RESERVE MECHANICAL CORP. F.K.A. RESERVE CASUALTY CORP.,
Petitioner,

ELECTRONICALLY FILED

v.

Docket No. 14545-16

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITIONER'S SIMULTANEOUS OPENING BRIEF

CERTIFICATE OF SERVICE

UNITED STATES TAX COURT

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

---

BRIEF FOR PETITIONER

VAL J. ALBRIGHT
Tax Court Bar No. AV0006
Tel. No. 214-999-4825
Fax No. 214-999-3825
Email: valbright@gardere.com
MICHELLE Y. KU
Tax Court Bar No. KM0624
Tel. No. 214-999-4256
Fax No. 214-999-3256
Email: mku@gardere.com
Gardere Wynne Sewell LLP
2021 McKinney Avenue, Suite 1600
Dallas, Texas 75201

COUNSEL FOR PETITIONER

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Tax Court Rules of Practice and Procedure

Federal Statutes

Other Authorities

UNITED STATES TAX COURT

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

BRIEF FOR PETITIONER

PRELIMINARY STATEMENT

This case is for redetermination of income tax deficiencies as follows:

Tax Year	Deficiency
2008	$144,538
2009	164,418
2010	168,305

Trial was held in Houston, Texas before the Honorable Kathleen Kerrigan on April 27 and 28 and May 1 and 2, 2017. Simultaneous opening briefs are due on August 4, 2017 and simultaneous reply briefs are due on October 3, 2017. The evidence consists of a stipulation of facts and exhibits attached thereto, trial witness testimony and exhibits received at trial or otherwise made part of the record.

A Rule 155 computation may be necessary if the Court determines that (1) Petitioner is not an insurance company for tax purposes and (2)(a) Petitioner's income is a different amount than the amount Respondent determined and/or (b) Petitioner is entitled to its deductions in computing its taxable income.[1]

QUESTIONS PRESENTED

1. Whether Petitioner Reserve Mechanical Corp. f.k.a. Reserve Casualty Corp. ("Petitioner" or "Reserve") was an insurance company for Federal income tax purposes. This issue is dependent on the following subsidiary issues:

a. Whether the risks Petitioner's insurance policies covered were insurable risks;

b. Whether there was risk shifting in Petitioner's insurance arrangements with its insureds;

c. Whether there was risk distribution in Petitioner's insurance arrangements with its insureds; and

d. Whether Petitioner's insurance arrangements with its insureds were within the commonly accepted notions of insurance.

---

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended, and Treasury Regulations thereunder, as in effect for and applicable to the year(s) in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

2. Alternatively, if Petitioner is not an insurance company for Federal income tax purposes:

a. Whether and to what extent Petitioner has taxable income.

b. Whether and to what extent Petitioner is entitled to its deductions in computing its taxable income.

PETITIONER'S REQUEST FOR FINDINGS OF FACT ("PRFF")

Petitioner asks the Court to find the following facts:

General Facts

1. At the time the Petition was filed, Petitioner was a corporation organized under the laws of Anguilla, British West Indies, a British Overseas Territory. (Stip. ¶¶ 1, 13; Ex. 13-J, p. RSV-0005477; Ex. 97-P, p. 16; Tr. 162:3-8, 204:10-14, 214:16-18, 453:13-17, 574:6-8, 733:8-15; 774:22-777:8).

2. The tax years at issue are 2008, 2009 and 2010, and Petitioner timely filed Form 990 series returns with Respondent for each of those tax years, specifically, Form 990-EZ (Short Form Return of Organization Exempt from Income Tax) for 2008 and Forms 990 (Return of Organization Exempt from Income Tax) for 2009 and 2010. (Stip. ¶¶ 3, 95).

3. Petitioner properly and timely elected to be treated as a domestic insurance company under § 953(d). (Stip. ¶ 19; Ex. 18-J).

4. During the tax years at issue, Petitioner filed tax returns and maintained books and records utilizing the accrual method of accounting. (Stip. ¶¶ 3, 35-37; Ex. 2-J, p. RSV-0004545; Ex. 3-J, p. RSV-0000647; Ex. 4-J, p. RSV-0004575; Ex. 24-J, p. RSV-0005786; Ex. 25-J, p. RSV-0005511; Ex. 26-J, p. RSV-0005519).

5. During the tax years at issue, Peak Casualty Holdings, LLC, a Nevada limited liability company that Norman L. Zumbaum ("Zumbaum") and Cory J. Weikel ("Weikel") co-equally owned, held 100% of Petitioner's outstanding stock. (Stip. ¶¶ 8, 25-26; Ex. 9-J, p. RSV-0005635).

6. Messrs. Zumbaum and Weikel are and, during the tax years at issue, were U.S. citizens and Idaho residents. (Stip. ¶ 27).

7. During the tax years at issue, Mr. Zumbaum served as Petitioner's Chief Executive Officer, President, Treasurer and Assistant Treasurer. (Stip. ¶ 29; Tr. 128:25-129:5, 131:6-16).

8. During the tax years at issue, Mr. Weikel served as Petitioner's Vice President, Secretary and Assistant Treasurer. (Stip. ¶ 30; Tr. 129:11-15).

9. Petitioner was incorporated in Anguilla on December 3, 2008, under § 9 of the Companies Act, 2000. (Stip. ¶ 7).

10. After its formation and during each of the tax years at issue, Petitioner held a Class "B" Insurer's General License from the Anguilla Financial Services Commission (the "Anguilla Regulator"), the Anguillan Government's licensing and regulatory body for Anguilla's financial services industry, including insurance companies. (Stip. ¶¶ 9-13; Exs. 10-J thru 13-J).

11. The Class "B" Insurer's General License "permit[s] a foreign insurer to carry on general foreign insurance business, but not long-term foreign insurance business, providing that it has and maintains an issued and paid up capital of at least $100,000." (Stip. ¶ 14; Ex. 14-J, p. 9; Tr. 213:7-25).

12. In accordance with the applicable legislation, during the tax years at issue, Petitioner was a "foreign insurer" engaged in "foreign insurance business," and none of Petitioner's insurance policies would constitute long-term foreign insurance business. (Stip. ¶ 14; Ex. 14-J, pp. 6-7; Tr. 213:7-25; entire record).

13. In 1997, Messrs. Zumbaum and Weikel formed Peak Mechanical & Components, Inc. ("Peak"), an Idaho corporation. (Stip. ¶¶ 45, 48; Ex. 34-J, p. 58; Tr. 102:9-20).

14. During the tax years at issue, and prior thereto, Messrs. Zumbaum and Weikel co-equally owned 100% of the

outstanding stock of Peak, which was treated as an S corporation for Federal income tax purposes. (Stip. ¶ 45).

15. During the tax years at issue, Messrs. Zumbaum and Weikel also co-equally owned 100% of the membership interests in RocQuest, LLC ("RocQuest") and ZW Enterprises, LLC ("ZW"), Idaho limited liability companies they had formed in or about 2006 that were treated as partnerships for Federal income tax purposes. (Stip. ¶¶ 46-48; Ex. 34-J, p. 36; Tr. 156:25-157:10).

16. During the tax years at issue, ZW was a lending company that financed the acquisition of a business in Osburn, Idaho for a former Peak employee. (Tr. 109:10-24).

17. During the tax years at issue, RocQuest owned certain real estate and facilities in Elko, Nevada and Osburn, Idaho that RocQuest leased to Peak for its operations. (Stip. ¶ 48; Ex. 34-J, p. 36; Tr. 107:10-108:9).

18. During the tax years at issue, RocQuest also owned certain real estate in Hayden Lake, Idaho that RocQuest leased to Premier Electric Motor, Inc. ("Premier"), a Peak affiliate that Messrs. Zumbaum and Weikel partially owned and that received 80% of its repair work business from Peak. (Stip. ¶ 48; Ex. 34-J, pp. 29, 32, 492-93; Tr. 108:4-109:9).

19. During the tax years at issue, Peak was engaged in the business of manufacturing, custom-designing, distributing,

selling, repairing and servicing equipment for the mining and construction industries and employed management personnel, shop managers and staff and outside salespersons. (Stip. ¶¶ 17, 48, 50; Ex. 16-J, p. RSV-0006014; Ex. 34-J, pp. 33-35, 490-93; Tr. 121:17-122:9).

20. In 2008, Peak's major customers included Newmont Mining Corporation (approximately 50% of Peak's total sales), Stillwater Mining Company ("Stillwater") (about 35% of Peak's total sales) and BHP Billiton, Ltd. (Stip. ¶¶ 17, 48; Ex. 16-J, p. RSV-0006014; Ex. 34-J, p. 7; Ex. 128-P, p. 1; Tr. 138:12-24).

21. During the tax years at issue, Peak's equipment was used in approximately 12 underground mines located in the states of Idaho, Nevada and Washington, and was also sold outside of the United States. (Tr. 120:25-121:16).

22. During the tax years at issue, Peak's manufacturing operations included precision fabricating and machining of new and rebuilt submersible pumps capable of pumping from 500 to 2,000 gallons of fluid per minute for use in underground mines. Peak sold, serviced and repaired such pumps as well. (Stip. ¶ 17; Ex. 16-J, p. RSV-0006014; Tr. 112:10-113:17).

23. Water is very common in underground mines and the constant presence and infiltration of water in the mines causes significant flooding risks that can only be addressed by

continually pumping the water out with equipment such as Peak's pumps. (Tr. 103:10-15, 112:10-113:2).

24. If Peak's pumps were to fail in an underground mine, the impacted area of the mine could be flooded and would have to be evacuated, leading to loss of production or worse. (Tr. 112:10-113:2, 115:24-116:8).

25. Operating an underground mine costs millions of dollars per day. (Tr. 112:7-9).

26. A deep underground mine is also a very hot working environment, with temperatures naturally around 140° to 150° Fahrenheit. (Tr. 92:12-24, 103:6-9).

27. The combination of the high temperatures and water results in extremely high humidity in underground mines, which is a harsh environment for equipment. (Tr. 105:10-22).

28. The mining equipment used in most underground mines also has diesel engines that produce noxious fumes and heat, which exacerbate the naturally poor ventilation conditions of underground mines. Mine ventilation fans thus must be utilized to maintain the breathability of the mine air, control the high temperatures and humidity, remove noxious fumes and bring in fresh air. (Tr. 103:20-105:9).

29. During the tax years at issue, Peak sold and serviced mine ventilation fans as large as 10 feet in diameter

with motors ranging from 500 to 1,500 horsepower. (Stip. ¶ 17; Ex. 16-J, p. RSV-0006014; Tr. 103:20-105:9).

30. If Peak's mine ventilation fans were to fail in an underground mine, the impacted area would have to be evacuated, leading to loss of production or worse. (Tr. 111:22-112:9).

31. During the tax years at issue, Peak also provided mine air barrier doors, which are large, hydraulically-operated, steel doors that control air flow in underground mines. (Stip. ¶ 48; Ex. 34-J, p. 493; Tr. 116:9-117:4).

32. During the tax years at issue, Peak also specially manufactured mining trucks that were used in underground mines to transport workers and materials, including explosives, lubricants and diesel fuel. Peak custom built its trucks to withstand the harsh operating environment of underground mines and to comply with applicable law. (Stip. ¶¶ 17, 48; Ex. 16-J, p. RSV-0006014; Ex. 34-J, p. 490-91, 493; Tr. 113:18-115:11).

33. Specifically, after totally dismantling road vehicles down to just the original body and frame, Peak would custom build mining trucks by, inter alia, installing specialty diesel engines (since gasoline engines were prohibited under applicable law such as the Federal Mine Safety and Health Act of 1977, 30 U.S.C. § 801 et seq.), custom designing front and rear wheel axles, suspension and other components, and otherwise

outfitting the trucks to withstand the harsh mine conditions and serve the mining industry's needs. (Stip. ¶¶ 17, 48; Ex. 16-J, p. RSV-0006014; Ex. 34-J, p. 490-91, 493; Tr. 113:18-115:11).

34. During the tax years at issue, Peak also designed, manufactured and re-manufactured guide wheels that were used on the sides of hoist conveyances, i.e., mine shaft elevators used in underground mines. (Stip. ¶ 48; Ex. 34-J, p. 493; Tr. 115:12-23).

35. A hoist conveyance can travel at 1,800 to 2,000 feet per minute and, at that velocity, the loss of a guide wheel can damage the mine shaft and endanger the hoist conveyance and anyone/anything it is transporting. (Tr. 115:19-23, 647:17-21).

36. An underground mine is a very dangerous working environment. (Tr. 92:12-24).

37. Mr. Zumbaum, like his father, worked in the mining industry almost the entirety of his adult life and knew of numerous mining personnel who had lost their lives in mining accidents, including Mr. Weikel's father who was killed by falling rock. Mr. Weikel also almost lost his life while working in an underground mine when he was buried by falling rock that broke his back, leg and ankle. Mr. Weikel was not expected to ever walk again but eventually overcame his paralysis, even though he continues to suffer many medical

problems due to the injuries he sustained. (Tr. 92:12-93:13, 105:23-107:4).

38. Congress passed the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9601 et seq., also known as "Superfund," on December 11, 1980 and amended it in 1986. The legislation's primary emphasis is on the cleanup of inactive hazardous waste sites and the liability for cleanup costs on arrangers and transporters of hazardous substances and on current and former owners of facilities where hazardous substances were disposed. Superfund liability is retroactive (parties may be held liable for acts that happened before Superfund's enactment in 1980); joint and several (any one potentially responsible party ("PRP") may be held liable for the entire cleanup of the site (when the harm caused by multiple parties cannot be separated)); and strict (a PRP cannot simply say that it was not negligent or that it was operating according to industry standards; if a PRP sent some amount of the hazardous waste found at the site, that party is liable). Superfund liability is triggered if hazardous wastes are present at a facility, there is a release (or a possibility of a release) of these hazardous substances, response costs have been

or will be incurred, and the defendant is a liable party. (Fed. R. Evid. 201 (Judicial Notice)[2]).

39. During the tax years at issue, Peak, RocQuest and ZW each had its principal place of business in Osburn, Idaho. (Stip. ¶ 49).

40. Osburn, Idaho is located in Idaho's Silver Valley, one of the largest mining districts in the world, in the Bunker Hill Mining and Metallurgical Complex Superfund Site (the "Bunker Hill Superfund Site"), one of the nation's largest, oldest and most complex Superfund sites designated by the U.S. Environmental Protection Agency (the "EPA"). (Tr. 109:21-110:22, 168:6-169:6, 685:6-686:10, 764:12-22; Fed. R. Evid. 201 (Judicial Notice)[3]).

---

[2] 42 U.S.C. § 9607 (PRPs can be held liable for, inter alia, all costs of removal or remedial action incurred, any other necessary costs of response incurred, damages for injury to, destruction of, or loss of natural resources and assessment costs for same, costs of any health assessment or health effects study, interest on the amounts recoverable, and punitive damages); EPA, Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and Federal Facilities, Enforcement, https://www.epa.gov/enforcement/comprehensive-environmental-response-compensation-and-liability-act-cercla-and-federal (last visited Aug. 4, 2017); EPA, Superfund Liability, https://www.epa.gov/enforcement/superfund-liability (last visited Aug. 4, 2017).

[3] EPA, National Priorities List (NPL) Sites - by State, https://www.epa.gov/superfund/national-priorities-list-npl-sites-state#ID (last visited Aug. 4, 2017); EPA, Superfund Sites in Reuse in Idaho, https://www.epa.gov/superfund-redevelopment-initiative/superfund-sites-reuse-idaho (last visited Aug. 4, 2017).

41. All of the mines in Idaho's Silver Valley are deep underground mines and are commonly more than 5,000 feet deep. As of the date of trial herein, the deepest mine in Silver Valley was the Hecla Lucky Friday mine, which is about 8,200 feet. (Tr. 102:18-103:5).

