underwriting, mathematical calculations, actuarial opinions, or evaluations of risks to establish the premiums. Instead, petitioner's premiums were proposed by Capstone and approved by Peak's owners to maximize tax benefits.

2. Petitioner's policies are incomplete

Petitioner's policies, as in Avrahami, were "less than a model of clarity." 149 T.C. No. 7, at 81. First, the insurance policies are "cookie cutter," produced by Capstone for its program, to create the appearance of insurance.

Second, the policies are incomplete. The 2008 directors and officer's liability policy has a blank schedule for the covered individuals. The 2008 tax liability and regulatory changes policies name two unknown entities, PAE and PAP, as insureds, theoretically leaving Peak and its affiliates uninsured for that risk.

Third, petitioner did not enter into *bona fide* insurance contracts. Peak's owners, Zumbaum and Weikel, signed insurance contracts with themselves. There was no arm's-length negotiation or due diligence conducted to determine a fair market value for the premiums prior to signing the insurance

contracts. Moreover, Peak's affiliates, RocQuest and 2W Enterprises, did not pay premiums on the policies where they were named as insureds, as all premiums were paid by Peak to reduce its profits. There is no evidence to explain the affiliates' needs for excess insurance or their participation in the arrangement.

3. There was no legitimate business reason for petitioner's arrangement

There was no legitimate business reason for Peak and its affiliates to acquire insurance from petitioner. Petitioner was not formed to manage Peak's risks. Instead, the risks of Peak's business remained with its pre-existing third party commercial insurance policies.

Notably, the feasibility study does not even discuss the principal risks facing Peak's business relating to its work in the mining industry. Equally, petitioner does not provide any insurance coverage with respect to any mining-related risk exposures. There is no mention of ventilation fan failure, winch failure, or the total cost exposure of a mine closure due to an equipment malfunction. While the feasibility study mentions automobile liability, petitioner did not provide commercial auto coverage despite Peak's reported losses. Petitioner's failure to provide insurance coverages relating to Peak's true risks and actual prior losses, coupled with the fact that the feasibility study was completed *after* petitioner was

organized and had issued two years' worth of policies to Peak, shows the lack of a genuine insurance purpose or business purpose for the arrangement.

The pre-existing third party commercial insurance policies for Peak *remained in force even after* petitioner was organized and issued its policies. Peak did not replace one of its third party commercial insurers, EMC, even after Peak's owner was displeased with the handling of the claim for snow accumulation on the building roof. The fact that Peak deemed it necessary to retain all of its third party insurance coverage further demonstrates Peak's arrangement with petitioner was not a *bona fide* insurance arrangement that covered actual risk.

It was the tax benefits of a micro captive insurance company, not a legitimate insurance arrangement, that attracted petitioner's owners. Capstone made a site visit in August 2008, and by December of the same year, petitioner had been organized, policies were issued, and a full year's worth of premium was paid. The haste and lack of care in the arrangement's execution further show that it lacked any legitimate business purpose.

IV. Petitioner's Arrangements Lack Economic Substance

Petitioner had no principal place of business or principal office in any judicial circuit at the time it filed its petition. Therefore, petitioner's case is appealable to the Tenth Circuit as it filed its tax returns with the Internal

Revenue Service Center in Ogden, Utah. I.R.C. § 7482(b)(1)(B). Accordingly, respondent has addressed the economic substance[2] argument based upon Tenth Circuit precedent. See Golsen v. Commissioner, 54 T.C. 742 (1970), aff'd on other grounds, 445 F.2d 985 (10th Cir. 1971).

A. Petitioner's arrangement has no business purpose and was created solely to achieve a tax result

Under the economic substance doctrine, courts may disregard transactions that lack business purpose and economic substance aside from those achieved from tax reduction. Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978); Sala v. U.S., 613 F.3d 1249 (10th Cir. 2010). Courts look at a taxpayer's "subjective" non-tax business motivation and at the "objective" economic substance beyond the tax benefits. Jackson v. Commissioner, 966 F.2d 598, 601 (10th Cir. 1992). The Tenth Circuit has adopted a flexible analysis that views the two factors not as independent prerequisites to finding an absence of economic substance, but instead as "more precise factors to consider." James v. Commissioner, 899 F.2d 905, 908-09 (10th Cir. 1990) citing Sochin v. Commissioner, 843 F.2d 351, 354 (9th Cir. 1988) abrogated in part on other grounds as recognized by Keane v. Commissioner, 865 F.2d 1088, 1092 n.8 (9th Cir. 1989) (noting the court does "not conduct a 'rigid two-step analysis' applying

