

USDC SCAN INDEX SHEET



BAR 11/22/04 11:25  
3:04-CV-02184 USA V. GUESS  
\*37\*  
\*DECL.\*

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Michael Lipman (SBN 66605)  
COUGHLAN, SEMMER & LIPMAN, LLP  
501 West Broadway, Suite 400  
San Diego, CA 92101-3564  
Tel: (619) 232-0800  
Facsimile: (619) 232-0107

Attorney for Defendants L. DONALD GUESS,  
XELAN INVESTMENT SERVICES, INC.,  
XELAN ANNUITY COMPANY, INC., AND  
XELAN ADMINISTRATIVE SERVICES, INC.

Of Counsel  
Darrell D. Hallett  
John M. Colvin  
CHICONE & HALLETT, P.S.  
1011 Western Avenue, Suite 803  
Seattle, WA 98104

**FILED**  
NOV 19 2004  
CLERK U.S. DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA  
BY [Signature] DEPUTY

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA

Plaintiff,

v.

L. DONALD GUESS; LESLIE S. BUCK;  
DAVID JACQUOT; MONTE T. MELLON; G.  
THOMAS ROBERTS; CHRIS G. EVANS;  
NIGEL BAILEY; DOCTORS BENEFIT  
INSURANCE COMPANY, LTD.; DOCTORS  
BENEFIT HOLDING COMPANY; DOCTORS  
INSURANCE SERVICES, INC.; XELAN  
INVESTMENT SERVICES, INC.; XELAN  
ANNUITY CO., LTD.; XELAN  
ADMINISTRATIVE SERVICES, INC.; XELAN  
FOUNDATION, INC.; XELAN OF TEXAS,  
INC.; XELAN, INC.; XELAN, THE ECONOMIC  
ASSOCIATION OF HEALTH  
PROFESSIONALS, INC.; PYRAMIDAL  
FUNDING SYSTEMS, INC.; dba XELAN  
INSURANCE SERVICES; XELAN PENSION

CASE No. 04-CV-2184 (AJB)

Judge: Larry A. Burns

Date: November 18, 2004  
Time: 10:30 a.m.

DECLARATION OF THOMAS W.  
PETTINGER

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SERVICES, INC.; XELAN FINANCIAL PLANNING, INC.; EURO-AMERICAN TRUST COMPANY; AMS TRUST COMPANY; and JOHN DOES, UNKNOWN PERSONS WHO ARE TRUSTEES OF XELAN LONG TERM CARE TRUST, XELAN DISABILITY EQUITY TRUST, XELAN MALPRACTICE EQUITY TRUST and XELAN MEDICAL SAVINGS EQUITY TRUST,

Defendants.

I, Thomas W. Pettinger, declare and state the following under penalty of perjury:

1. I am over 18 years of age and competent to make this declaration and do so from personal knowledge.

2. I am currently a Radiologist performing services at West Park Hospital in Cody, Wyoming. I have been a participant in the xelan Group Supplemental Disability Plan ("Group Plan") since 1996.

3. I began work at West Park Hospital in 1995 following completion of my residency at the University of California, Davis campus. I was then 32 years old. My salary as a resident was very modest. My wife looked after our two children. We had very limited financial means.

4. When I joined West Park, its radiologist was in his sixties, had health problems, and was not familiar with modern radiology techniques. The West Park surgeons were frequently sending their radiology work outside the hospital. After I joined with West Park, I rapidly began receiving the bulk of the Radiology work. Within six months of joining West Park, my income increased dramatically to several hundred thousand dollars.

1           5. I was very active (and remain so) in outdoor sports with some danger of injury,  
2 including rock climbing and mountain biking. I am also a licensed pilot and have flown small  
3 airplanes in the Rocky Mountain area.

4           6. As my income grew dramatically, I became concerned about protection for myself and  
5 my family should I become temporarily or permanently disabled. I had obtained disability insurance  
6 coverage from Northwestern Mutual Life Insurance Company. However, I was not able to obtain  
7 disability coverage which would pay in excess of \$10,000 per month. I felt this amount was greatly  
8 insufficient to protect my income stream.