42. Mining operations began in the area in 1883 and continue today. Historic mining and milling methods disposed of tailings in rivers and streams. Those practices spread contaminants throughout the floodplain of the South Fork Coeur d'Alene River. Contamination also comes from large waste piles, waste rock, and past air emissions from smelter operations. Soil, sediment, groundwater and surface water became contaminated with heavy metals such as lead. Those metals pose risks to people and the environment. Cleanup efforts are ongoing and expected to continue for 50 to 60 more years. (Tr. 93:24-94:4, 110:7-111:7, 119:4-120:24; Fed. R. Evid. 201 (Judicial Notice)[4]).

43. During the tax years at issue, Peak's manufacturing and repair facilities were located about 200 feet from the Coeur d'Alene River in an area the U.S. Federal Emergency Management

---

[4] EPA, Superfund Site: Bunker Hill Mining and Metallurgical Complex, Smelterville, ID, Site Details, https://cumulis.epa.gov/supercpad/SiteProfiles/index.cfm?fuseaction=second.topics&id=1000195#Risk (last visited Aug. 4, 2017); EPA, Superfund Sites in Reuse in Idaho, supra note 3.

Agency designated as a floodplain. (Tr. 119:17-21, 171:14-172:7).

44. When Messrs. Zumbaum and Weikel started Peak, they knew Peak's operations would expose Peak and them to potential Superfund liability. (Tr. 117:5-121:12, 169:7-172:7; see also Tr. 685:14-686:10, 764:12-22, 968:22-969:12).

45. During the tax years at issue, Peak's operations, including its repair work and servicing of mining equipment, implicated environmental and health safety issues directly tied to the mining industry and exposed Peak and its owners and customers in the Bunker Hill Superfund Site to Superfund liability. (Stip. ¶ 17; Ex. 16-J, p. RSV-0006014-6017; Tr. 117:5-121:12, 169:7-172:7, 685:14-686:10, 764:12-22, 968:22-969:12; Fed. R. Evid. 201 (Judicial Notice)[5]).

46. For example, as part of Peak's submersible pump and mine ventilation fan repair and re-fabrication work, Peak had to pressure wash, steam clean and sandblast the equipment to clean off residual hazardous materials and pollutants from the mining operations, including lead, zinc and ammonium nitrate from blasting operations. (Stip. ¶ 17; Ex. 16-J, p. RSV-0006014; Tr. 117:9-24).

[5] Supra note 2 thru note 4.

47. Due to the dangers associated with handling such materials and pollutants, Peak required its employees to wear personal protective equipment, rubber boots, jackets, and safety glasses during cleaning. (Tr. 118:24-119:3).

48. Peak also had to control and store the fluid runoff containing such materials and pollutants on-site at Peak's facilities with cleaning bays, sumps and containment areas until such runoff could be treated and hauled off for disposal. (Tr. 117:25-118:23).

49. The EPA closely scrutinizes mining-related activities in the Bunker Hill Superfund Site to ensure compliance with Superfund rules and protect against further contamination. (Tr. 119:4-16, 169:7-170:16, 1001:1-11).

50. During the tax years at issue, Peak was unable to obtain pollution coverage from commercial insurers. (Stip. ¶ 17; Ex. 16-J, p. RSV-0006016; Tr. 123:15-124:10, 766:12-767:24; see also Tr. 1001:1-11).

51. Mr. Zumbaum was unaware of any insurers that offered pollution coverage to companies like Peak operating in the Bunker Hill Superfund Site during the tax years at issue. (Tr. 123:15-124:10; see also Stip. ¶ 17; Ex. 16-J, p. RSV-0006021).

52. Given the level of government scrutiny on companies like Peak, Messrs. Zumbaum and Weikel were also concerned about liability exposure from regulatory changes. (Tr. 787:20-788:3).

53. Messrs. Zumbaum and Weikel discussed their concerns with Robert E. Pope, the President and owner of Mining Equipment Ltd. ("MEL"), a mining equipment company based in Colorado with additional operations in New Mexico and China, for which Messrs. Zumbaum and Weikel had worked prior to forming Peak and from which Peak occasionally purchased equipment. (Tr. 95:20-96:3, 98:2-99:18, 124:11-125:9, 647:10-648:9, 760:18-761:2; see also Stip. ¶ 8; Ex. 9-J, p. RSV-00005650, RSV-0005664).

54. MEL's business was similar to Peak's. MEL provided the mining industry with equipment including, inter alia, rail gear, locomotives, transportation cars, cement mixer equipment, load hauling dump trucks, loaders, mine ventilation fans, stage winches, hoist conveyances, etc., for use in mining operations. (Tr. 96:4-97:1, 647:17-21).

55. During Mr. Zumbaum's second year at MEL, he was having Thanksgiving dinner with Mr. Pope when he learned that a stage winch that MEL had supplied to a construction company doing a deep vertical shaft had fallen and killed someone working below. (Tr. 97:2-98:1, 99:19-101:15, 167:16-24).

56. MEL settled the lawsuit for $1 to $2 million dollars, which made a lasting impression on Mr. Zumbaum who believed that MEL was not at fault for the liability because the construction company that had rented MEL's stage winch had hired an outside engineer to design the facility that would hold the winch and the facility had failed causing the winch to fall down the shaft killing someone working below. (Tr. 99:19-101:4, 167:16-24).

57. Messrs. Zumbaum and Weikel had a good relationship with Mr. Pope, who had supported them when they left MEL to form Peak, and considered him a mentor. (Stip. ¶ 8; Ex. 9-J, pp. RSV-00005650, RSV-00005664; Tr. 98:18-99:3, 647:14-648:9).

58. Mr. Pope advised that Peak should consider obtaining more insurance coverage in light of the growth that Peak was experiencing and suggested forming a captive insurance company and contacting Capstone Associated Services, Ltd. ("Capstone"). (Tr. 124:11-125:9; see also Tr. 178:9-15, 185:5-10, 313:23-314:19, 647:10-648:9).

59. By 2008, Peak's revenues had grown sharply and its projected revenues for 2008 were estimated to be in excess of $9 million. (Stip. ¶ 17; Ex. 16-J, p. RSV-0006014; see also Stip. ¶ 48; Ex. 34-J, p. 58; Tr. 313:23-314:19, 363:7-364:4, 395:25-396:2).

60. In early 2008, Peak had a negative experience with an insurance company when a snow storm significantly damaged the roof on one of Peak's buildings. (Tr. 122:11-123:12, 175:11-176:11).

61. Peak filed a claim with its insurer, Employers Mutual Casualty Company ("EMC"), but EMC would not offer anything more than a $2,000 repair. Peak argued with EMC for months to increase the offer but EMC refused. Peak ultimately spent $25,000 out-of-pocket to replace the damaged roof. (Stip. ¶ 48; Ex. 34-J, pp. 1-4; Tr. 122:11-123:12, 175:11-176:11).

62. This experience, among others, influenced Mr. Zumbaum's decision to form Petitioner. (Tr. 177:22-178:8).

63. There are numerous instances where insurance companies have declined to promptly pay a claim, resulting in the insured having to sue the insurance company seeking to collect on the insured's claim. (Tr. 783:3-784:16).

64. Prior to 2008, Peak was required to restate its income tax returns for 3 years because its accountant had failed to properly report Peak's income. (Tr. 146:20-23, 148:10-21, 149:15-150:16).

65. Peak only realized the magnitude of its accountant's failure when Peak hired another accounting firm to review Peak's prior returns and that firm advised Peak that it would have to

file amended returns with Respondent for 3 years. (Tr. 148:10-21, 149:15-150:16).

66. Based on this advice, Peak and Messrs. Zumbaum and Weikel filed amended income tax returns with Respondent and paid substantial additional income taxes.[6] It was Mr. Zumbaum's understanding that Respondent had agreed to waive penalties if amended returns were filed and additional income taxes were paid. (Tr. 148:10-21, 149:15-150:16).

67. Based on their discussions with Mr. Pope and his advice and recommendation of Capstone, Messrs. Zumbaum and Weikel contacted Capstone. (Tr. 124:11-125:16; see also Stip. ¶ 17; Ex. 16-J, pp. RSV-0006017-6018; Tr. 178:9-15, 185:5-10, 313:23-314:19, 647:10-648:9).

68. After Messrs. Zumbaum and Weikel reached out to Capstone about their business concerns and objectives, Capstone requested information, including financial information, existing insurance policies and other information, about Peak and its affiliates and performed a Captive Insurance Feasibility Study (the "Reserve Feasibility Study"), which advised Messrs. Zumbaum and Weikel that forming a captive insurance company to provide specified insurance coverages was feasible and practical to

---

[6] Mr. Zumbaum testified that he could not recall the exact amount but that he knew it was more than $200,000. (Tr. 147:18-21).

supplement their existing insurance coverages. (Stip. ¶ 17; Ex. 16-J; Tr. 125:17-128:2, 310:15-312:15).

69. The purpose of a captive feasibility study is to evaluate the factors (including a client's risks, existing insurance coverages, risk management needs, financial ability, etc.) that would make a captive insurance company feasible for that particular client. (Tr. 313:13-317:6).

70. In connection with preparing the Reserve Feasibility Study, Stewart Feldman ("Feldman") and Lance McNeel ("McNeel") of Capstone traveled to Osburn, Idaho on August 13, 2008, and conducted an on-site inspection of the various operations and facilities of Peak and its affiliates, interviewed Messrs. Zumbaum and Weikel and other employees, documented their observations with photographs and otherwise, and collected additional information to complete the Reserve Feasibility Study. (Stip. ¶ 17; Ex. 16-J, p. RSV-0005994; Tr. 127:3-23, 160:1-25, 166:16-20, 306:8-310:3, 378:3-24, 685:4-687:9, 769:4-9).

71. Robert L. Snyder, II ("Snyder") an independent consultant from Willis HRH of Houston (n.k.a. Willis Towers Watson) ("Willis"), which, as of the date of trial herein, was the third largest risk management, insurance brokerage and employee benefits advisory firm worldwide, also reviewed,

edited, approved and signed the Reserve Feasibility Study. (Stip. ¶ 17; Ex. 16-J, p. RSV-0005999; Tr. 18:8-19:6, 25:18-26:3, 28:10-29:2, 57:5-8).

72. At the time he reviewed, edited, approved and signed the Reserve Feasibility Study, Mr. Snyder was a Senior Vice-President of Willis and had substantial years of experience in the insurance industry and with captive feasibility studies and captive insurance companies in general. (Ex. 97-P, pp. 2-3, 92-94; Tr. 18:17-22:23, 61:8-62:17).

73. Mr. Snyder held the Associate of Risk Management ("ARM") designation and a law degree and was a member of the Texas bar, although Mr. Snyder is not and has never been a practicing attorney. (Ex. 97-P, pp. 2-3, 92-94; Tr. 21:24-22:23).

74. The ARM designation is an insurance industry designation that is focused on risk management and is earned by successfully completing a course of study and examinations. (Tr. 304:22-305:3).

75. The Reserve Feasibility Study concluded that the formation of a captive insurance company for Peak and its affiliated companies would be feasible, reasonable, practical and the best alternative risk mechanism option for the proposed

insureds. (Stip. ¶ 17; Ex. 16-J, RSV-0005999, RSV-0006042; Tr. 33:12-34:13, 62:2-25).

76. Ultimately, Messrs. Zumbaum and Weikel decided to form Petitioner. (Stip. ¶¶ 7, 8; Ex. 9-J; Tr. 128:3-24).

77. During the tax years at issue, Petitioner issued the following direct written insurance policies:[7]

Insurance Policy	2008	2009	2010
Excess Pollution Liability	Yes (Exs. 41-J, 143-J, 53-J)	Yes (Exs. 65-J, 144-J, 145-J, 73-J)	Yes (Exs. 150-J, 144-J, 88-J)
Product Recall	Yes (Exs. 48-J, 143-J, 53-J)	Yes (Exs. 70-J, 144-J, 145-J, 73-J)	Yes (Exs. 153-J, 144-J, 88-J)
Punitive Wrap	Yes (Exs. 45-J, 143-J, 53-J)	Yes (Exs. 69-J, 144-J, 145-J, 73-J)	Yes (Exs. 84-J, 144-J, 88-J)
Excess Employment Practices Liability	Yes (Exs. 46-J, 143-J, 53-J)	No	No
Loss of Services	Yes (Exs. 39-J, 143-J, 53-J)	Yes (Exs. 64-J, 144-J, 73-J)	Yes (Exs. 149-J, 144-J, 88-J)

[7] The insurance policy names used in this table are not the actual policy names as shown on their respective cover pages but shorthand names generally describing the covered risk(s). If applicable, the trial exhibits for the insurance policies are referenced as well. Exhibits 149-J, 150-J, 151-J, 152-J, and 153-J are corrected exhibits replacing Exhibits 79-J, 80-J, 82-J, 83-J, and 85-J, respectively, as described in the parties' Joint Motion for Leave to Re-open the Record and Submit Corrected Exhibits (filed May 30, 2017; granted June 2, 2017).

Insurance Policy	2008	2009	2010
Weather Related Business Interruption	Yes (Exs. 40-J, 143-J, 53-J)	No	No
Loss of Major Customer	Yes (Exs. 37-J, 143-J, 53-J)	Yes (Exs. 61-J, 144-J, 73-J)	Yes (Exs. 76-J, 144-J, 88-J)
Expense Reimbursement - Legal Expenses	No	Yes (Exs. 63-J, 144-J, 73-J)	Yes (Exs. 78-J, 144-J, 88-J)
Excess D&O Liability	Yes (Exs. 36-J, 143-J, 53-J)	Yes (Exs. 60-J, 144-J, 145-J, 73-J)	Yes (Exs. 75-J, 144-J, 146-J, 88-J)
Regulatory Changes	Yes (Exs. 44-J, 50-J, 143-J, 53-J)	Yes (Exs. 68-J, 144-J, 73-J)	Yes (Exs. 152-J, 144-J, 88-J)
Excess Intellectual Property Package	Yes (Exs. 43-J, 143-J, 53-J)	Yes (Exs. 67-J, 144-J, 145-J, 73-J)	Yes (Exs. 151-J, 144-J, 88-J)
Expense Reimbursement	Yes (Exs. 38-J, 143-J, 53-J)	Yes (Exs. 62-J, 144-J, 73-J)	Yes (Exs. 77-J, 144-J, 88-J)
Tax Liability	Yes (Exs. 42-J, 49-J, 143-J, 53-J)	Yes (Exs. 66-J, 144-J, 73-J)	Yes (Exs. 81-J, 144-J, 88-J)
Excess Cyber Risk	Yes (Exs. 47-J, 143-J, 53-J)	No	No

(Stip. ¶¶ 53, 55-57, 61, 69, 71, 75, 77, 79, 83; Exs. 36-J thru 50-J, 53-J, 60-J thru 70-J, 73-J, 75-J thru 78-J, 81-J, 84-J, 88-J, 143-J thru 146-J, 149-J thru 153-J; Tr. 6:13-7:25, 1017:4-1020:2).

78. During the tax years at issue, Petitioner's direct written insurance policies named Peak, RocQuest and ZW as insureds, although Peak was the primary insured.[8] (Stip. ¶¶ 53, 69, 77; Tr. 157:11-158:5).