[2] Respondent is not asserting the codified version of the economic substance doctrine set forth at I.R.C. § 7701(o).

the subjective and objective factors, but rather focus[es] 'holistically on whether the transaction had any practical economic effects other than the creation of income tax losses.'"). Petitioner bears the burden to show that the purported insurance arrangement at issue has economic substance. Gregory v. Helvering, 293 U.S. 465 (1935); T.C. Rule 142(a); see also Coltec Industries, Inc. v. U.S., 454 F.3d 1340, 1355 (Fed Cir. 2006).

For all of the reasons stated above and those detailed in respondent's opening brief, petitioner's arrangement was not created to reduce Peak's insurance costs or to more efficiently manage Peak's risks. There is no evidence that Peak consulted with anyone other than Capstone concerning a potential captive insurance arrangement. (RPFF ¶ 44). However, Peak's owner was aware that the premiums paid by Peak to petitioner would reduce Peak's federal income tax liability. (RPFF ¶ 130). As a result, Peak's insurance expenses soared with the creation of petitioner and the excess coverages, yet Peak never terminated its pre-existing commercial third party coverages. There is no business reason for petitioner's captive arrangement as it existed solely to achieve a tax motivated result and, therefore, lacks economic substance.

B. If the Court finds that petitioner's arrangement lacks economic substance, petitioner still has income from a transaction in furtherance of a tax avoidance scheme

When a transaction lacks economic substance, the characterization of the transaction is disregarded and the transaction is taxed according to its substance. See Rice's Toyota World v. Commissioner, 752 F.2d 89, 95 (4th Cir. 1985). Accordingly, the payments from Peak to petitioner constitute income from a transaction in furtherance of a tax avoidance scheme. Therefore, the payments are subject to a 30 percent U.S. gross basis withholding tax.

Petitioner argues that respondent's position is inconsistent in disregarding petitioner's arrangements, but also finding the premium payments to be income to petitioner. In support petitioner cites Bank of New York Mellon Corp. v. Commissioner, T.C. Memo. 2013-225. This case, however, is vastly different from Mellon. In the underlying case in Mellon, the Court held that the STARS transaction lacked economic substance. Bank of New York Mellon Corp. v. Commissioner, 140 T.C. 15 (2013). The Court, on a motion to reconsider, ruled that the spread *stemming* from the STARS transaction was not includible in the taxpayer's gross income since the underlying transaction lacked economic substance and the Court cannot choose how to selectively apply the doctrine to the consequences of a transaction. Mellon, T.C. Memo. 2013-55 at *5. Thus, the

taxpayer in Mellon had already lost the tax benefits of the transaction from the underlying case and the Court just took the next additional step as a natural result of that ruling. See Mellon 140 T.C. 15 (2013).

Here, the underlying transaction has not yet been acted upon and in the instant case, the concern is whether the section 881(a) withholding tax is applicable after the transaction is found to lack economic substance. In American Metallurgical Coal Co. v. Commissioner, the Court determined that the transaction was created solely to generate a tax benefit and even though the transaction lacked economic substance, the Court held that the payments were subject to section 881(a) withholding tax. American Metallurgical Coal Co. v. Commissioner, T.C. Memo. 2016-139, at *10. Much like in American Metallurgical, while the underlying insurance transaction lacks economic substance, it does not eliminate the fact that money moved from Peak to petitioner, and without an exclusion from tax, the money is subject to a withholding tax under section 881(a).

Lastly, Peak has already received the full tax benefit for its deduction of the purported premium payments to petitioner. To allow for the deductions on Peak's returns to stand, and exclude from petitioner's income monies that were moved as the result of a transaction created solely for tax benefits, would

enable Zumbaum and Weikel (the owners of both Peak and petitioner) to reap the full tax benefits of their improper tax avoidance scheme despite its lack of economic substance.