9           7. The Group Plan came to my attention in 1995. I reviewed the materials regarding the  
10 terms of the plan, and discussed it with a xélan financial counselor. I requested an accountant, who  
11 had been an Internal Revenue Service ("IRS") agent and who had done work for my family for many  
12 years, to review the plan, including the tax consequences of it. The accountant spoke with the xélan  
13 counselor and, after reviewing the plan, advised me that he believed the premiums would be  
14 deductible under the tax laws.

15           8. I requested a local attorney to incorporate my practice as of January 1, 1996, under the  
16 name of Range & River Radiology, P.C. ("Range & River"). Range & River made premium  
17 payments for disability coverage under the Group Plan.

18           9. I executed documents which I understood made Range & River a participant in the  
19 Group Plan (Exhibits 1 & 2).

20           10. I understand the basic terms of the plan are as follows. Range & River makes annual  
21 premium payments, which provide me with a benefit in the event I become unable to work in my own  
22 occupation and/or any occupation. A minimum annual payment of \$4,000 is required. If the  
23 minimum premium is not paid during each of the first seven years of participation, all rights under the  
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policy are forfeited. The disability benefits are the greater of a guaranteed minimum, or the amount of my premium payments, as adjusted for earnings and/or losses on the insurance company reserves, and for the claims and forfeiture experience of all the participants in the Group Plan. After seven years of participation, an election can be made for a refund of premiums paid. The refund is determined by reference to total premiums paid by Range & River, and the investment performance and claims and forfeiture experience of the total reserves.

11. When I initially joined the plan, I could and did select a category of investments held as insurance company reserves. The choices I made would determine the adjustment to my premium contribution for investment gains and losses for purposes of determining my disability and/or benefit refund (Exhibit 3). The investment choices were not open-ended, but limited to three different investment elections. I understand that after several years this feature of the plan was eliminated.

12. I understand that the insurance company reserves, which would come from all of the doctor's premium contributions, would be held in accounts with a broker/dealer, and/or trust company. For a number of years I understood that all of the reserves were kept at an account at SEI (a large institutional investment company located in Pennsylvania). SEI provided a separate accounting to me, reflected in monthly statements, which showed 96% of the total premium paid on the policy, plus or minus investment gains or losses. I understood that the monthly statements did not include any adjustment for the claims and forfeiture experience of the total group, which experience would be taken into account in determining my benefit or refund. For a number of years the account statements did not specifically state this (Exhibit 4a). In later years, the SEI statement provided the following under the heading "For Your Information":

"The addressee is a certificate holder in a group insurance policy. The account value represents the approximate benefits payable in the event of

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a claim. Actual benefits may vary due to experience of the total pool of the insureds and policy terms." (Exhibit 4b)

13. Currently, I receive from Johnson, Lambert & Company periodic statements regarding contributions and benefits. Exhibit 5 is a copy of the most recent statement.

14. I also periodically receive an insurance certificate. Exhibit 6 is a copy of the most recent certificate.

15. I did not, and do not, believe that the investments held in the SEI account constitute money belonging to me. Rather, I have always understood they are part of the insurance company reserves.

16. I have always understood that my premium contributions were at risk for disability payments to other doctors. I understand that is the case with any insurance policy.

17. During 2003, I passed the seven-year requirement to request a premium refund. To date, I have not chosen to do so.

18. I have always understood that any amount received as a benefit, either pursuant to a claim or refund, must be reported as income for tax purposes. Nobody has expressly or impliedly told me to the contrary, and I have always intended to do so.

19. After I began participation in the plan, I was provided with a legal opinion by the law firm Eckert, Seamans, Cherin & Mellott (Exhibit 7). I understood this firm to be large and reputable. Although I understood that it was the firm's opinion that premium contributions by Range & River would qualify for deduction under the tax laws, and I was so advised by an accountant, as set forth above, I always understood that I could be audited, and that the Internal Revenue Service could disagree with the advice I had been provided. I understand nothing in life is assured, especially tax deductions.