79. During the tax years at issue, Petitioner's direct written insurance policies provided the following insurance coverages:

a. Excess Pollution Liability - Covered insured for a broad set of pollution-related risk exposures (such as bodily injury, property damage, investigation costs, clean-up costs, fines, business interruption, extra expense, and diminution of value) relating to the ownership or operation of facilities including, but not limited to, (i) on-site new and/or pre-existing conditions clean-up and diminution in value; (ii) third-party claims for on-site bodily injury, property damage, and clean-up of new and/or pre-existing conditions; (iii) third-party claims for off-site (where pollution has migrated from the owned property) bodily injury, property damage, and clean-up of new and/or pre-existing conditions; (iv) third-party claims for off-site bodily injury, property damage, and clean-up costs at non-owned locations; (v) third-

[8] It is common practice in the insurance industry for an insurance policy to cover to more than one insured, such as commonly-owned companies. (Tr. 378:25-380:12).

party claims for on-site clean-up costs at non-owned locations; (vi) pollution release from transported cargo carried by covered autos; and (vii) third-party claims from transportation of a product or waste exposures at insured's location, exposures emanating from that location, transportation to and from that location, and disposal of waste generated at that location.

b. Product Recall - Covered insured for (i) expenses involved with a mandatory or voluntary recall of specified products; and (ii) liability for a third party's business interruption due to such third party's impaired property resulting from insured's recalled products.

c. Punitive Wrap - Covered insured against the failure to cover punitive or exemplary damages due to the enforcement of any law or judicial ruling that precludes the insuring of such damages in a scheduled policy.

d. Excess Employment Practices Liability - Covered insured for (i) a broad set of employment-related risk exposures including, but not limited to, employment discrimination, sexual harassment, wrongful termination, breach of employment contracts, failure to employ or promote, wrongful discipline, failure to provide a safe work environment free of workplace violence; and (ii) violations of civil rights of third-party non-employees such as customers or vendors.

e. Loss of Services - Covered insured (i) against the ensuing business interruption that would result from an involuntary loss of services of a covered key person (such as a resignation, extended illness, loss of license, etc.); and (ii) for legal expenses involved in employment disputes and intellectual property or non-compete disputes following the loss of services of a covered key person.

f. Weather Related Business Interruption - Covered insured for business interruption and extra expenses that result from catastrophic events such as earthquake, tsunami, flood, hurricane, windstorm, tornado, or snow/hail storm. Claim trigger does not require direct loss to property.

g. Loss of Major Customer - Covered insured against the ensuing business interruption and extra expense that would result from a loss of a major customer(s) while insured establishes a suitable replacement(s) to resume normal business operations.

h. Expense Reimbursement - Legal Expense - Reimbursed insured for legal expenses incurred when (i) there is no underlying insurance to provide defense; (ii) defense expenses have been exhausted; and (iii) insured challenges the primary insurer's failure to defend a claim or cover a judgment.

i. Excess D&O Liability - Covered insured for a

broad set of loss exposures related to alleged executive liability and indemnification risks arising from wrongful acts (which include any breach of duty, neglect, error, misstatement, misleading statement, omission, or other action wrongfully taken or attempted) or any other breaches of duty of officers or directors committed under the law of any jurisdiction or in violation of administrative or regulatory rules of any jurisdiction.

j. Regulatory Changes - Covered insured against compliance expenses and ensuing business interruption and extra expense that would result from various regulatory changes that would adversely impact insured's normal business operations if such changes were implemented or for a change in the regulatory authority and/or enforcement policies of existing regulations.

k. Excess Intellectual Property Package - Covered insured for a broad set of both first-party and/or third-party intellectual property-related risk exposures including, but not limited to, copyright, trademark, and patent infringement, unfair competition (including violations of anti-trust laws), libel and slander, misappropriation, unauthorized use, theft, loss or other damage to intellectual property.

l. Expense Reimbursement - Reimbursed insured for expenses related to situations specified in the coverage form

including public relations expense to mitigate adverse publicity from events including, but not limited to, an actual or imminent liability incident, labor dispute, bankruptcy or terrorism incident.

m. Tax Liability - Covered insured against a significant and unexpected "adverse final resolution" if the filed tax returns are challenged by the Federal taxing authority.

n. Excess Cyber Risk - Covered insured for a broad set of computer, network, and internet-related exposures including (i) content liability and interruption of service liability; (ii) first-party coverage of both insured's tangible and intellectual property from several specified perils including "cyber attack," virus, computer crime, unauthorized access or use, and inadvertent errors and omissions; (iii) broad business interruption and extra expense coverage to include not only insured's loss, but also business interruption and extra expense of a dependent business; (iv) coverage to extend to the differential between revenues generated before the loss and after the loss; (v) coverage for "cyber-extortion"; and (vi) additional coverages for investigation and rewards, along with coverage for post-loss systems crisis management such as the costs for additional public relations and/or systems

consultants. (See Ex. 104-P, pp. 23-26; PRFF 77).

80. During the tax years at issue, Petitioner's direct written policies provided coverage for gaps in Petitioner's existing insurance coverages or were supplemental to but not duplicative of Petitioner's existing insurance coverages. (Stip. ¶¶ 17, 48; Ex. 16-J, pp. RSV-0006014-6028; Ex. 34-J, pp. 4-15, 151-489; Ex. 104-P, pp. 22-26; Tr. 59:22-60:12, 686:11-19; PRFF 77-79).

81. During the tax years at issue, the insureds under the foregoing direct written insurance policies paid approximately 80% of the premiums to Petitioner, as the "Lead Insurer," and approximately 20% of the premiums to PoolRe Insurance Corp. ("PoolRe"), as the "Stop Loss Insurer," pursuant to Joint Underwriting Stop Loss Endorsements (the "Stop Loss Endorsements") that Petitioner and its insureds and PoolRe entered into each year at issue.[9] (Stip. ¶¶ 35-37, 39-44, 58, 61, 72, 75, 80, 83; Ex. 17-J, p. RSV-0005753; Exs. 24-J thru 26-

[9] For tax years 2008 and 2009, 81.5% of the direct written premiums were paid to Petitioner and 18.5% of the direct written premiums were paid directly to PoolRe under the Stop Loss Endorsements applicable to those tax years. (Stip. ¶ 61; Ex. 53-J, p. RSV-0005810, ¶ 4.A; Ex. 73-J, p. RSV-0003106). For tax year 2010, 80.1% of the direct written premiums were paid to Petitioner and 19.9% of the direct written premiums were paid directly to PoolRe under the Stop Loss Endorsement applicable to tax year 2010. (Stip. ¶ 75; Ex. 87-J, p. RSV-0003231).

J, 28-P thru 33-J, 53-J, 73-J, 88-J; Tr. 382:12-383:13, 746:17-754:24 (Ex. 134-P, p. 1); see specifically Tr. 748:16-749:23).

82. Under the foregoing direct written insurance policies as modified by the Stop Loss Endorsements, Petitioner, for its part, received $335,853, $365,224 and $356,697 in premiums from the insureds during tax years 2008, 2009 and 2010, respectively. (Stip. ¶¶ 3, 35-38; Exs. 2-J thru 4-J; Ex. 24-J, p. RSV-0005785; Ex. 25-J, RSV-0005510; Ex. 26-J, p. RSV-0005518; Ex. 27-J, p. RSV-0005527; Tr. 702:9-703:23, 705:24-708:4, 710:8-711:14).

83. During tax years 2008, 2009 and 2010, PoolRe, a corporation whose owner was unrelated to Petitioner, its owners, its insureds and Capstone, was a regulated insurer that existed under the laws of the British Virgin Islands, a British Overseas Territory, during 2008, and in early 2009, it was re-domiciled in Anguilla. (Stip. ¶¶ 20, 59-65; Ex. 19-J, p. RSV-0005778; Exs. 54-J thru 56-J; Tr. 51:5-52:24, 382:12-19, 734:4-9, 802:10-21, 804:9-23).

84. From April 15, 2009 through December 31, 2010, PoolRe held a Class "B" Insurer's General License issued by the Anguilla Regulator. (Stip. ¶¶ 66-67; Exs. 57-J, 58-J; Tr. 382:12-19).

85. Petitioner also received $145,736, $159,403 and $154,617 during tax years 2008, 2009 and 2010, respectively, in premiums for its participation in 2 reinsurance arrangements with or through PoolRe, specifically, the CreditRe Reinsurance Arrangement (as defined below) pursuant to Credit Insurance Co-Insurance Contracts (the "Co-Insurance Contracts") and the PoolRe Quota Share Reinsurance Arrangement (as defined below) pursuant to the Quota Share Reinsurance Policies (the "Quota Share Policies") that Petitioner and PoolRe entered into each year at issue. (Stip. ¶¶ 3, 35-38; Exs. 2-J thru 4-J; Ex. 24-J, p. RSV-0005785; Ex. 25-J, RSV-0005510; Ex. 26-J, p. RSV-0005518; Ex. 27-J, p. RSV-0005527; Tr. 702:9-703:23, 705:24-708:4, 710:8-711:14; see also Stip. ¶¶ 58-60, 72-74, 80-81, 83; Exs. 51-J, 71-J, 86-J).

86. Pursuant to the Co-Insurance Contracts, Petitioner, through PoolRe, participated in a reinsurance arrangement with Credit Reassurance Corporation, Ltd. ("CreditRe"), a corporation whose owner was unrelated to Petitioner, its owners, its insureds and Capstone (the "CreditRe Reinsurance Arrangement"). As part of the CreditRe Reinsurance Arrangement, Petitioner received premiums (the "CreditRe Reinsurance Premiums") for assuming risks from PoolRe, which itself assumed risks from third-party insurers, and the risks ultimately related to a

large pool of many thousands of risks that were directly written by Lyndon Property Insurance Company ("Lyndon"), a U.S. based insurance company that is a subsidiary of Protective Life Corporation (a New York Stock Exchange company), that served as the original ceding company. (Stip. ¶ 20; Ex. 19-J, p. RSV-0005778; Ex. 114-P; Ex. 125-P, p. 7; Tr. 438:10-439:2, 443:3-445:21, 458:3-18, 460:12-465:7, 735:23-736:13, 753:3-754:24 (Ex. 134-P)).

87. During the tax years at issue, the ultimate producers of the underlying risk coverages that Petitioner reinsured through PoolRe as part of the CreditRe Reinsurance Arrangement were: (a) Lyndon; and (b) ARIA (SAC) Ltd. ("ARIA"), a Bermuda-domiciled insurance company. The owners of Lyndon and ARIA are unrelated to PoolRe, Petitioner, its owners, its insureds and Capstone. (Stip. ¶ 20; Ex. 19-J, p. RSV-0005778; Ex. 114-P; Tr. 443:3-445:21, 458:3-18, 460:12-465:7).

88. Pursuant to the Quota Share Policies, Petitioner participated in a reinsurance arrangement with PoolRe (the "PoolRe Quota Share Reinsurance Arrangement") whereby Petitioner received premiums (the "PoolRe Quota Share Reinsurance Premiums") in exchange for assuming a certain amount of blended or pooled risks that PoolRe ceded to Petitioner. (Stip. ¶ 18; Ex. 17-J, p. RSV-0005753; Tr. 753:3-754:24 (Ex. 134-P, p. 1)).

89. As shown below, the total net written premiums Petitioner received under the foregoing direct written insurance policies, the CreditRe Reinsurance Arrangement and the PoolRe Quota Share Reinsurance Arrangement during tax years 2008, 2009 and 2010 was $481,589, $524,627 and $511,314, respectively, of which more than 30% was from premiums from non-affiliates and less than 70% was from direct written premiums from affiliates:

	2008	2009	2010
a. CreditRe Reinsurance Premiums	$ 69,500	$ 76,500	$ 66,000
b. PoolRe Quota Share Reinsurance Premiums	76,236	82,903	88,617
c. Affiliated Direct Written Premiums	335,853	365,224	356,697
d. Total Net Written Premiums (a + b + c)	$481,589	$524,627	$511,314
e. Total Non-Affiliated Premiums as a Percentage of Total Net Written Premiums [(a + b)÷d]	30.3%	30.4%	30.2%
f. Affiliated Direct Written Premiums as a Percentage of Total Net Written Premiums (c ÷ d)	69.7%	69.6%	69.8%

(Stip. ¶¶ 3, 35-38; Exs. 2-J thru 4-J; Ex. 24-J, p. RSV-0005785; Ex. 25-J, RSV-0005510; Ex. 26-J, p. RSV-0005518; Ex. 27-J, p. RSV-0005527; Tr. 702:9-703:23, 705:24-708:4, 710:8-711:14;

PRFF 82, 85).

90. During the tax years at issue, depending on the year, approximately 150 different insureds and between 51 and 56 separate and unaffiliated insurance companies participated in the PoolRe Quota Share Reinsurance Arrangement with between 429 and 575 direct written insurance policies similar to those Petitioner issued. These other insureds and insurance companies were unrelated to Petitioner and its owners and had joint underwriting stop loss endorsements and quota share reinsurance policies similar to those Petitioner entered into with PoolRe. (Stip. ¶¶ 18, 20; Ex. 17-J, p. RSV-0005753; Ex. 19-J, p. RSV-0005778; Ex. 104-P, pp. 12 at n.25, 14, 15; Tr. 703:10-15, 753:13-754:12, 811:1-21 (Ex. 134-P)).

91. The risks that PoolRe assumed from each insured under each of the direct written policies pursuant to the joint underwriting stop loss endorsements were the risks in excess of the risk layer covered by the participating insurance company under the direct written insurance policies. This meant that the coverage that the insurance company provided would pay any covered losses to the extent of the coverage provided by such insurance company, before the coverage that PoolRe provided under the joint underwriting stop loss endorsements would

respond. (Ex. 104-P, pp. 14-17; see e.g., Stip. ¶¶ 61, 75, 83; Exs. 53-J, 73-J, 88-J).

92. As part of the PoolRe Quota Share Reinsurance Arrangement, each participating insurance company would, pursuant to the quota share reinsurance policy for such insurance company, assume an amount of blended or pooled risks from PoolRe equal to the amount of risk PoolRe, pursuant to the joint underwriting stop loss endorsement for such insurance company, assumed from such insurance company's insureds under that insurance company's direct written insurance policies. PoolRe would then pay such insurance company reinsurance premiums for assuming the ceded risks. (Stip. ¶ 18; Ex. 17-J, p. RSV-0005753; Tr. 753-54 (Ex. 134-P, p. 1)).

93. More specifically, as part of the PoolRe Quota Share Reinsurance Arrangement, 18.5% of the direct written premiums for each participating insurance company's policies during tax years 2008 and 2009 were paid to PoolRe under the direct written insurance policies as modified by the joint underwriting stop loss endorsements (the remaining 81.5% of the direct written premiums being paid to the participating insurance company), and the participating insurance company assumed an equal amount of blended or pooled risk from PoolRe in return for reinsurance premiums. This premium allocation for the PoolRe Quota Share

Reinsurance Arrangement was based on, inter alia, the input and advice of Myron Steves & Co. ("Myron Steves"), who had determined that the allocation was reasonable. (Stip. ¶¶ 20, 94; Ex. 19-J, pp. RSV-0005755-5756; Ex. 96-J, p. RSV-0008954, ¶ 3; Tr. 20:2-4, 20:23-21:4, 35:6-16, 368:17-370:8, 639:10-13, 894:13-20; see also PRFF 107).

94. The premium allocation for the PoolRe Quota Share Reinsurance Arrangement was modified for tax year 2010 based on, inter alia, the input and advice of Glicksman Consulting, LLC, an actuarial consulting firm and its principal, Steven A. Glicksman ("Glicksman").[10] As a result, 19.9% of the direct written premiums for each participating insurance company's policies during the tax year 2010 were paid to PoolRe under the direct written insurance policies as modified by the joint underwriting stop loss endorsements (the remaining 80.1% of the direct written premiums being paid to the participating insurance company), and the participating insurance company assumed an equal amount of blended or pooled risk from PoolRe in return for reinsurance premiums. (Stip. ¶¶ 83, 93; Ex. 88-J, p. RSV-0003231; Ex. 95-J; Tr. 370:5-371:2).

[10] Mr. Glicksman was one of several actuaries that Capstone consulted over a number of years, held the Fellow of the Casual Actuarial Society designation and was a Member of the American Academy of Actuaries. (Stip. ¶ 93; Ex. 95-J; Tr. 371:11-14, 639:6-9, 807:18-24).

95. By participating in the PoolRe Quota Share Reinsurance Arrangement, each insurance company, such as Petitioner, insured hundreds of unaffiliated insureds under hundreds of unaffiliated insurance policies. (Stip. ¶ 18; Ex. 17-J, p. RSV-0005753; Ex. 104-P, pp. 14-17; Tr. 753:13-754:12 (Ex. 134-P, p. 1)).