V. For the Foregoing Reasons, Petitioner is Not Exempt from Taxation under Section 501(a) as an "Insurance Company" Described in Section 501(c)(15), Not Eligible to Make An Election Under Section 953(d), and the Payments from Peak to Petitioner for the Tax Avoidance Transaction are Subject to a 30 Percent Tax Imposed By Section 881

To be described in section 501(c)(15), petitioner must be a company more than half the business of which is issuing insurance or reinsuring the risks underwritten by insurance companies, have gross receipts for the taxable years at issue that do not exceed $600,000, and have more than 50 percent of such gross receipts consist of premiums. I.R.C. §§ 501(c)(15); 816(a). For the reasons discussed above, petitioner did not issue insurance or reinsurance contracts during the taxable years at issue and, consequently, petitioner did not receive more than 50 percent of its gross receipts from insurance premiums. Thus, petitioner is not an insurance company described in section 501(c)(15) and is not exempt from taxation under section 501(a).

Moreover, section 953 is applicable only to an insurance company deriving more than 50 percent of their business from issuance of insurance and reinsurance contracts. Petitioner did not do so. Thus, petitioner is ineligible to make an election pursuant to section 953(d) to be treated as a domestic

corporation. Instead, petitioner is a controlled foreign corporation for federal tax purposes.

It is undisputed that petitioner reported receiving payments of $481,792, $548,059, and $561,017 for the taxable years 2008, 2009 and 2010, respectively. In light of the foregoing, these payments are not exempt from tax. Section 881(a) imposes a 30 percent tax on the amount received from sources within the United States (i.e., Peak) by a foreign corporation (i.e., petitioner) on fixed or determinable annual or periodical gains ("FDAP") not effectively connected with a U.S. trade or business. FDAP includes all types of gross income other than what has been excluded by regulations. Treas. Reg. § 1.1441-2(b)(1)(i),(ii). Moreover, contrary to petitioner's claim, it is not entitled to any deductions on its FDAP income as, by definition, it is not effectively connected with a U.S. trade or business.

In the alternative, however, petitioner did not receive payments from CreditRe as discussed above. In the interest of equity, even though petitioner reported the full amount as income on the Forms 990, the amounts listed from CreditRe of $69,500, $76,500 and $66,000 for the 2008, 2009, and 2010 tax years respectively, should not be subject to the section 881(a)(1) withholding tax as they were not received by petitioner.

The payments from Peak to petitioner, a foreign corporation, were made in connection with an improper tax avoidance transaction, not pursuant to an insurance arrangement. Petitioner is not engaged in the business of insurance, or any trade or business within the U.S. Nonetheless, petitioner received the money and reported it as income on its Forms 990.

Despite reporting the payments as income on its Forms 990, petitioner now claims that the payments, if not for insurance, were capital contributions. However, petitioner is bound by the form of its transaction and cannot disavow its terms absent "strong proof." See Hamlin's Trust v. Commissioner, 209 F.2d 761, 765 (10th Cir. 1954)(parties cannot later attempt to avoid tax consequences by claiming that the substance of the transaction differed from form). The "strong proof" rule prevents a taxpayer from disavowing the form of an agreement in the absence of "strong proof" that a different arrangement was intended. The petitioner has not introduced any proof that the parties intended a capital contribution. Accordingly, the payments at issue were made in connection with an improper tax avoidance transaction and are subject to a 30 percent tax under section 861(a)(1) for each of the taxable years at issue.

VI. Petitioner's Experts are Biased

The testimony of petitioner's experts is unreliable because of the relationship each expert has with Capstone, as

the promoter, through the Feldman Law Firm. Dr. Doherty has previously consulted with Capstone regarding its insurance structure. (RPFF ¶ 256). Mead and Solomon, petitioner's actuaries, relied upon data provided by or aggregated by Capstone and did not look to any third party data or third party premium amounts in their analysis. (RPFF ¶¶ 136-137, 257-263). Kinion had very limited experience with Anguilla captives. (RPFF ¶ 252). Snyder, who was both an expert and fact witness, signed the feasibility study and was a director of PoolRe. (RPFF ¶¶ 62, 194). Finally, Liptz utilized unaudited financial information prepared by Capstone to prepare an independent audit report *after* petitioner was selected for IRS audit. (RPFF ¶¶ 224-225). Given their biases, the opinions of petitioner's experts should be afforded no weight.

CONCLUSION

It follows that the determination of the Commissioner of Internal Revenue should be sustained.

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