1           20. In fact, my tax returns, and those of Range & River, were selected for an IRS audit  
2 beginning in 1998. I was represented by the Law Firm of Williams, Coulson, Johnson, Lloyd, Parker  
3 & Tedesco ("Williams Coulson"), in the examination. I understood the Law Firm provided the  
4 information requested by the IRS in the audit and the subsequent Administrative appeal. Attached as  
5 Exhibits 8a through 8i, are copies of correspondence between Williams Coulson and the IRS, and  
6 copies of materials submitted to Williams Coulson by the IRS. A settlement offer was made by the  
7 Appeals office, which I chose not to accept. Ultimately, I was issued Notices of Deficiency (Exhibits  
8 9 & 10), where the IRS took the position, as I understand it, that the deductions for premiums were  
9 not allowable. I also understand no negligence and/or fraud penalties were asserted by the IRS. I  
10 subsequently paid the tax and interest. After filing the required refund claims with the IRS, I initiated  
11 suit on behalf of myself and Range & River in the United States District Court for the District of  
12 Wyoming (Exhibit 11). The lawsuit, which I understand will resolve the deductibility of the premium  
13 payments, is presently pending before the Court.  
14  
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16           21. I have been informed during the past few years that many other doctors who had  
17 participated in the Group Plan had their tax returns selected for examination. To my knowledge, no  
18 case has proceeded to court.

19           22. In 1996, Range & River's premium contribution was \$100,000. I reported \$390,000 as  
20 income from the radiology practice on my personal income tax return. For 1997, the premium  
21 contribution was \$119,000. I reported \$650,000 as compensation income on my personal tax return  
22 for that year.  
23

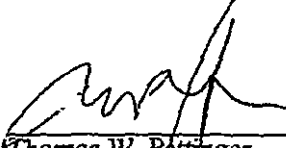
24           23. As in the case of these years, I have never paid premiums and claimed deductions  
25 anywhere near 100% of my net practice income. I have always reported substantial amounts as  
26

1 taxable income from my practice on my personal income tax returns. I have participated in no xélan  
2 program other than the Group Plan, and claimed no other deductions related to xélan.

3 24. I understand the government is attempting to permanently take over all of the reserves  
4 of the insurance company, and, apparently, it does not intend to protect my rights as a participant to  
5 disability and/or refund benefits. Not only will this action, if permitted, deprive me of the benefits to  
6 which I believe I am entitled, it will deprive me of these benefits before I have had the opportunity to  
7 prove in court that the tax deductions claimed with respect to the disability program are in fact  
8 legitimate. I believe the government's efforts to freeze all the assets of Doctors Benefit Insurance  
9 Company, Ltd. ("DBIC") will, in any event, likely severely hamper my ability to prove my case in the  
10 Wyoming District Court. I doubt the Receiver obtained by the government will provide me with  
11 assistance in obtaining and presenting the facts relative to the operation of the insurance company,  
12 including actuarial studies, claims information, and financial information that I have expected would  
13 be provided by DBIC.  
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16 25. I declare under penalty of perjury under the laws of the United States and the State of  
17 Wyoming that the foregoing is true and correct to the best of my knowledge.

18 DATED this 18<sup>th</sup> day of November, 2004

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22 Thomas W. Pettinger  
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**Declaration of Thomas W. Pettinger**

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# Exhibit 1

D-9

**JOINDER AND PARTICIPATION AGREEMENT  
TO THE  
XÉLAN DISABILITY EQUITY TRUST**

A group insurance trust with the **ROYAL TRUST CORPORATION OF CANADA** Trustee, dated October, 1995 exists for the purpose of making available a group insurance plan providing disability income protection to corporate members of **XÉLAN, THE ECONOMIC ASSOCIATION OF HEALTH PROFESSIONALS**. The trust is named the **XÉLAN DISABILITY EQUITY TRUST**.

The undersigned who is a corporate member in good standing of **XÉLAN, THE ECONOMIC ASSOCIATION OF HEALTH PROFESSIONALS** desires to and does hereby join in and become a Participant in the said trust. The undersigned agrees to be bound by the terms and conditions of the aforesaid trust and by any group insurance policy held by said trust. Furthermore, the undersigned agrees to furnish any records or information which may be required by the Trustee or by the Administrator of the Trust in connection with the administration of the Trust. This Agreement is made this 31<sup>st</sup> day of December, 1996.