96. During each of the tax years at issue, PoolRe received about $30 million in premium payments under all of its joint underwriting stop loss endorsements for that year with the approximately 150 different insureds participating in the PoolRe Quota Share Reinsurance Arrangement. (Tr. 753:13-754:12, 811:5-21).

97. During each of the tax years at issue, the PoolRe Quota Share Reinsurance Premiums that Petitioner received represented between 1.35% and 1.55% of the total premiums PoolRe received from all of the insureds under all of the joint underwriting stop loss endorsements for that year. (Tr. 753:13-754:12, 811:5-21 (Ex. 134-P)).

98. Petitioner paid losses of $61,160 for the tax year 2008, $410,152.19 for the tax year 2009 and $56,399.81 for the tax year 2010. [2008: (Stip. ¶ 39; Ex. 28-P, p. 4; Tr. 722:16-22); 2009: (Stip. ¶¶ 40, 84-88; Ex. 29-P, pp. 9-10; Exs. 89-J thru 91-J, 128-P, 129-P; Tr. 136:21-139:2, 141:24-144:13,

557:19-565:19, 722:4-723:22, 737:22-739:1); 2010: (Stip. ¶ 41; Ex. 30-P, p. 11; Tr. 723:23-724:23)].

99. The losses Petitioner paid included the payment on a claim Peak filed under the 2009 Loss of Major Customer Insurance policy. The claim was the result of a significant reduction of orders from Stillwater (the "Stillwater Loss"), a customer that represented about 35% of Peak's total sales. (Stip. ¶¶ 71, 75, 84-88; Exs. 61-J, 73-J, 89-J thru 91-J, 128-P, 129-P, 144-J; Tr. 136:21-139:2, 141:24-144:13, 557:19-565:19, 722:4-724:23, 737:22-739:1, 1017:4-1020:2).

100. The claim trigger under the policy was a reduction of more than 10% of sales. Since the Stillwater Loss represented a 16% reduction of Peak's total sales, the policy coverage applied to Peak's claim. (Stip. ¶ 71; Ex. 61-J, p. RES0000649; Ex. 128-P).

101. On May 27, 2009, Peak and Petitioner entered into a Settlement and Release Agreement regarding the Stillwater Loss under which Petitioner agreed to pay Peak $164,820, which Petitioner paid through the issuance of two checks, one dated April 21, 2009 for $150,000 and the other dated May 27, 2009 for $14,820, both payable to Peak. (Stip. ¶¶ 84-88; Ex. 89-J; Ex. 90-J, p. RSV-0005617, § 2.0; Exs. 91-J, 128-P; Tr. 141:24-144:13).

102. Due to further losses from the Stillwater Loss, the claim was re-opened on August 25, 2009. (Ex. 128-P; Tr. 144:7-18).

103. As a result, on September 10, 2009, Petitioner issued another check to Peak for $175,000 in payment of the re-opened claim. (Stip. ¶ 89; Exs. 92-J, 128-P; Tr. 143:7-145:17).

104. On January 30, 2012, Petitioner and Peak amended the May 27, 2009 Settlement and Release Agreement by entering into a Settlement and Release Agreement Addendum No. 1 under which Petitioner and Peak agreed that the total to be paid under the claim was $339,820. (Stip. ¶ 90; Ex. 93-J; Tr. 143:7-145:17).

105. Peak included the payments it received from Petitioner in Peak's income for Federal income tax reporting purposes. (Tr. 144:3-146:19).

106. During the tax years at issue, Capstone provided Petitioner with support services in connection with the management and administration of Petitioner's insurance arrangements. These services included liaising with the Anguilla Regulator and assisting with compliance with Anguilla insurance law, underwriting (e.g., drafting of policies, assisting in determining policy premiums, etc.), claims handling and processing, accounting and reporting, preparing and/or maintaining general ledgers, financial statements and other

records related to Petitioner's operations, coordinating with independent actuaries, underwriters, auditors, and other professionals and other matters associated with Petitioner's operations as an insurance company. (Stip. ¶ 8; Ex. 9-J, pp. RSV-0005632, RSV-0005639; Tr. 633:13-643:9, 813:15-18).

107. The independent actuaries, underwriters, auditors, and other professionals Capstone coordinated with on Petitioner's behalf included Myron Steves, a large, regional insurance brokerage, underwriting and insurance consulting firm and large regional managing general agent that also performed brokerage services for Lloyd's of London ("Lloyd's"); Mid-Continent General Agency, Inc. ("Mid-Continent"), a large, reputable managing general insurance underwriter that performed underwriting for other companies; various outside actuaries; Willis, the second largest insurance or risk management firm in the world; and Hilb, Rogal & Hobbs ("HRH"), a large national insurance firm that later merged with Willis. (Stip. ¶ 20; Ex. 19-J, pp. RSV-0005755-5756; Tr. 320:11-17, 638:14-640:21).

108. During 2008 and until June 30, 2009, Atlas Insurance Management (Anguilla) Limited, served as the resident manager of Petitioner in Anguilla. (Stip. ¶¶ 8, 20; Ex. 9-J, pp. RSV-0005632, RSV-0005639; Ex. 19-J, pp. RSV-0005690, RSV-0005698; Exs. 119-R thru 122-R; Tr. 508:15-509:11, 515:23-519:19).

109. Once Petitioner was incorporated and licensed as an insurance company in Anguilla, Atlas' role was to serve as Petitioner's regulatory liaison in Anguilla and to provide a local office in Anguilla for Petitioner. Capstone assumed this role after June 30, 2009, and Fiona Curtis served as Capstone's insurance manager in Anguilla. (Tr. 75:11-18, 508:15-509:20, 813:15-18).

110. Mr. McNeel, a Vice-President of Capstone and Director of Insurance Operations who headed up Capstone's insurance department, was the primary person responsible for developing premium amounts for insurance policies written by Capstone-managed captive insurance companies such as Petitioner during 2008, 2009 and 2010. (Tr. 297:6-15, 323:8-324:10, 381:19-21, 636:10-637:20).

111. Mr. McNeel, having working for prominent insurance companies and other companies with insurance or insurance-related business, had extensive experience as both an insurance underwriter and a broker. (Tr. 298:16-304:9, 637:10-638:13).

112. An insurance underwriter evaluates and prices risks for insurance purposes and is also involved in negotiating premiums. An insurance broker places insurance. (Tr. 301:8-302:23).

113. Mr. McNeel also held the ARM and the Chartered Property and Casualty Underwriter ("CPCU") designations. The CPCU designation is an insurance industry designation for property and casualty insurance underwriters that is earned by successfully completing a course of study and examinations. (Tr. 304:12-305:3, 636:14-19).

114. Mr. McNeel also held licenses from the State of Texas for property and casualty insurance, life and health insurance, and claims adjusting. (Tr. 305:4-12).

115. During 2008, 2009 and 2010, Mr. McNeel obtained pricing indications from Mid-Continent specific to the coverages and the policy periods for Petitioner's direct written insurance policies to assist in determining policy premiums. A "pricing indication" is an indication of what the premium pricing should be. (Ex. 109-P; Tr. 320:11-323:21, 330:21-343:18).

116. The Mid-Continent professionals who provided the pricing indications were seasoned underwriting professionals familiar with pricing methodologies used by both domestic insurers and Lloyd's syndicates. (Stip. ¶ 92; Ex. 94-J; Tr. 323:22-324:10, 404:2-19).

117. Many of the insurance coverages that Petitioner wrote during the tax years at issue were not readily available in the commercial markets and for which there was no market-

based rating manual. (Stip. ¶ 92; Ex. 94-J; Tr. 323:22-324:10, 404:2-19).

118. Generally, the types of coverages that Petitioner's direct written insurance policies provided involved low frequency/high severity claims, and were more like those written by Lloyd's, requiring the application of underwriting judgment in premium pricing. (Stip. ¶ 92; Ex. 94-J; Ex. 104-P, pp. 22-26; Ex. 107-P, pp. 5-7; Tr. 323:22-324:10, 404:2-19).

119. The process utilized by Mid-Continent involved the evaluation of exposures for a given line of insurance, examination of historic loss data, if any, the consideration of increased limits factors that might be applicable, and acknowledgment of market rate adjustments that might impact the commercial market's pricing of risk on a cyclical basis. (Stip. ¶ 92; Ex. 94-J; Tr. 323:22-324:10, 404:2-19).

120. In providing pricing indications for Petitioner, Mid-Continent would request and review information specific to Petitioner's insureds' businesses, including, but not limited to, their existing insurance policies, financial reports, information regarding operations and other available information that would normally be reviewed as part of the underwriting process. (Tr. 342:3-343:18).

121. During the tax years at issue, after considering the input and advice from Capstone and others, including Mid-Continent's pricing indications, Petitioner set the premiums for its direct written policies. While Petitioner did not increase its premium pricing above the amounts recommended in Mid-Continent's pricing indications, it did make downward adjustments. (Stip. ¶ 92; Ex. 94-J; Tr. 135:7-136:10, 323:15-324:10, 375:21-377:21, 637:10-23).

122. Mr. McNeel also used the pricing indications that Mid-Continent had prepared in previous years for insurance coverages similar to those Petitioner's direct written insurance policies provided in order to construct base rate averages or guide rates for these types of insurance coverages. In order to account for the varying limits of coverage, Mr. McNeel also developed a list of "increase limits factors" that he then used in the process of constructing these base rate averages for the different types of coverages (e.g., cyber risk coverage, D&O liability, employment practices liability, pollution, expense reimbursement, etc.). (Exs. 110-P, 111-P; Tr. 311:17-316:22, 345:6-349:4, 351:10-353:22, 355:10-356:23).

123. When the based rate average was based on revenue of the insured, the base rate average that Mr. McNeel constructed would be stated as a percentage of revenue with different rates

determined for different band levels of revenue. (Ex. 110-P; Tr. 311:17-314:19, 352:17-353:22).

124. When the based rate average was based on the number of employees of the insured, the base rate average that Mr. McNeel constructed would be stated as an amount per employee, with different rates determined for insureds with different band levels of employees. (Ex. 110-P; Tr. 315:10-22).

125. Mr. McNeel also determined an individual risk premium modifier (the "IRPM") that he used to adjust premiums as appropriate. (Ex. 110-P; Tr. 354:18-355:19).

126. During the tax years at issue, Mr. McNeel used this average pricing data to prepare "Rating Worksheets" that he used to estimate premiums for Petitioner's direct written insurance policies.[11] The Rating Worksheets reflected, inter alia, the particular policy, the policy limits, the exposure base, the rate to be applied to the exposure base, the increase limits factor, and the premium amount. (Ex. 112-P; Tr. 353:15-356:15, 359:2-15).

127. The Rating Worksheets, which were similar to rating worksheets used by many commercial insurance companies, were

[11] For tax year 2008, the estimated policy premiums reflected in Mr. McNeel's Ratings Worksheet and Mid-Continent's pricing indication were for a shortened policy period of less than one year. (Ex. 109-P, p. 1; Ex. 112-P, p. 1; Tr. 366:2-12).

prepared before Petitioner's direct written insurance policies were issued. (Ex. 112-P; Tr. 360:10-361:11).

128. During the tax years at issue, Petitioner's premiums for its direct written insurance policies were the product of input and advice from seasoned insurance professionals, including those at Mid-Continent and Capstone, and were reasonable in amount as independently confirmed by 2 actuaries who testified at the trial herein. (Exs. 113-P, 117-P; PRFF 110-127).

129. After consultation with Capstone and The Feldman Law Firm LLP (the "Feldman Firm"), Petitioner was formed under Anguilla law based on a combination of factors, including the dearth of states in the U.S. in 2008 that had experience with small insurance companies, particularly captive insurance companies, and Anguilla's regulatory framework which was based on the regulatory framework provided by the United Kingdom for its overseas territories. The United Kingdom is well-recognized for its insurance expertise developed over several hundred years. (Ex. 97-P, p. 16; Tr. 775:4-778:8).

130. Anguilla's regulatory framework in effect during the tax years at issue for captive insurance companies such as Petitioner was very similar to the captive insurance laws now

seen in many U.S. states, including Delaware. (Ex. 103-P, p. 7).

131. Anguilla has a precise and reasonably rigorous application process for property and casualty insurers like Petitioner. (Stip. ¶ 8; Ex. 9-J; Ex. 97-P, p. 17).

132. Anguilla uses a license class system that distinguishes between domestic and foreign insurers as well as single and group licenses, which is similar to the license class systems utilized in some U.S. states, e.g., Delaware. (Stip. ¶ 14; Ex. 14-J, pp. 8-10; Ex. 103-P, p. 7).

133. Similar to the requirements in many U.S. states, Anguilla also has requirements designed to ensure that only "fit and proper" persons are owners of the captive insurance companies that Anguilla licenses. (Stip. ¶ 14; Ex. 14-J, pp. 10-11; Ex. 103-P, p. 7).

134. Anguilla law also requires a business plan for the captive insurance company and the Anguilla Regulator's prior approval of any changes to the business plan, which is a typical requirement for captive insurance companies. (Stip. ¶ 15; Ex. 15-J, p. 6; Ex. 103-P, p. 7).

135. Anguilla law also requires each insurer to appoint an insurance manager with its principal office in Anguilla, and further requires annual audits of captive insurance companies by

independent certified public accountants ("CPAs"). (Stip. ¶ 14; Ex. 14-J, pp. 15-17; Ex. 103-P, p. 8; Tr. 726:13-24, 813:1-18).

136. Anguilla law also requires the maintenance of adequate reserves and has capital requirements and allows the Anguilla Regulator to establish a solvency margin for each insurer. (Stip. ¶ 14; Ex. 14-J, pp. 8-10; Ex. 103-P, pp. 8-9; Tr. 714:6-716:1).

137. Anguilla, like the National Association of Insurance Commissioners ("NAIC"), does not require small captive insurance companies such as Petitioner to utilize actuarial studies to support reserves for potential insurance claims. (Stip. ¶¶ 8, 14, 17; Ex. 9-J, p. RSV-0005681, n.1; Ex. 14-J, pp. 15-17; Ex. 16-J, p. RSV-0006039, n.2; Tr. 728:9-729:24).

138. Captive insurance companies in Anguilla are also subject to examination by the Anguilla Regulator, which may take enforcement actions if a captive insurance company is not in compliance with Anguilla law. (Stip. ¶ 14; Ex. 14-J, pp. 19-20; Ex. 103-P, pp. 8-9; Tr. 650:10-20, 798:10-18).

139. During the tax years at issue, Petitioner was subject to and regulated by the Anguilla Regulator. (Ex. 103-P, pp. 8-9).

140. As of the date of trial herein, Anguilla was the fifth largest captive domicile worldwide. (Ex. 97-P, p. 16).

141. During the tax years at issue, Petitioner maintained corporate minutes. (Stip. ¶¶ 32-34; Exs. 21-J thru 23-J).

142. During the tax years at issue, Petitioner maintained a bank account at AmericanWest Bank (n.k.a. Banner Bank) and an investment account at D.A. Davidson & Co. Both of these accounts were under Petitioner's exclusive control. (Stip. ¶¶ 42-44; Exs. 31-J thru 33-J; Tr. 725:23-726:12).

143. During each of the tax years at issue, Petitioner, with the assistance of Capstone, prepared and maintained books and records, including general ledgers, and financial statements, including balance sheets and income statements. (Stip. ¶¶ 35-37, 39-41; Exs. 24-J thru 26-J, 28-P thru 30-P, 126-P, 127-P; Tr. 550:16-556:15).

144. Petitioner also prepared and maintained statutory financial statements for appropriate reporting periods overlapping with the tax years at issue, which Petitioner also timely filed with the Anguilla Regulator, as required by and in compliance with Anguilla law.[12] (Stip. ¶ 38; Exs. 27-J, 125-P; Tr. 525:24-526:3, 546:18-9, 566:7-569:14).

---

[12] The Anguilla Regulator waived the 2008 audit requirement for Petitioner as it was incorporated in the fourth quarter of 2008. Petitioner, however, did prepare and file a statutory financial statement for the period from inception to December 31, 2009 and for the period from inception to December 31, 2010. (Stip. ¶ 38; Exs. 27-J, 125-P, 133-P; Tr. 730:17-733:15).

145. David B. Liptz, a California-licensed CPA specializing in accounting and audit work for captive insurance companies, and his accounting firm, Liptz & Associates, Inc., reviewed and opined on the statutory financial statements Petitioner filed with the Anguilla Regulator. (Stip. ¶ 38; Exs. 27-J, 125-P; Tr. 522:9-526:22).

146. Mr. Liptz and his accounting firm, which the Anguilla Regulator approved to submit audit reports to it, filed Petitioner's statutory financial statements for the periods from inception through December 31, 2010 with the Anguilla Regulator on Petitioner's behalf. (Tr. 566:7-569:17, 571:25-572:7).

147. Mr. Liptz and his accounting firm also performed audits of Petitioner for the tax years at issue following audit procedures mandated by the California Board of Accountancy (the "CBA"), the American Institute of Certified Public Accounting ("AICPA") and the Anguilla Regulator, whose mandated procedures for performing audits were very similar to the audit procedures prescribed under U.S. generally accepted accounting principles ("GAAP"). Mr. Liptz and his accounting firm were also subject to peer review by the CBA to ensure that they were properly performing such financial audits. (Tr. 528:4-529:2, 540:1-5).

148. The procedures Mr. Liptz and his accounting firm followed in performing these audits included requesting and

reviewing copies of Petitioner's general ledgers and trial balances; verifying the existence of Petitioner's insurance policies, expenses, assets, revenue (including insurance and reinsurance premium income), and bank and investment accounts, including independently contacting the bank and investment firms to confirm the balances in those accounts; and interviewing Capstone personnel tasked with assisting Petitioner in the preparation and maintenance of Petitioner's records. (Tr. 527:8-18, 529:3-530:17, 531:1-541:15 574:1-576:14, 577:2-578:10).

149. The opinions that Mr. Liptz and his firm provided for the periods from Petitioner's inception through December 31, 2010 were unqualified audit opinions. (Tr. 586:18-25).

150. For the period from inception in 2008 through December 31, 2010, Petitioner satisfied Anguilla law's minimum solvency margin requirements for insurance companies like Petitioner. During this same period, Petitioner's premium to surplus ratio was equal to or better than 3-to-1, a normal measure used by captive insurance regulators to evaluate the capital of captive insurance companies, reflecting a strong financial position. (Stip. ¶ 38; Ex. 27-J, p. RSV-0005530; Ex. 125-P, pp. 9-10; Tr. 214:11-13, 714:6-715:1; see also Stip. ¶ 14; Ex. 14-J; Ex. 103-P, p. 10).

151. During the tax years at issue, Petitioner was validly formed and existing, owned substantial assets (including its own bank and investment accounts), issued insurance policies, collected premiums and paid losses pursuant to such policies, made the necessary filings with the Anguilla Regulator, maintained books and records, issued both statutory and financial accounting financial statements audited by an independent accounting firm, had officers and directors (and held director, shareholder and other meetings), filed tax returns, was administered on a day-to-day basis by Capstone, as directed by Petitioner's officers and directors, employed attorneys, underwriters, claims adjusters, accountants, risk managers, actuaries, and other professionals and service providers as necessary, and took all other actions necessary for its operation as a valid insurance company. (PRFF 1-4, 7-82, 85-150).

152. On August 31, 2009, Petitioner filed with Respondent a Form 1024 Application for Recognition of Exemption Under § 501(a), as an insurance under § 501(c)(15). (Stip. ¶ 20; Ex. 19-J).

153. The application described, in detail, Petitioner's formation and insurance arrangements, including how premiums were being determined, and attached copies of relevant

documents, including Petitioner's incorporation documents, regulatory filings with the Anguilla Regulator, insurance and reinsurance contracts, § 953(d) election, financials, and other documents containing relevant information. (Stip. ¶ 20; Ex. 19-J; Tr. 655:2-656:8, 659:20-672:5).

154. The Feldman Firm assisted Petitioner in the preparation of the application. (Stip. ¶ 20; Ex. 19-J, pp. RSV-0005689-5694; Tr. 659:20-660:16).

155. Since 1999, the Feldman Firm had filed 39 applications for tax-exempt status for insurance companies similar to Petitioner that had received favorable rulings from Respondent for each of those 39 captive insurance companies. (Ex. 132-P; Tr. 656:2-656:9, 657:7-10, 672:18-677:21).

156. As of the date Petitioner's application was filed, the Feldman Firm had not received any adverse determinations for any applications for tax-exempt status for insurance companies similar to Petitioner. (Ex. 132-P; Tr. 657:5-10).

157. As of August 31, 2011, 7 captive insurance companies similar to Petitioner had also been examined by Respondent and had received no-change letters. (Tr. 653:7-654:12).

158. There was no substantive difference between Petitioner's application and those of the 39 insurance companies similar to Petitioner that had received favorable rulings. Each

of the applications was each several hundred pages in length, attached copies of the insurance policies issued and contained detailed descriptions of the insurance company's ownership, operations, policies, premium pricing, reinsurance and pooling arrangements, applicable insurance regulations, etc. (Ex. 132-P; Tr. 659:13-61:19, 662:24-672:5, 666:20-672:21; 675:24-677:21).

159. The Feldman Firm later filed 12 applications for tax-exempt status, four of which were denied and eight of which (including Petitioner's) were withdrawn once it was determined, based on conversations with Respondent's National Office, that Respondent's position on captive insurance companies had changed so that no further favorable rulings under § 501(c)(15) would be forthcoming. (Tr. 657:5-659:10, 679:1-682:14).

160. Respondent has not offered any explanation as to why he no longer issues favorable rulings under § 501(c)(15) for insurance companies. (Entire record).

161. Respondent's deficiency notice (the "SND") determined that Petitioner was not a tax-exempt insurance company within the meaning of § 501(c)(15), effective for tax years 2008, 2009 and 2010, and further determined income tax

deficiencies for each of those tax years.[13] (Stip. ¶ 2; Ex. 1-J, pp. 1, 4).

162. The SND asserts that Petitioner's insurance and reinsurance transactions lack economic substance and that "the amounts disallowed were not paid to an insurance company and that they were not paid for insurance." (Stip. ¶ 2; Ex. 1-J, p. 4).

163. The SND alternatively determined that Petitioner is not an insurance company "since its primary and predominant activity is not insurance." (Stip. ¶ 2; Ex. 1-J, p. 4).

164. The SND also asserts that because Petitioner is not an insurance company, its election to be taxed as a domestic insurance company was invalid. (Stip. ¶ 2; Ex. 1-J, p. 4).

165. The SND further asserts that the premium income Petitioner received under the direct written insurance policies constituted taxable income to Petitioner, even though Respondent's notice also determined that such premiums were paid under arrangements that lacked economic substance and did not constitute insurance. (Stip. ¶ 2; Ex. 1-J, p. 4).

---

[13] Respondent also issued a Final Adverse Determination Letter ("FADL") to Petitioner on March 30, 2016 for the tax years 2008, 2009 and 2010, alleging that Petitioner is not tax-exempt. (Stip. ¶ 24; Ex. 20-J). The FADL is the subject of a separate proceeding under the same caption as the instant proceeding and is not at issue herein. See U.S. Tax Court Dkt. No. 14544-16X.

166. The SND further determined that Petitioner should have filed Forms 1120F for each of the tax years 2008, 2009 and 2010. (Stip. ¶ 2; Ex. 1-J, p. 4).

167. The SND further determined that Petitioner should be subject to tax at 30% under § 881(a) without the benefit of any deductions. (Stip. ¶ 2; Ex. 1-J, p. 4).

168. The risks Petitioner insured or reinsured during the tax years at issue were insurance or insurable risks for statutory and financial accounting purposes. (Ex. 130-P, p. 1, ¶ 1).

169. There was risk shifting in Petitioner's insurance arrangements during the tax years at issue for statutory and financial accounting purposes. (Ex. 130-P, pp. 1-2; Tr. 592:20-595:7).

170. The insurance and reinsurance arrangements Petitioner entered into during the tax years at issue constituted insurance for statutory and financial accounting purposes. (Ex. 130-P, pp. 1-2).

171. Petitioner was an insurance company during the tax years at issue for financial and statutory accounting purposes. (Ex. 130-P, pp. 1-2).

172. The insurance and reinsurance arrangements Petitioner entered into during the tax years at issue provided

"insurance," as that term is understood by economists and risk management theorists and professionals, and (a) the policies insure insurable risks; (b) the risks are shifted; (c) the risks are distributed; and (d) the insurance arrangements constitute insurance as it is commonly understood. (Ex. 97-P, pp. 1-2, 18; Ex. 104-P, pp. 5, 14, 17-18, 22-28; Ex. 114-P).

173. Petitioner was an insurance company as that term is understood by economists and risk management professionals and theorists. (Ex. 97-P; Ex. 104-P, p. 5).

174. During the tax years at issue, Petitioner's gross receipts did not exceed $600,000. (Stip. ¶ 3; Exs. 2-J thru 4-J; entire record).

175. Nowhere in the record is there any explanation by Respondent as to why Petitioner's premiums should be taxable if such premiums do not constitute insurance for Federal income tax purposes. (Entire record).

Ultimate Facts

176. The insurance arrangements Petitioner entered into during the tax years at issue, including the direct written policies and the 2 reinsurance arrangements (i.e., the CreditRe Reinsurance Arrangement and the PoolRe Quota Share Reinsurance Arrangement), were valid and had economic substance. (Entire record).

177. The risks that were the subject of Petitioner's direct written policies during the tax years at issue constituted insurable risks. (Entire record).

178. The risks that were the subject of the CreditRe Reinsurance Arrangement and the PoolRe Quota Share Reinsurance Arrangement during the tax years at issue were insurable risks. (Entire record).

179. During the tax years at issue, Petitioner's insureds (Peak, RocQuest and ZW) shifted their risk to Petitioner under the direct written insurance policies Petitioner issued and to PoolRe with regard to the risks that were the subject of the Stop Loss Endorsements. (Entire record).

180. There was risk distribution with respect to the risks that Petitioner insured or reinsured during each of the tax years at issue. (Entire record).

181. During the tax years at issue, the insurance arrangements Petitioner entered into were consistent with the commonly accepted notions of insurance. (Entire record).

182. In each of the tax years at issue, more than half of Petitioner's business was the issuing of insurance contracts, and Petitioner was therefore an insurance company within the meaning of § 831(c) for each of those tax years. (Entire record).

183. During the tax years at issue, Petitioner was tax-exempt under § 501(c)(15). (Entire record).

184. Alternatively, if the Court finds that Petitioner's premium income (in whole or in part) for the tax years at issue is not insurance premium income, the premium amounts constitute non-taxable contributions to capital. (Entire record).

185. Alternatively, if the Court finds that Petitioner is not an insurance company for any of the tax years at issue, Petitioner exercised reasonable cause and good faith with respect to its compliance with any Federal income tax filing and payment requirements, and accordingly, Petitioner is entitled to its deductions in computing its taxable income for such years. (Entire record).

POINTS RELIED UPON

Petitioner was validly formed, existing and adequately capitalized during tax years 2008, 2009 and 2010. In each tax year at issue, more than half of Petitioner's business was the issuing of insurance contracts that satisfy the 3-part test to constitute insurance for tax purposes. During each tax year at issue, Petitioner's gross income did not exceed $600,000. Thus, Petitioner was an insurance company for Federal income tax purposes and was exempt from tax under § 501(c)(15).

At trial herein, Petitioner offered the testimony of

numerous witnesses who described Petitioner's insurance arrangements in detail. Moreover, Petitioner offered the uncontroverted testimony of numerous experts who testified that Petitioner's insurance arrangements, including its reinsurance arrangements, constituted insurance for insurance industry purposes. Petitioner also offered the testimony of 2 experts who confirmed that the premiums for Petitioner's direct written insurance policies were reasonable in amount.

Respondent, on the other hand, offered no credible evidence that Petitioner is not an insurance company. Nor did Respondent provide any explanation for the abrupt 180° shift in his treatment of applications for recognition of tax-exempt status under § 501(c)(15). Instead, the evidence that Respondent offered did nothing to demonstrate that Petitioner is not an insurance company or to demonstrate that Petitioner is not tax-exempt under § 501(c)(15). Respondent also failed to offer any credible evidence or reasoning to support his unworkably restrictive position that an insured does not need insurance until the insured actually has losses, i.e., one's house has to have burned down at least once before purchasing fire insurance is warranted. Worse yet, Respondent appears to have built his entire case on one expert witness' testimony and reports which are unreliable and entitled to no weight.

If the Court finds that Petitioner is not an insurance company for tax purposes or that the premiums charged in Petitioner's policies should be reduced, the Court must then evaluate the nature of the premiums or excess premiums that Petitioner receive during the tax years at issue. Any amounts in excess of premiums received would constitute contributions to capital under § 351 and not taxable income to Petitioner. The amounts treated as contributions to capital would not be considered in determining whether more than half of Petitioner's business was from the issuance of insurance policies.

Moreover, if the Court finds that Petitioner is not an insurance company for tax purposes or that the premiums charged in Petitioner's policies should be reduced, Petitioner should be allowed its deductions in computing tax due since Petitioner exercised reasonable cause and good faith in filing the tax returns that it filed for the tax years at issue.

ARGUMENTS

I. Petitioner is exempt from tax under § 501(c)(15) because (i) Petitioner is an insurance company because more than half of its gross receipts consist of premiums, and (ii) Petitioner's gross receipts for the year do not exceed $600,000.

Respondent appears to take issue only with (i) whether

Petitioner is an "insurance company" and (ii) whether more than 50% of Petitioner's income in each tax year consisted of premiums received for reinsurance. An "insurance company" within the meaning of §§ 831(c) and 816(a) is a company more than half of the business of which is insuring or reinsuring such contracts. Thus, if more than half of Petitioner's income is income from writing insurance or reinsurance, Petitioner is an insurance company and is tax-exempt under § 501(c)(15).[14]

Petitioner presented the expert reports and testimony of the following experts:[15]

1. Dr. Neil Doherty opined that Petitioner's arrangements constituted insurance, and that Petitioner was an insurance company, as those terms are understood by economists and risk management professionals. (Ex. 104-P).

2. Steven W. Kinion opined that Petitioner was an insurance company from a regulatory perspective. (Ex. 103-P).

3. Robert L. Snyder II opined that Petitioner was a feasible and effective risk management option for Petitioner's affiliated insureds, that Petitioner's insurance arrangements covered insurance risks, and that Petitioner's operations were

[14] Petitioner is not a life insurance company, which would not qualify for exemption under § 501(c)(15), and Petitioner does not understand Respondent to contend otherwise.

[15] Messrs. Snyder and Liptz also testified as fact witnesses.

consistent with those of a property and casualty insurance company operating in a domicile such as Anguilla. (Ex. 97-P).

4. David B. Liptz opined that during the tax years at issue, Petitioner was an insurance company, and the insurance arrangements that Petitioner entered into were insurance from a financial and statutory accounting perspective. (Ex. 130-P).

5. Gary Fagg opined that Petitioner's reinsurance of certain contracts increased risk distribution. (Ex. 114-P).

6. Esperanza Mead and Michael Solomon opined that the premiums for Petitioner's direct written insurance policies were reasonable in amount. (Exs. 113-P, 117-P).

Respondent's expert, Donald J. Riggin ("Riggin"), opined that Petitioner's insurance arrangements were not insurance. (Exs. 136-R, 137-R). Dr. Doherty and Messrs. Liptz and Solomon submitted rebuttal reports to Mr. Riggin's opening report. (Exs. 107-P, 131-P, 147-P). As discussed below, Mr. Riggin's testimony is entitled to no weight. See Arg. I.A.6 at pp. 80-95, infra.