Corporate Participant: Range E. River Rd  
Thomas W. Pettinger  
By: [Signature]

Accepted by: **Xélan Disability Equity Trust**

by: [Signature]

Corporate Address: West Park Hospital  
Dept. of Radiology  
707 Sheridan Ave  
Cody WY 82414

Corporate Phone Number:

(307) 578-2370

7/18/96

EXHIBIT

EXHIBIT 1 - pg 1

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# Exhibit 2

**ADOPTION AGREEMENT**

By resolution of the Board of Directors the Range & River Radiology, P.C.  
a corporation organized in the state of Wyoming, hereby elects to  
participate in the Xélan Disability Equity Trust ("the Trust") as described in the Trust  
Agreement.

Corporate Participant:

Thomas W. Pettinger

By: Thomas W. Pettinger  
Corporate Officer

Name of Individual to to be Insured: Thomas W. Pettinger

Does the individual named above  
currently have a disability  
policy/policies? (yes or no)

yes

If yes, please list the name of  
the insurance company/companies  
and the amount of monthly benefit  
available under the policy/policies.

Northwestern Mutual Life  
Insurance Company/Companies

10,000+  
Monthly Benefit

Is the individual named above  
currently disabled or currently  
collecting disability benefits from  
any source? (yes or no)

No

If yes, please describe the type  
of disability, the amount of  
benefits received and any other  
relevant information.

N/A

# Exhibit 3



D-8

Employer: Kangas & River Radiology

Premium: \$100,000.00 (100%)

**INVESTMENT ELECTION FORM**

As part of my employer's decision to participate in the Xélan Disability Equity Trust (the "Trust"), I hereby select the following investment percentages:

Group Disability "own occupation" Policy (Equity Type)	96.0%
Income Policy (Non-Equity Type)	<u>4.0%</u>
<b>TOTAL</b>	<b>100.0%</b>

I understand that the reserves supporting the insurance policies purchased by the Trust will be held in a segregated account with a Broker/Dealer and/or Trust Company and shall be invested according to the percentages specified below:

• U. S. Government Securities Fund	<u>35</u> %
• Core Fixed Income Fund	<u>35</u> %
• S&P 500 Index Fund	<u>30</u> %
<b>TOTAL</b>	<b>100.0%</b>

I understand that specific investments within these categories will be chosen by the Trust's investment advisor. I further understand that I may change those percentages twice a year by so informing the Administrator of the Trust in writing. I further understand that, I will receive a monthly statement from the Broker/Dealer and/or Trust Company regarding the current value of these investments.

AGREED TO:

Thomas W. Pettinger  
Signature, Employee

Thomas W. Pettinger  
Name (typed or printed)

Date: 12/31/96

63 Sage Creek Rd., Cody, WY  
Employee Address 82414

(807) 578-2370  
Employee Phone Number

9/14/63  
Employee Date of Birth

466-27-7529  
Employee Social Security #

NOTE: Make premium check payable to Xélan Disability Equity Trust. Make one time set-up fee and first year annual administration fee check for \$1900 payable to Xélan, Inc.

090115  
11/18/96

# Exhibit 4a



THE ECONOMIC ASSOCIATION  
OF HEALTH PROFESSIONALS  
Investment Management Division  
401 West A Street, Suite 2210  
San Diego CA 92101

## Statement of Value and Activity

April 1, 1997 - April 30, 1997

Xelan Disab Ins FBO T. Pettinger  
Account # 45061ZZZZZZZ

0007245 01 AB 0 251 \*\*ALTO T 0580 02414-0

|||||

Thomas W. Pettinger, MD  
Range & Rive Radiology  
63 Sage Creek RD  
Cody, WY 82414-9672

Your Investment Representative is:  
Xelan, Inc.  
401 W. A Street, Ste. 2210  
San Diego, CA 92101

### For Your Information

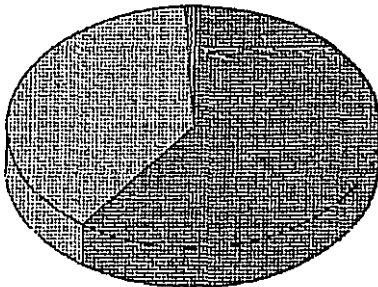
Your Statement of Value and Activity has been designed to keep you up-to-date on the activity in your account. It provides you with an easy-to-read summary of your account balance and history of your transactions during the past time period.