A. Petitioner's insurance arrangements constitute insurance for tax purposes.

An insurance arrangement constitutes insurance for tax purposes if it (i) involves an insurance risk, (ii) effectuates risk shifting and risk distribution, and (iii) is consistent

with the commonly accepted notions of insurance. Helvering v. Le Gierse, 312 U.S. 531 (1941); AMERCO v. Comm'r, 96 T.C. 18 (1991), aff'd, 979 F.2d 162 (9th Cir. 1992); Sears, Roebuck & Co. v. Comm'r, 96 T.C. 61 (1991), aff'd in part and rev'd in part, 972 F.2d 858 (7th Cir. 1992); Rent-A-Center, Inc. v. Comm'r, 142 T.C. 1 (2014); Securitas Holdings, Inc. v. Comm'r, T.C. Memo. 2014-225. This test "focus[es] on the individual contract between the insured and the insurer." Humana, Inc. v. Comm'r, 881 F.2d 247, 251 (6th Cir. 1989).

However, "[c]onsistent with [Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943)], when applying the tax laws to captive insurers, courts initially have sought to determine whether the [captive insurance arrangement] should be classified as a 'sham.'" Kidde Indus. Inc. v. U.S., 40 Fed. Cl. 42, 50 (1997). When the insurance arrangement is not a sham, "courts generally have proceeded to apply the definition of 'insurance' provided by Le Gierse and determine whether risk shifting and risk distribution are present." Id. at 51; see also Malone & Hyde v. Comm'r, 62 F.3d 835, 840 (6th Cir. 1995); Humana, 881 F.2d at 252.

1. Petitioner's insurance arrangements were not shams.

In determining whether a captive insurance arrangement is a

sham, courts have focused on whether the captive was (1) formed for a valid business purpose, and (2) financially able to bear the risks transferred to it. See, e.g., Malone & Hyde, 62 F.3d at 840-41; Humana, 881 F.2d at 252-56; Kidde, 40 Fed. Cl. at 51.

Petitioner was formed for a valid business purpose, i.e., to issue insurance contracts, and Petitioner took all actions necessary to operate as a validly formed and functioning insurance company. (PRFF 151). As Petitioner's witnesses explained, after Peak's mining equipment business had grown substantially, Messrs. Zumbaum and Weikel consulted Mr. Pope, their mentor and a fellow mining equipment business owner, who advised them to consider forming a captive insurance company to better manage the risks associated with their growing business. (PRFF 53-59). Messrs. Zumbaum and Weikel were well-aware of the risks associated with Peak's business, including (a) the dangerous conditions in underground mines where Peak's equipment was utilized (PRFF 21-37, 41-42, 47, 55-56), (b) the critical functions (e.g., mine ventilation fans, mine air barrier doors, mining trucks, hoisting equipment and submersible pumps) that Peak's equipment performed (PRFF 21-35), (c) the liability exposure from operating a business that manufactured, custom-designed, distributed, sold, repaired and serviced mining equipment (PRFF 21-37, 41-42, 47, 55-56), (d) the liability

exposure from others using or misusing Peak's equipment (PRFF 22-38, 41-49, 52-56), (e) the high concentration of Peak's sales among a few major customers, the loss of any one of which could financially cripple, if not, devastate Peak (PRFF 20, 99-104), (f) the liability exposure from a recall of Peak's products (PRFF 21-35), (g) the liability exposure for Peak's officers and directors from operating an equipment company that supported the dangerous mining industry (Id.), (h) the regulatory, pollution and weather related risks associated with operating in the mining industry, the Bunker Hill Superfund Site, and a floodplain in the Bunker Hill Superfund Site (PRFF 38-52), and (i) the potential for litigation associated with the business, industry and environmental conditions under which Peak operated (Entire record). The mining industry and Peak's business clearly involve a high degree of risk. (Entire record). Moreover, the Reserve Feasibility Study confirmed all of these factors and concluded that the formation of a captive insurance company to provide the insurance that Petitioner ultimately provided was reasonable and appropriate. (PRFF 68-76).

During the tax years at issue, Petitioner was licensed as an insurance company under Anguilla law and otherwise was in compliance with Anguilla law. (PRFF 10-12, 144, 146-147, 150-151). Petitioner collected insurance and reinsurance premiums

and paid losses under the policies that it either issued or reinsured. (PRFF 82, 85, 89, 98-104). Moreover, Petitioner had assets, maintained bank and investment accounts containing its assets and held a Class "B" Insurer's General License from the Anguilla Regulator. (PRFF 10-11, 142, 150-151). At all times relevant hereto, Petitioner met Anguilla law's capitalization and solvency requirements and was financially able to bear the risks that it insured. (PRFF 150-151). Petitioner met a premium-to-surplus ratio that insurance regulators often utilized to determine whether an insurance company had sufficient assets to pay potential claims. (PRFF 150). Petitioner properly filed U.S. income tax returns and otherwise conducted its affairs as an insurance company. (PRFF 151). Because Petitioner was a viable entity and its insurance and reinsurance contracts were valid, there was risk shifting in Petitioner's insurance arrangements.

Respondent did not determine that Petitioner itself was a sham and presented no evidence to support his allegation that Petitioner's insurance arrangements were shams. (See Ex. 1-J, p. 4; entire record). Moreover, despite his position that the arrangements were shams, Respondent inconsistently determined that the premiums from the arrangements was income to Petitioner. (Ex. 1-J; PRFF 165); see Bank of New York Mellon

Corp. v. Comm'r, T.C. Memo. 2013-225 (slip op. at 13-14), supplementing 140 T.C. 15 (2013), aff'd, 801 F.3d 104 (2d Cir. 2015), cert. denied, __ U.S. __, 136 S. Ct. 1377 (2016).

Had Petitioner's request for determination been filed at an earlier time, the issues that were the subject of the trial herein would have been the subject of a favorable determination that Petitioner was a tax-exempt insurance company under § 501(c)(15). (PRFF 152-160). Respondent, however, abruptly abandoned his favorable ruling policy and declined to issue favorable determinations any further. (Id.). In doing so, Respondent did not cite any intervening change in governing law or any other changed circumstance; instead, the only reason given was that there was a new manager in charge of Respondent's determination process.[16] (Id.). Respondent's arbitrary position is thus nothing more than ipse dixit. See Transco Exploration Co. v. Comm'r, 949 F.2d 837, 840 (5th Cir. 1992) ("Although the Commissioner is entitled to change his mind, he ought to do more than stride to the dais and simply argue in the opposite direction."). Respondent's failure to present credible evidence in support of his position confirms this to be the case.

2. Petitioner's policies covered insurable risks.

"[I]nsurance risk is involved when an insured faces some

[16] Some might say there was "a new sheriff in town."

loss-producing hazard (not an investment risk), and an insurer accepts a payment, called a premium, as consideration for agreeing to perform some act if and when that hazard occurs." R.V.I. Guaranty Co., Ltd. v. Comm'r, 145 T.C. 209, 235 (2015) (internal quotation marks omitted) (quoting Black Hills Corp. v. Comm'r, 101 T.C. 173 (1993), aff'd, 73 F.3d 799 (8th Cir. 1996)); see also Harper Grp. v. Comm'r, 96 T.C. 45, 58 (1991), aff'd, 979 F.2d 1341 (9th Cir. 1992); AMERCO, 96 T.C. at 38-40. Insurance risks are risks that can cause a financial loss to the insured and generally require a fortuitous event and not investment or speculative risks. R.V.I. Guaranty, 145 T.C. at 235.

In R.V.I. Guaranty, this Court held that contracts that indemnified the lessor-owner of leased property against the decline in value of the residual interest in the leased property (i.e., the value of the property at the time the lease terminated and the property reverted to the lessor-owner) covered insurance risks. Id. This Court premised this holding in large part on the treatment of the contracts for accounting, regulatory and insurance industry purposes. Id. at 235-46.

Here, Petitioner's fact and expert witnesses testified that, during the tax years at issue, Petitioner's insurance policies covered insurable risks (a) for accounting purposes,

(b) for regulatory purposes and (c) from an insurance industry perspective. (Ex. 97-P, pp. 2, 12-16; Ex. 103-P; Ex. 104-P, pp. 20-26; Ex. 130-P; PRFF 168, 172). Even Respondent's expert, Mr. Riggin, conceded that most of the types of risks Petitioner's insurance policies covered were insurable risks: (a) Product Recall; (b) Regulatory Changes; (c) Punitive Wrap; (d) Loss of Major Customer; (e) Excess Intellectual Property Package; (f) Expense Reimbursement insofar as it covers defense costs arising from civil litigation; (g) Excess Employment Practices Liability; (h) Excess Cyber Risk insofar as it is not responding to post-loss systems crisis management such as public relations and consulting costs associated with a cyber-related event; (i) Expense Reimbursement - Legal Expenses; (j) Excess Pollution Liability; and (k) Weather Related Business Interruption. (Ex. 136-R, pp. 11-12, 25-32; Tr. 967:12-971:9-14).

Mr. Riggin, however, claimed that certain of Petitioner's policies did not cover insurable risks on the grounds that they were not fortuitous risks. As Dr. Doherty explained in his reports, (i) each of Petitioner's policies, without exception, covered insurable risks because, inter alia, these or similar coverages are marketed as insurance products by commercial insurance companies and are available in the commercial marketplace. (Ex. 104-P, p. 5, ¶ 1, p. 18, ¶ 2d, pp. 22-26, ¶

3c, p. 27; Ex. 107-P, pp. 7-8; see also Ex. 97-P, p. 2, ¶ 2, pp. 12-16); see R.V.I. Guaranty, 145 T.C. at 245. Mr. Riggin's opinion to the contrary lacks factual or analytical support.

Specifically, with respect to the Loss of Services policy, the loss of an employee (due to death, disability, resignation, etc.) is a fortuitous event and clearly a pure risk in that it represents a loss without a chance for gain. Notably, the Loss of Services policy "excludes the cases which are obviously induced by the employer's own decisions (firing, failure to replace in a timely fashion, etc.) and thereby concentrates coverage on fortuitous losses." (Ex. 107-P, p. 8).

The Tax Liability policy is specifically designed to protect the insured from situations where the underlying legal conclusions supporting tax treatment may be subject to future challenge by tax authorities, which is neither a business nor an investment risk. A contrary ruling or challenge by tax authorities is a fortuitous event, and the insurance thereof is a pure insurable risk. (Ex. 107-P, p. 8; Ex. 104-P, p. 25).

With respect to the Expense Reimbursement and Excess Cyber Risk policies, Mr. Riggin objects to these policies only insofar as they cover crisis management and public relations expenses responding to covered events.[17] As Dr. Doherty explained, an

[17] Presumably, Mr. Riggin concedes that the remainder of the

expense incurred as a result of a rational reaction to a fortuitous event, is a fortuitous cost. As such, the risks of incurring these expenses are fortuitous and thus insurable risks. (Ex. 107-P, pp. 7-8; see also Ex. 104-P, pp. 24-25).

With respect to the Excess D&O Liability policy, Mr. Riggin suggests that the coverage cannot respond because "the company has but two directors, and each are [sic] officers of the company. As such, the company cannot sue itself, so . . . there is no insurable interest." (Ex. 136-R, App. E (p. 29)). In doing so, however, Mr. Riggin ignores the fact that many private companies buy D&O liability coverage "because of potential claims from customers or suppliers" against the directors and officers. (Tr. 71:14-72:20). Further, as noted in the Reserve Feasibility Study, "D&O suits do not necessarily emanate from shareholders" and "[p]rivate companies, as well as publicly traded ones, are exposed to claims and suits against directors and officers by customers, suppliers, and competitors for alleged 'wrongful acts.'" (Stip. ¶ 17, Ex. 16-J, p. RSV-0006021, ¶ (10)). Mr. Riggin did not address this inconvenient fact or the Reserve Feasibility Study in his analysis, stating on cross-examination that he was familiar with the study "only

---

coverage under these policies covers insurable risks, since the policies cover more than crisis management and public relations expenses.

in the fact that it exists." (Tr. 996:19-22; see also Tr. 997:1-9).

3. There was risk shifting in the insurance arrangements entered into by Petitioner.

When Petitioner and its insureds are considered as separate entities, the risk shifting prong of Le Gierse is clearly met. Humana, 881 F.2d at 252. In exchange for premiums, the insureds shifted to Petitioner the financial risks that in any given year the insurance claims would exceed the amount of the premiums paid (i.e., Petitioner absorbed the unpredictability or "variability" of the losses). Kidde, 40 Fed. Cl. at 56-57 ("the relevant risk that is transferred in an insurance relationship [is] the 'variability of loss,' i.e., the risk that the amount of the loss suffered will exceed the average or expected amount of the loss"); Sears, 972 F.2d at 862 ("Corporations do not insure to protect their wealth and future income, . . . [but instead] insure to spread the costs of casualties over time.").

Risk shifting is evaluated by "examin[ing] the economic consequences of the captive insurance arrangement to the 'insured' party to see if that party has, in fact, shifted the risk. In doing so, [courts should] look only to the insured's assets . . . to determine whether it has divested itself of the adverse economic consequences of a covered [insurance risk]."

Clougherty Packing Co. v. Comm'r, 811 F.2d 1297, 1305 (9th Cir. 1987) (emphasis added); see also Humana, 881 F.2d at 252; Hospital Corp. of America v. Comm'r, T.C. Memo. 1997-482, 74 T.C.M. (CCH) at 1041. Where the risks have been effectively shifted, a claim payment by the insurer will have no effect on the balance sheet of the insured. See id.

Under the insurance policies at issue, if an insured sustained an insured loss, Petitioner would reimburse the insured for that loss. Therefore, the economic reality of Petitioner's insurance arrangements was that if and when a loss occurred and was paid by Petitioner, the net worth of the insureds would not be reduced accordingly. Humana, 881 F.2d at 253. There is simply no direct connection between a loss Petitioner paid and the balance sheets of the insureds. Id.

Petitioner's insurance arrangements were not shams, and for purposes of applying the balance sheet test, Petitioner and its insureds must be respected as separate legal entities as Moline Properties dictates. Accordingly, under the balance sheet test, there was risk shifting in Petitioner's insurance arrangements.

4. There was risk distribution in Petitioner's insurance arrangements.

"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, 142 T.C. at 24. As this Court reasoned in Rent-A-Center:

> By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smoothes out losses to match more closely its receipt of premiums. This distribution also allows the insurer to more accurately predict expected future losses. In analyzing risk distribution, we look at the actions of the insurer because it is the insurer's, not the insured's, risk that is reduced by risk distribution.

Id. (citations and internal quotation marks omitted). By increasing the total number of independent, randomly occurring risks that an insurer faces (i.e., by placing risks into a larger pool), the insurer benefits from the mathematical concept of the law of large numbers. Kidde, 40 Fed. Cl. at 53; Clougherty, 811 F.2d at 1300; Securitas, T.C. Memo. 2014-225 (slip op. at 27); (see also Ex. 104-P, pp. 7-9).

Whereas risk shifting looks to the insured's assets, risk distribution looks solely to the pool of risks assumed by the insurer, and ignores the relationship between the insurer and any single insured. Humana, 881 F.2d 247 at 256-57 (citing Comm'r v. Treganowan, 183 F.2d 288, 291 (2d Cir. 1950); Sears, 972 F.2d at 861 (risk distribution analyzed from insurer's perspective); Harper, 96 T.C. at 59 ("once premiums are pooled together, the payor's identity (i.e., the insured) is lost").