### Your Activity Summary

	This Period	Year to Date
Beginning Market Value	\$106,452.13	\$0.00
Additions	0.00	108,480.00
Withdrawals	-195.16	-195.16
Income	523.61	793.32
Change in Market Value	2,763.16	465.58
Ending Market Value	\$109,543.74	\$109,543.74

### Your Portfolio Allocation

Your account is currently allocated among the investments specified on the right. Percentages may not be exact due to rounding.



Investment	Balance
39% Domestic Equities	\$42,278.54
39% S&P 500 Index Fund	42,278.54
60% Fixed Income	\$66,955.03
30% Int.-duration Govt. Fund	33,208.26
30% Core Fixed Income Fund	33,146.77
1% Cash & Equivalents	\$910.17
1% Prime Obligation Fund	910.17
100% Total Portfolio Value	\$109,543.74

EXHIBIT 4A - pg 4

Statement Period: April 1, 1997 to April 30, 1997

**The Value of Your Portfolio Investments**

<i>Investment</i>	<i>Shares</i>	<i>Share Price (\$)</i>	<i>Market Value</i>
<b>Domestic Equities:</b>			<b>\$42,278.54</b>
S&P 500 Index Fund	1,668.200	25.42	42,278.54
<b>Fixed Income:</b>			<b>\$66,355.03</b>
Intermediate-duration Govt. Fund	3,423.532	9.70	33,208.26
Core Fixed Income Fund	3,278.612	10.11	33,146.77
<b>Cash &amp; Equivalents:</b>			<b>\$910.17</b>
Prime Obligation Fund	910.170	1.00	910.17
<b>Total Portfolio Value</b>			<b>\$109,543.74</b>

**Your Portfolio Activity Detail**

<i>Date</i>	<i>Activity Description</i>	<i>Shares</i>	<i>Value/ Share (\$)</i>	<i>Cash Amount</i>
04/01/97	Received Dividend Int.-duration Govt. Fund			\$160.25
04/01/97	Received Dividend Prime Obligation Fund			4.19
04/01/97	Received Dividend Core Fixed Income Fund			173.75
04/01/97	Purchased Prime Obligation Fund	4.190	1.000	-4.19
04/01/97	Reinvested Dividend Core Fixed Income Fund	17.358	10.010	-173.75
04/01/97	Reinvested Dividend Int.-duration Govt. Fund	16.641	9.630	-160.25
04/10/97	Received Dividend S&P 500 Index Fund	1,655.497	0.112	185.42
04/10/97	Reinvested Dividend S&P 500 Index Fund	7.703	24.070	-185.42
04/17/97	Investment Adv & Custody Fee			-195.16
04/18/97	Sold Prime Obligation Fund	195.160	1.000	195.16

SEI Trust Company, Oaks, PA 19456-1099  
 A wholly owned subsidiary of SEI Investments

Xelan Disab Ins FBO T. Pettinger - Account # 45061ZZZZZZ

# Exhibit 4b

**xelan**  
**INVESTMENT SERVICES, INC.**  
 401 West A Street, #2210  
 San Diego, CA 92101

Your Financial Advisor Is:  
 Xelan Investment Services, Inc.

**Statement of Value and Activity**

June 1, 2002 - June 30, 2002

Xelan Insurance Co Ltd CH Pettinger  
 Account # 45061ZZZZZZ

0410291 01 AB 0.280 A T7 00750 02414 9672 638 K10

Thomas W. Pettinger, MD  
 Range & Rive Radiology  
 63 Sage Creek Rd  
 Cody, WY 82414-9672

**For Your Information**

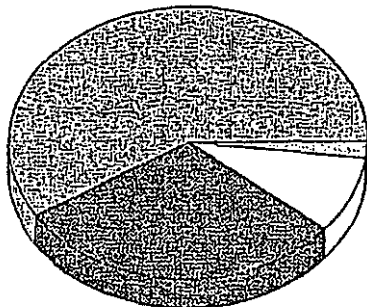
The addressee is a certificate holder in a group insurance policy. The account value represents the approximate benefits payable in the event of a claim. Actual benefits may vary due to experience of the total pool of the insureds and policy terms