During the tax years at issue, Petitioner issued direct written policies that covered the risks of Peak and its various affiliates and entered into reinsurance arrangements that covered thousands of unaffiliated insureds. (PRFF 77-79, 81-82, 85-93, 95-97). More specifically, Petitioner's insureds entered into Stop Loss Endorsements with an independent insurer, PoolRe, which resulted in 18.5%/19.1% of the direct written premiums being paid to PoolRe by Petitioner's insured affiliates. (PRFF 81). At the same time, under the Quota Share Policies, Petitioner, through PoolRe, reinsured risks that were pooled under similar joint underwriting stop loss endorsements that PoolRe entered into with approximately 150 insureds unrelated to Petitioner and its owners and insureds. (PRFF 81, 85, 88, 90-93, 95-97). In exchange for assuming the pooled risks, Petitioner received reinsurance premiums. (PRFF 85, 88-89). Petitioner also reinsured unrelated risks that PoolRe reinsured from CreditRe, which involved many thousands of unaffiliated insureds. (PRFF 85-87, 89). In total, the premiums Petitioner received under the 2 reinsurance arrangements constituted more than 30% of the total premiums Petitioner received during each of the tax years at issue. (PRFF 89).

The evidence in this case demonstrates that the risk distribution here exceeds the 29% threshold that was endorsed by

this Court and the Ninth Circuit Court of Appeals in Harper. (PRFF 89). This Court in Harper found that a captive insurer that received 29% of its premium revenue from unrelated parties satisfied the requirements for risk distribution. 96 T.C. at 59-60.

Here, sufficient independent risks are present to provide adequate risk distribution. (Ex. 104-P; PRFF 172). In fact, Dr. Doherty opined that there was more risk distribution in the present case than there was in Harper. (Ex. 104-P, pp. 18-19; PRFF 172).

5. Petitioner's insurance arrangements were consistent with the commonly accepted notions of insurance.

In determining whether an insurance arrangement is consistent with the commonly accepted notions of insurance, court have considered whether (1) the captive was organized, operated and regulated as an insurance company; (2) the insurer was adequately capitalized; (3) the insurance policies were valid and binding; (4) the premiums were reasonable; and (5) the premiums were paid and the losses were satisfied. Rent-A-Center, 142 T.C. at 25; Securitas, T.C. Memo. 2014-225 (slip op. at 27); Kidde, 49 Fed. Cl. at 51-52; Harper, 96 T.C. at 60; AMERCO, 96 T.C. at 42.

Petitioner's insurance arrangements satisfy each of the above factors and are consistent with commonly accepted notions of insurance. (PRFF 10-11, 77-82, 85-89, 98-129, 141-160).

Respondent's basis for his position that Petitioner's insurance arrangements were not consistent with the commonly accepted notions of insurance is unclear, especially in light of the 39 favorable rulings (and no unfavorable rulings) that Respondent issued determining that captives similarly situated to Petitioner were tax-exempt under § 501(c)(15). (PRFF 152-160). Nor is it clear on what basis Respondent contends that the premiums that Petitioner received were not actual premiums. Insofar as the basis is Mr. Riggin's opinion on premium pricing, it is wholly unreliable and unhelpful to the Court.[18]

Mr. Riggin's opinion is that premiums must be determined utilizing either (1) actuarial methods based on "actuarially sufficient" loss data, (2) the Commercial Lines Manual (the "CLM")[19] or (3) the "wealth of supporting data found in any commercial multiline insurer." (Ex. 136-R, p. 4, ¶ 8). Mr. Riggin's opinion, however, is unworkable and contrary to insurance industry practices, existing case law, and

---

[18] Mr. Riggin's testimony and reports are addressed further in Argument I.A.6 at pp. 80-95, infra.

[19] The CLM is a compilation of insurance-related information. (See Ex. 136-R, p. 4, ¶ 8).

Respondent's own published ruling position. (See Ex. 107-P, pp. 4-6). The untenable nature of Mr. Riggin's position at trial is clearly illustrated by his opinion that a putative insured does not need insurance unless and until losses have been suffered.

In Harper, this Court addressed the issue of setting premiums for a captive insurance company and its insured affiliates. 96 T.C. at 50. The premiums rates charged in Harper "were determined by reference to competitive pricing" gathered by the petitioner's management in the course of their business and incorporated in the rates approved by the captive insurance company "and other relevant factors." Id. This Court specifically held that the determination of the premiums in this manner was proper. Id. at 60. Notably, "[s]uch rates were not determined by reference to actuarially determined loss projections." Id. at 50 (emphasis added).

Here, after considering the input and advice from various insurance professionals, including Mr. McNeel, a Capstone employee with substantial insurance and insurance underwriting expertise, and data sources, including Mid-Continent's pricing indications, Petitioner set the premiums for its direct written policies. (PRFF 106-107, 110-128). While Petitioner did not increase its premium pricing above the amounts recommended in Mid-Continent's pricing indications, it did make downward

adjustments. (PRFF 121). The premium pricing methodology employed here was consistent with the methodology described to Respondent when he issued the 39 favorable rulings to captives similarly situated to Petitioner. Respondent issued the 39 favorable rulings without contesting the methodology. (PRFF 152-160). Moreover, Dr. Doherty, while not opining on the pricing results, viewed the methodology as reasonable. (Ex. 107-P, pp. 5-7).

It is undisputed that Petitioner's policies provided coverages for which loss data was not readily available to forecast potential losses. (PRFF 117-118). The evidence in this case demonstrates that in the insurance industry, insurance policies are regularly written without readily available loss data to forecast losses. (Ex. 147-P, p. 2); see also Arg. I.A.6 at pp. 80-95, infra. Petitioner also introduced the expert testimony of two actuaries, Ms. Mead and Mr. Solomon, who performed actuarial analyses and determined that the premiums Petitioner Charged during the tax years at issue were reasonable in amount. (Exs. 113-P, 117-P; PRFF 128).

6. The Testimony of Respondent's Expert Witness is Unreliable and Should Be Disregarded.

Mr. Riggin, Respondent's sole expert witness, testified at trial and offered opening and rebuttal reports. (Exs. 136-R,

137-R). Petitioner's experts, Dr. Doherty and Messrs. Liptz and Solomon, rebutted Mr. Riggin's opening report and testified at trial as to the reasons why they disagreed with his opinions. (Exs. 107-P, 131-P, 147-P). As shown below, Mr. Riggin's testimony and reports are unreliable and unhelpful to the Court and are not entitled to any weight.

Rule 143(g) provides, inter alia, that an expert's report shall contain a list of all publications authored in the previous 10 years. Rule 143(g)(1)(D). At trial, Mr. Riggin testified that he knew of and had complied with this requirement, and Respondent's counsel confirmed that he had discussed this requirement with Mr. Riggin. (Tr. 871:8-22, 909:2-910:9, 1004:7-1005:6). During his testimony on cross-examination, however, it became abundantly clear that Mr. Riggin had not complied. In fact, Mr. Riggin admitted that he had intentionally not disclosed articles that he dubiously described as "self-published" on LinkedIn and not published by a "third party." (Tr. 909:2-910:9). Rule 143(g) provides for no such exception. Worse yet, the publications that Mr. Riggin failed to disclose directly contradicted the opinions he had advocated to this Court, clearly demonstrating the unreliability of his opinions.

Mr. Riggin's position at trial was that an insurance policy

cannot be priced and is not valid insurance unless the premiums are developed using the CLM, actuarial methodology, or "the wealth of supporting data found in any commercial multiline insurer."[20] (Ex. 136-R, p. 4, ¶ 8; see also Tr. 886:9-893:24). Yet, in his article entitled Captive Fundamentals, which was not listed in his report despite being "published on October 10, 2016," Mr. Riggin wrote that a hypothetical pipeline company could insure against warranty risk by utilizing a captive notwithstanding that there were no historical losses from which to project future losses (described in the article as a "shot-in-the-dark" (emphasis added)) or determine premiums. (Ex. 138-P).

The thrust of Mr. Riggin's testimony and reports was that Petitioner did not have sufficient loss data to actuarially determine premiums, but he also readily admitted that such loss data was not required to determine a premium. (Ex. 136-R, p. 4; Tr. 875:6-877:18). Mr. Riggin also conceded that if an insurance company used its "best judgment" to determine a premium for such insurance, the coverage would still constitute insurance. (Tr. 879:1-6). Mr. Riggin also conceded on cross-

[20] On cross-examination, Mr. Riggin testified nonsensically that the premium is separate from the insurance contract. (Tr. 883:8-887:2). If that were true, his untenable position (i.e., that there can be no valid insurance where pricing is not done according to one of the 3 methods he advocates) would collapse.

examination that actuaries have techniques to determine premiums when such data is unavailable or inadequate for these purposes, testifying, "I readily accept that good actuaries have ways of approximating premiums that have no basis in any historical losses." (Tr. 877:3-18, 990:6-18; see also Ex. 147-P).

Mr. Riggin further admitted that in the case of terrorism insurance, insurance companies set premiums for such coverage even though there is insufficient loss data to reliably forecast losses, the CLM does not cover this type of coverage, and insurance companies generally do not have a "wealth of data" to set premiums for this type of coverage, which he described as a "one-off."[21] (Tr. 877:3-878:25). Mr. Riggin made similar statements regarding satellite insurance coverage. (Tr. 880:1-882:25). Mr. Riggin further admitted that there are situations in which the market and not actuarial science is used to establish rates and premiums. (Ex. 136-R, p. 14, ¶ 53; Tr. 966:14-967:7).

Mr. Riggin previously had written an article "determining a

[21] Mr. Riggin conceded that there is growth and evolution in the insurance industry, but claimed that that there is "not a lot." (Tr. 880:8-14). Mr. Riggin's attempt to minimize the growth and evolution of the insurance industry is unsurprising given that evolution of insurance products creates serious issues for Mr. Riggin's position about premium pricing. Presumably this is also why he referred to examples of newer insurance coverages (e.g., terrorism, satellite, cyber risk) as "one-offs." (Tr. 863:12-17, 876:1-2, 879:23-880:7, 881:6-25, 908:13-23, 948:3-949:2, 949:3-21, 987:11-25, 989:25-990:18).

fair and reasonable insurance rate (premium) for cyber risk within the captive's primary layer is practically impossible. Any rate would be based purely on speculation." (Ex. 141-P, p. 2) (emphasis added). This article was not disclosed as one of Mr. Riggin's publications in contravention of Rule 143(g). (Tr. 946:4-950:17). Nevertheless, in this article, Mr. Riggin makes clear that he believes that insurance covering cyber risks is insurance, stating "[l]ike a hurricane, cyber liability is a catastrophic risk." (Ex. 141-P, p. 2). Mr. Riggin also conceded on cross-examination that accurate loss projections for hurricanes and earthquakes are very difficult to make, but only after he was shown Ex. 141-P, yet another undisclosed article that he had previously authored. (Ex. 141-P; Tr. 946:4-950:17).

Adding insult to injury, despite claiming that loss data for the types of insurance contracts written by Petitioner were not in the CLM, Mr. Riggin admitted that he had not even reviewed the CLM in about a year.[22] (Tr. 886:9-891:15). Nor did he know whether there was loss data in the CLM for the insurance contracts written by Petitioner. (Tr. 887:3-891:15).

Nor did he know what "wealth of supporting data" the professionals assisting Petitioner had access to for purposes of

[22] Notably, he also testified that the CLM was only available to insurance companies, which raises questions as to whether Mr. Riggin even had access to the CLM. (Tr. 903:18-21).

pricing premiums for Petitioner's insurance contracts. (Tr. 892:24-898:15, 899:2-902:18). Mr. Riggin acknowledged that the professionals assisting Petitioner were from large, reputable insurance firms, such as Willis, HRH, Myron Steves and Mid-Continent, but conceded that he did not know anything about their premium pricing capability or the data sources they had available to them. (Id.; see also Ex. 17-J, p. RSV-0005755-5756). Nowhere does Mr. Riggin provide the parameters for the "wealth of supporting data" that he allegedly believes is adequate to determine premiums.

Mr. Riggin admitted on cross-examination that he is not an accountant or an expert regarding FAS 113 or its application. (Tr. 872:23-25, 874:1-3, 924:20-21). Nevertheless, in his report, Mr. Riggin opines on FAS 113 (a copy of which is attached as Appendix D to his report) and its application without any disclaimer whatsoever concerning his capability to do so. (Ex. 136-R, pp. 6, 11-12, App. D (p. 24), App. E (pp. 25-27, 31); Tr. 868:13-869:4). In an article entitled "Structured Insurance Programs," published in 2009, Mr. Riggin, before addressing FAS 113, cautioned "Far be it from me to dispense tax and accounting advice, so the following comments are for educational purposes only." (Ex. 139-P, p. 4). When asked about his ability to apply FAS 113, he responded that

"anybody with a brain can read [FAS] 113 and can make a determination as to what it means."[23] (Tr. 913:11-917:20).

Mr. Riggin also admitted that he is not an actuary (Tr. 925:7-9), and yet Respondent sought to rebut the actuarial opinions of Petitioner's experts, Ms. Mead and Mr. Solomon. (Ex. 137-R, pp. 7-9; Tr. 867:7-25). Mr. Riggin admitted on cross-examination that he did not actually undertake to determine and did not determine whether the premiums Petitioner charged were overstated or understated. (Tr. 925:10-21). Mr. Riggin had no expertise in these actuarial matters, and his testimony on these matters should be disregarded.

Mr. Riggin was evasive, combative and vague when it suited him.[24] Even when asked by the Court whether the captive feasibility studies he prepared were similar to the Reserve Feasibility Study (Ex. 16-J), Mr. Riggin equivocated and ultimately, did not answer the Court's questions. (Tr. 981:5-16). Mr. Riggin testified that commercial insurance includes captive insurance, but later stated that commercial insurance

---

[23] If this were true, it draws into question whether Mr. Riggin's "expert" testimony regarding FAS 113 is helpful to this Court or properly the subject of expert testimony. See Fed. R. Evid. 702.

[24] On cross-examination, Mr. Riggin denied that he had addressed confidence levels that an actuary might have in making a loss forecast, and Respondent's counsel objected to this line of questioning. (Tr. 965:1-11). However, Mr. Riggin discussed this in his direct testimony. (Tr. 863:12-864:8).

did not include captive insurance. (Tr. 869:17-871:7). He also testified that the need for the coverages in question was "baseless," even though he had no basis for his claim. (Tr. 926:7-927:20). Mr. Riggin testified that he had reviewed the Reserve Feasibility Study (Ex. 16-J), which addressed the need for a captive insurance company and the coverages at issue, but he further testified that he had no opinion concerning this study (Tr. 996:19-997:9), even though he claimed to have done a lot of captive feasibility studies, which apparently was the primary type of work that he had performed during his career (Tr. 929:23-25). Mr. Riggin also testified that he views captives with premiums of less than $1 million (e.g., § 501(c)(15) captives like Petitioner) as illegitimate. (Tr. 839:14-25, 843:7-844:3, 872:1-22, 983:22-985:2). Mr. Riggin's testimony in this reqard indicates that he disagrees with §§ 501(c)(15) and 831(b), although he admitted to having worked with 10 or 15 § 501(c)(15) captives. (Tr. 871:23-872:22).

Mr. Riggin also testified that "[t]raditional captive managers do not normally perform feasibility studies, whereas promoters do write feasibility studies," because there is a "gross conflict of interest."[25] (Ex. 136-R, p. 7, ¶ 19; Tr.

[25] As is the case with most, if not all, of Mr. Riggin's testimony, his testimony does not provide any basis for his poorly-defined "traditional captive manager versus promoter"

927:21-928:24). Claiming that he is not a "promoter," Mr. Riggin adamantly maintained that he had no involvement with a captive after completing the feasibility study. (Tr. 927:21-928:24, 929:17-936:17, 937:3-939:20, 979:18-981:4). Indeed, Mr. Riggin categorically denied that he had ever been an officer of a captive after it had been formed where he had done the feasibility study. (Tr. 934:17-21). And yet, almost in the same breath, he retracted that statement when confronted with his resume. (Tr. 934:22-935:10). Mr. Riggin also admitted that he was the one (referring to himself repeatedly as the "quarterback") who hired the captive managers, actuaries, accountants and lawyers and that he did so from "a handful of managers that [he had] come to trust." (Tr. 930:7-933:4, 979:6-981:4). At no point, however, did he state that he had no financial interest in determining who was picked to be on the team for which he was the "quarterback." Instead, Mr. Riggin simply concluded that there was no "gross conflict of interest" in his activities and that once the captive is formed, he is off "the team" and puts himself "out to pasture."[26] (Id.).

---

distinction. Notably, in Rent-A-Center, the insurance consulting firm that prepared the captive feasibility study served had an affiliate serving as the captive manager, but there was no discussion therein of this purported distinction. See 142 T.C. at 2 and n.6.

[26] Mr. Riggin also testified inconsistently with this testimony that he was not involved in "implementation" which is formation

Furthermore, while Mr. Riggin testified that his services 90% of the time are limited to doing the captive feasibility study, he was very unclear as to what services he provided in the remaining 10% of the time. (Tr. 931:21-934:16).

Mr. Riggin also made a point in his report that Petitioner would be unable to pay the limits on all of the policies that it had issued for each of the tax years 2008, 2009 and 2010. (Ex. 136-R, pp. 10-11, ¶¶ 32-34; Tr. 942:22-943:17). The reason for pointing this out, however, is unclear since Mr. Riggin opined in an article he had previously authored that "[t]he premium cannot match the maximum amount of liability." (Ex. 140-P, p. 3). Paying the maximum amount of claims at one time under all outstanding policies of an insurance company would defeat the purpose of insurance in the first place (not to mention, risk distribution or the law of large numbers). On cross-examination, Mr. Riggin stated that he was simply making an observation in his report. (Tr. 945:19-20). Mr. Riggin's report did not state that Mr. Riggin believed that such a circumstance was appropriate, consistent with the article that he had authored.

Mr. Riggin also made assumptions about the fact that Petitioner's insureds could decide whether to file a claim,

---

of the captive. (Tr. 930:10-931:20, 937:7-938:9).

suggesting that the reason that no claim would be filed would be for tax reasons, even though conceding that in almost any insurance setting, a potential claimant has the option of filing a claim. (Tr. 951:1-955:7).

Mr. Riggin opined that homogeneity was a requirement for the existence of risk distribution. (Ex. 136-R, p. 12, ¶¶ 39ff.). Mr. Riggin, however, readily admitted that he had criticized Respondent's position in Rev. Rul. 2005-40, 2005-2 C.B. 4, in yet another one of Mr. Riggin's undisclosed publications. (Ex. 108-P; Tr. 957:5-959:21). Rev. Rul. 2005-40 is Respondent's official position, and there are serious issues with Respondent's expert taking a position inconsistent with Respondent's own rulings, since it raises questions about equal treatment of taxpayers. See Treas. Reg. § 601.601(d); Internal Revenue Manual 32.2.2 (Aug. 11, 2004); see generally Rogovin, Mitchell, and Korb, Donald L., The Four R's Revisited: Regulations, Rulings, Reliance and Retroactivity in the 21st Century: A View From Within, 46 Duq. L. Rev. 324, 331 (Spring 2008).

Mr. Riggin's undisclosed publication states that "if portfolio theory is used as the rationale for risk distribution, which it has been done, (incorrectly), sanctioned by Rev. Rul. 2005-40 and Harper, insurance is not created, regardless of what

you call the structure." (Ex. 108-P, p. 3). Mr. Riggin's article also states that Rev. Rul. 2005-40 "essentially codified the Court's decision in [Harper]." (Ex. 108-P, p. 1) Mr. Riggin's report is very critical of the "portfolio theory," which his article (Ex. 108-P, p. 3) states is sanctioned by Rev. Rul. 2005-40. (Ex. 136-R, p. 12, ¶¶ 39ff). Dr. Doherty, Petitioner's expert, in his rebuttal report, directly refutes Mr. Riggin's position regarding portfolio theory. (Ex. 107-P, pp. 1ff; Tr. 290:10-292:9, 294:23-295:1).

Mr. Riggin's article is correct that Rev. Rul. 2005-40 adopted the approach set forth in Harper, because the ruling favorably cites AMERCO and Ocean Drilling & Exploration Co. v. U.S., 988 F.2d 1135, 1153 (Fed. Cir. 1993) on the risk distribution issue. Dr. Doherty, Petitioner's expert herein, testified for the prevailing party in each of those 3 cases on the pooling/risk distribution issue. Ocean Drilling, 988 F.2d at 1149-50; Harper, 96 T.C. at 54-55, 57-59; AMERCO, 96 T.C. at 33. Moreover, Ocean Drilling relied on Harper, and Harper relied on AMERCO, on this same issue. Ocean Drilling, 988 F.2d at 1148-1150; Harper, 96 T.C. at 57-60 and n.10. Here, in his rebuttal report, Dr. Doherty strongly disagreed with Mr. Riggin's homogeneity requirement, stating that "Mr. Riggin's statement that homogeneous exposures are necessary in order to

estimate expected losses is patently false." (See Ex. 107-P, p. 5).

In Notice 2005-49, 2005-2 C.B. 14, Respondent requested comments concerning the relevance of homogeneity in determining whether risks are adequately distributed for an arrangement to qualify as insurance. To date, Respondent has not published any additional guidance stating that homogeneity is required. See, e.g., Chief Counsel Advice 200849013 (Dec. 5, 2008). Mr. Riggin, while conceding that portfolio diversity had some benefit, could not quantify the amount of benefit portfolio diversity provided, nor could he quantify the amount of homogeneity that he believed was required. (Ex. 136-R, pp. 12ff; Tr. 962:21-964:21).

In his rebuttal report, Mr. Riggin opined that "[n]one of [Peak's] risk exposures, save one, ever produced an insurance claim." (Ex. 137-R, p. 5, ¶ 14). Mr. Riggin further states

> [i]n the almost total absence of loss activity [sic] it is clear that these so-called 'risk exposures' were not only insignificant, they were unnecessary. In fact, the lack of claims activity during the years 2008 to 2010 renders these 'risks' wholly unqualified to be called risks in the first place.

(Id. (emphasis added); see also Tr. 971:15-972:2, 997:10-15). This appears to be the essence of Mr. Riggin's position, i.e., insurance is unwarranted until losses are suffered.

When subjected to scrutiny under cross-examination,

however, Mr. Riggin's opinion, as articulated in his reports, falls apart:

> Q: So if I have never had my house burned down, would you recommend that I not buy homeowners insurance?
>
> A: Not at all, because there certainly is a possibility that your house might burn down.

(Tr. 974:6-10). Mr. Riggin's attempt to ameliorate the controversial nature of his opinion by couching it in terms of "a possibility of a loss" fared no better and demonstrates the elasticity of his testimony. In connection with Mr. Riggin's assertion that "you shouldn't get insurance until you know you can measure the loss," the Court asked "how are you able to sometimes determine if there ever is going to be a loss" and how could something like what happened to MEL with the stage winch "be foreseen[.]" (Tr. 985:3-9, 985:24-986:8). In response to the Court's inquiry, Mr. Riggin unequivocally abandoned both positions in relation to Peak, conceding that even though Peak had no history of suffering a loss similar to the one MEL had suffered with its stage winch, Peak had a possibility of suffering such a loss so that insurance should be purchased. (Tr. 986:9-16 (stating "there certainly would be a risk that that could happen" and that "in that case insurance certainly should be purchased")).

Mr. Riggin also testified that the NAIC is an association of the insurance commissioners of the various states. (Tr.

997:16-998:7). When asked about the statement that the NAIC issued stating that the NAIC provided an exemption to any requirement of actuarial opinions for small insurers with less than $1 million in total direct premiums plus assumed written premiums and less than $1 million in total direct premiums plus assumed loss and loss adjustment expense reserves at the end of the year, Mr. Riggin declined to address the NAIC's statement and how it might impact his views. (Tr. 998:8-999:18; see also Stip. ¶ 17; Ex. 16-J, p. RSV-0006039, n.2).

Mr. Riggin, although acknowledging that Petitioner's insureds were operating in an environmental Superfund site (Tr. 968:22-25, 974:25-975:2) and a floodplain (Tr. 975:3-5), stated in his report that "[l]ike all of Reserve's coverages, a claim for pollution liability is unlikely in extremis." (Ex. 137-R, p. 5, ¶ 15; Tr. 974:13-24). Mr. Riggin's opinion appears to be entirely premised on the factually and legally erroneous assumption that persons and entities operating in a Superfund site are immune from liability for pollution risk.[27] (Tr. 1001:25-1002:17). Mr. Riggin testified that "you do not have

[27] Mr. Riggin testified at the same time that "[a] Superfund site is an environment where the EPA watches over every single thing that happens. . . . Virtually no commercial insurers will cover pollution in a Superfund site for that very reason." (Tr. 1001:3-11). Mr. Riggin did not reconcile this position with his assumption that persons in a Superfund site are immune from liability. He also did not have any idea as to why the EPA would regulate in a Superfund site. (Tr. 1003:6-19).

liability" for acts of pollution that you otherwise would have liability for because "under the Superfund rules you do not have liability." (Tr. 1002:9-13). In other words, according to Mr. Riggin, anyone operating in a Superfund site is immune from liability. (Tr. 1002:9-17). Presumably, Mr. Riggin believes that the best place to dump toxic waste would be a Superfund site because there would be no liability for illegal dumping. Not only is this opinion nonsensical and contrary to the law, but it is entirely baseless, as Mr. Riggin himself subsequently confirmed on cross-examination:

> Q: So you're immune from liability if you're in a Superfund site?
>
> A: I believe that's the case, but I actually cannot opine on that.

(Tr. 1002:14-17).

Most importantly, Mr. Riggin's fundamental misunderstanding of Superfund liability as it relates to Peak and its affiliates further demonstrates that what Mr. Riggin had to offer to the Court was primarily innuendo, dubious, elastic and contradictory testimony, and unreliable, confusing and unsupported opinions, notwithstanding the boundless accounting, actuarial, tax and legal expertise Respondent attributed to him. Mr. Riggin's testimony and reports should not be given any weight.

7. If the Premiums Petitioner Charged Were Excessive, then to the Extent of Such Excess, the Premiums Would Constitute Contributions to Capital.

The SND's determination that the premiums that Petitioner received were not insurance premiums cannot be reconciled with Respondent's position that Petitioner had income from such transactions:

> It is determined that the purported insurance and/or reinsurance transactions lack economic substance. Further, it is determined that the amounts disallowed were not paid to an insurance company and that they were not paid for insurance.

(Ex. 1-J, Sched. I-A: Expl. of Items).

Respondent's determination that the amounts Petitioner received nevertheless constituted income from such arrangements is inconsistent with the notion that such arrangements lack economic substance or that such amounts were not paid for insurance. See, e.g., Carnation Co. v. Comm'r, 71 T.C. 400, 415 (1978), aff'd, 640 F.2d 1010, 1013 (9th Cir.), cert. denied, 454 U.S. 965 (1981); Rev. Rul. 2005-40, 2005-2 C.B. 4 (premiums paid under an arrangement that is not an insurance contract may instead be characterized as a loan, a contribution to capital (to the extent of net value, if any), a non-insurance indemnity arrangement, or otherwise based on the substance of the

arrangement); see also Rev. Rul. 77-316, 1977-2 C.B. 53, declared obsolete by Rev. Rul. 2001-31 C.B. 1348 (premium amounts that are not insurance premiums are capital contributions). If Petitioner's insurance arrangements are found to be lacking in economic substance, then there should be no income to be taxed, as a finding that the premiums were received in whole or in part for an indemnity arrangement would suggest a business purpose for the payments, which is inconsistent with the notion that there was no economic substance in such arrangements. See Bank of New York Mellon, T.C. Memo. 2013-225 (slip op. at 13-14).

Thus, Respondent's SND is internally inconsistent, and Respondent should have the burden of proof on whether Petitioner's insurance arrangements have economic substance or constitute insurance for tax purposes. See Tauber v. Comm'r, 24 T.C. 179 (1955). If the amounts Petitioner received were not for insurance, to the extent that such amounts were received from Peak, RocQuest and ZW, such amounts would more appropriately be treated as contributions to capital or non-taxable advances or deposits. Thus, assuming arguendo that the Court finds that there was no insurance, the SND substantially overstates the amount of tax that would be due.

If the Court were to find merely that the amount of the

premiums was overstated, then to the extent of such overpayment, the overpayments were contributions to capital, and Petitioner would still satisfy the requirements of § 501(c)(15).

8. Petitioner's § 953(d) election is valid for each of the tax years 2008, 2009 and 2010.

Because Petitioner is an insurance company for Federal income tax purposes, its election to be taxed as a domestic insurance company is valid for each of the tax years 2008, 2009 and 2010.

9. Petitioner is tax-exempt under § 501(c)(15).

Petitioner is an insurance company with gross receipts less than $600,000 for each of the tax years 2008, 2009 and 2010. Petitioner is also an insurance company for tax purposes and is tax-exempt under § 501(c)(15).

II. If Petitioner is held not to be an insurance company for Federal income tax purposes, Petitioner is entitled to its deductions in computing its taxable income.

As set forth above, if the premiums Petitioner received were not for insurance, the SND overstated Petitioner's income. If Petitioner is not an insurance company and had income that is taxable, Petitioner properly filed Form 990 series returns for each of the tax years 2008, 2009 and 2010. In doing so, Petitioner acted reasonably and in good faith based on the

belief that it was a tax-exempt insurance company that had filed a valid § 953(d) election and because Respondent had previously issued 39 favorable tax-exempt status determinations for similarly-situated captive insurance companies that had participated in the PoolRe and CreditRe reinsurance/pooling arrangements. Under § 1.882-4(a)(3)(ii), Petitioner had reasonable cause for filing the return that it filed, and accordingly, Petitioner would be entitled to its deductions in computing its net income subject to Federal income tax.

COURT'S QUESTIONS

At the conclusion of the trial, the Court asked the parties to respond to two questions: (1) Can premiums be determined without historical loss data; and (2) Were the policies Petitioner issued duplicative of other insurance coverage of Petitioner's insureds. (Tr. 1040:12-24). Petitioner respectfully submits that the first question is answered by the discussion in Arguments I.A.5 at pp. 77-80 and I.A.6 at pp. 80-95, supra. Indeed, Petitioner's premium pricing methodology is consistent with Harper. The second issue is a factual issue, which is addressed by Petitioner's requested findings of fact. (See PRFF 80; see also Ex. 97-P, pp. 1-2, 12-18, wherein Mr. Snyder discusses the relationship between Petitioner's insurance coverage and the existing coverage that

Petitioner's insureds otherwise carried; Ex. 104-P, pp. 22-26, wherein Dr. Doherty discusses the nature of the insurance policies at issue). Based on the evidence cited in support of the requested findings of fact and Mr. Snyder and Dr. Doherty's testimony and reports, Petitioner's insurance coverage was not duplicative.

CONCLUSION

Petitioner is an insurance company for Federal income tax purposes and is exempt from tax under § 501(c)(15).

Respectfully submitted,

Dated: August 4, 2017

VAL J. ALBRIGHT
Tax Court Bar No. AV0006
Tel. No. 214-999-4825
Fax No. 214-999-3825
Email: valbright@gardere.com
MICHELLE Y. KU
Tax Court Bar No. KM0624
Tel. No. 214-999-4256
Fax No. 214-999-3256
Email: mku@gardere.com

Gardere Wynne Sewell LLP
2021 McKinney Avenue, Suite 1600
Dallas, Texas 75201

COUNSEL FOR PETITIONER

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing Brief for Petitioner was served on counsel for Respondent by delivering the same by eService and United States Postal Service, first class mail, addressed as follows:

G. Roger Markley
Special Trial Attorney
(Large Business & International)
Office of Chief Counsel - IRS
200 W. Adams St., Ste. 2400
Chicago, IL 60606

Dated: August 4, 2017

Val J. Albright
Counsel for Petitioner