**Your Activity Summary**

	<i>This Period</i>	<i>Year to Date</i>
Beginning Market Value	\$778,269.97	\$675,802.00
Additions	0.00	124,800.00
Withdrawals	0.00	-4,441.57
Income	1,047.60	6,660.70
Change in Market Value	-34,811.37	-58,314.93
Ending Market Value	\$744,506.20	\$744,506.20

**Your Portfolio Allocation**

Your account is currently allocated among the investments specified on the right. Percentages may not be exact due to rounding.



<i>Investment</i>	<i>Market Value</i>
<input checked="" type="checkbox"/> <b>59% Domestic Equities</b>	<b>\$442,026.04</b>
20% Large Cap Value Fund	153,314.10
17% S&P 500 Index Fund	131,946.14
17% Large Cap Growth Fund	122,927.02
3% Small Cap Value Fund	19,017.46
2% Small Cap Growth Fund	14,821.32
<input checked="" type="checkbox"/> <b>30% Fixed Income</b>	<b>\$225,534.91</b>
10% Intermediate-Duration Govt. Fund	76,609.83
9% Core Fixed Income Fund	65,845.65
8% GNMA Fund	58,944.76
3% High Yield Bond Fund	24,134.67
<input type="checkbox"/> <b>9% International Equities</b>	<b>\$65,081.05</b>
9% International Equity Fund	65,081.05
<input checked="" type="checkbox"/> <b>2% Cash &amp; Equivalents</b>	<b>\$11,864.20</b>
2% Prime Obligation Fund	11,864.20
<b>100% Total Portfolio Value</b>	<b>\$744,506.20</b>

EXHIBIT 4B - pg 6

Statement Period: June 1, 2002 to June 30, 2002

**The Value of Your Portfolio Investments**

<i>Investment</i>	<i>Shares</i>	<i>Share Price (\$)</i>	<i>Market Value</i>
<b>Domestic Equities 59%</b>			<b>\$442,026.04</b>
Large Cap Value Fund	8,867.212	17.29	153,314.10
S&P 500 Index Fund	4,307.742	30.63	131,946.14
Large Cap Growth Fund	7,941.022	15.48	122,927.02
Small Cap Value Fund	1,101.823	17.26	19,017.46
Small Cap Growth Fund	1,186.655	12.49	14,821.32
<b>Fixed Income 30%</b>			<b>\$225,534.91</b>
Intermediate-Duration Govt Fund	7,282.303	10.52	76,609.83
Core Fixed Income Fund	6,301.019	10.45	65,845.65
GNMA Fund	5,906.289	9.98	58,944.76
High Yield Bond Fund	3,078.402	7.84	24,134.67
<b>International Equities 9%</b>			<b>\$65,081.05</b>
International Equity Fund	7,471.992	8.71	65,081.05
<b>Cash &amp; Equivalents 2%</b>			<b>\$11,864.20</b>
Prime Obligation Fund	11,864.200	1.00	11,864.20
<b>Total Portfolio</b>			<b>\$744,506.20</b>

**Your Portfolio Activity Detail**

<i>Date</i>	<i>Activity Description</i>	<i>Shares</i>	<i>Share Price (\$)</i>	<i>Cash Amount</i>
06/03/02	Received Dividend Core Fixed Income Fund Dividend from 5/1/02 to 5/31/02			282.99
06/03/02	Received Dividend GNMA Fund Dividend from 5/1/02 to 5/31/02			270.88
06/03/02	Received Dividend High Yield Bond Fund Dividend from 5/1/02 to 5/31/02			177.35
06/03/02	Received Dividend Intermediate-Duration Govt. Fund Dividend from 5/1/02 to 5/31/02			301.99
06/03/02	Received Dividend Prime Obligation Fund Dividend from 5/1/02 to 5/31/02			14.39
06/03/02	Purchased Prime Obligation Fund	14.390	1.000	-14.39
06/03/02	Reinvested Dividend Core Fixed Income Fund	27.158	10.420	-282.99
06/03/02	Reinvested Dividend GNMA Fund	27.197	9.960	-270.88
06/03/02	Reinvested Dividend High Yield Bond Fund	21.734	8.160	-177.35
06/03/02	Reinvested Dividend Intermediate-Duration Govt Fund	28.954	10.430	-301.99
06/11/02	Sold Large Cap Value Fund St Loss: 138.26	460.886	17.880	8,240.65
06/11/02	Sold Intermediate-Duration Govt. Fund St Gain: 40.79, LT Gain: 2.76	684.945	10.440	7,150.83

Statement Period: June 1, 2002 to June 30, 2002

**Investment ADV & Custody Fees to be Assessed to your Account in July**

Based on a market value of \$744,506.20 and the following annual fee schedule:

\$	0 and above	1.20%
----	-------------	-------

an Investment ADV & Custody Fee of \$2,233.52 will be assessed to this account in July.

Note: There may be other fees assessed to this account. This represents the Investment ADV & Custody Fee, only





# Exhibit 5

# Doctors Benefit Insurance Company, Ltd.

A Licensed Barbados Insurance Company

The Business Centre, Upton • St Michael, Barbados, W.I.

## Statement of Benefits

Member Name:

Thomas W. Pettinger, MD  
707 Sheridan Avenue  
Cody, WY 82414

Certificate Number 1158

March 31, 2004

Group Policy	Total Units	Unit Value	Reserve Value*
Disability	93,570.98	\$ 10.6391	\$ 995,507.87

\* The Reserve Value represents the Certificate's Total Units multiplied by the current Unit Value, as of March 31, 2004. This value is your experience adjusted account balance as of the date of the statement and therefore represents an estimate of the benefits that would be received in the event of an "own occupation" claim. The experience adjusted account balance is subject to adjustment based upon certain minimums (described below) and the claims and forfeiture experience of the total pool of insureds. Your benefits may differ; please consult your certificate.

There is a minimum "own occupation" benefit equal to 110% of total premiums paid.  
There is a minimum "any occupation" benefit equal to 400% of total premiums paid.

Questions or Inquiries should be made to:

Third-Party Administrator

Doctors Insurance Services Inc.  
P.O. Box 1115  
Stevensville, MD 21666  
1-800-388-3722

Business Office

Doctors Benefit Insurance Company Ltd.  
The Business Centre, Upton  
St. Michael, Barbados, W.I.  
1-246-437-5431

Premium Accounting

Johnson Lambert & Company  
CPAs & Consultants  
11710 Plaza America Drive  
Suite 300  
Reston, VA 20190

Investment Management

xélan Investment Services Inc.  
401 West A Street  
San Diego, California 92101  
The Vanguard Group  
Institutional Investors  
100 Vanguard Boulevard  
Malvern, PA 19355

Available Exclusively to Members

xélan  
The Economic Association of Health Professionals, Inc.  
Darryl Nelson, Financial Counselor  
401 West A Street  
Suite 2210  
San Diego, California 92101

Every effort has been made to assure the validity of the values represented on this statement. Typographic or computer errors, if any, will be corrected on subsequent statements. Please contact DBIC immediately to report problems or errors on this statement.



# Exhibit 6

**DOCTORS BENEFIT INSURANCE COMPANY, LTD.**

Administrative Office : R.G. Hodge Plaza  
PO Box 3261  
Road Town, Tortola  
British Virgin Islands

Executive Office: The Business Centre  
Upton  
St Michael, Barbados

**SUPPLEMENTAL DISABILITY INSURANCE CERTIFICATE**

CERTIFICATE NUMBER: 1158                      EFFECTIVE DATE: 03/31/2004  
MEMBER/INSURED: Thomas W. Pettinger                      ISSUE AGE: 40  
GENDER: M                      PREMIUM PAID: \$ 88,068  
MINIMUM ANNUAL PREMIUM: \$4000

**COVERAGE:**

**Disability Income – "Own Occupation":** Under the "Own Occupation" section of the Policy, a Member is considered to be disabled if and when he can no longer perform all of the duties of the Member's Regular Occupation for at least forty hours during a regular work week for at least fifty weeks during a calendar year. Moreover, said condition must have existed for at least 120 consecutive days and, if required by Us, must be attested to by an independent physician. Also, no coverage shall exist under the "Own Occupation" section if the insured has reached the age of 76 or if no premiums have been received within twelve months of incurring an Accident, manifesting a Sickness, or of filing a claim.

Maximum Annual Benefit: \$160,000  
Estimated Aggregate Lifetime Benefit: \$1,092,462

**Disability Income – "Any Occupation":** Under the "Any Occupation" section of the Policy, a Member is considered to be disabled only if, in Our judgment after investigation, the Member cannot perform any of the duties of any occupation for wage or profit for any period of time. This includes consulting, part time employment of any nature, self-employment in any venture that is intended to produce any revenues, or any other activity by the Member that is intended to generate income for the Member or any other person. Moreover, said condition must have existed for at least 120 consecutive days and must be attested to by an independent physician. Also, no coverage shall exist under the "Any Occupation" section if the insured has reached the age of 65 or if no premiums have been received within twelve months of incurring an Accident, manifesting a Sickness, or of filing a claim.

Maximum Annual Benefit: \$160,000  
Estimated Aggregate Lifetime Benefit: \$3,972,588

ELIMINATION PERIOD: 120 days for both "Own Occupation" and "Any Occupation"

**DOCTORS BENEFIT INSURANCE COMPANY, LTD.**

**CERTIFICATE BENEFITS**

**"Own Occupation"**

If disability occurs under the "own occupation" section of the policy, the benefit paid shall equal 110% of aggregate premiums paid or the insured's experience adjusted benefit, whichever is greater. The insured's experience adjusted benefit shall equal 96% of premiums paid as adjusted by the experience of the total pool of insureds as described in the Policy.

**"Any Occupation"**

If disability occurs under the "any occupation" section of the policy, the benefit shall equal 400% of aggregate premiums paid less any benefits paid under the "own occupation" benefit. No "any occupation" benefits shall be paid until the "own occupation" benefits are fully exhausted.

**Minimum Premiums Required / Experience Adjusted Refund Benefit**

If at least the minimum premium is not paid for any calendar year prior to the 7th anniversary (3rd anniversary in certain circumstances) of the first effective date of the certificate, the certificate and all coverage shall lapse with no benefit.

If at least the minimum premium is not paid for any calendar year subsequent to the 7th anniversary (3rd anniversary in certain circumstances), the certificate shall lapse and the experience adjusted refund benefit shall be paid in a single lump sum. Any experience adjusted benefit is subject to the experience of the total pool of insureds and the adjustment is calculated at the time of payment.

**Other**

There is no death benefit under the policy. If the insured dies, this certificate shall lapse with no benefit payable.

The company shall issue an amended certificate each year to reflect the benefits payable based on premiums received on an inception to date basis. Benefits will be payable on the cumulative premiums paid as of the first date of disability. All estimated benefits reflected above shall be reduced by benefits previously paid. Any conflict between the terms of this Certificate and the Policy shall be governed by the terms of the Policy.

APPROVED: DOCTORS BENEFIT INSURANCE COMPANY, LTD.

By:

*Nigel J. Bailey*

(Authorized Signatory)

## Information About Your Insurance

The idea for this disability insurance program originated with *xélan's* doctor members in the mid 1990's who were faced with a cutback in available disability insurance coverage. For highly productive doctors, a significant percentage of their annual net practice income (50% or more) could not be insured from normal commercial sources. Moreover, "own occupation" type coverage had been curtailed even further and lifetime benefits had been eliminated in nearly all instances. The need for additional supplemental disability coverage was clearly present for many *xélan* doctor members.

It is important to remember that participation in this Group Supplemental insurance policy is strictly limited to members of *xélan*, the Economic Association of Health Professionals, Inc. Failure to continue your membership in this organization will cause you to become ineligible for continued coverage.

### Management / Administration / Service

While the Company is domiciled and licensed in Barbados, management and day-to-day administration for the Company is located at:

Doctors Benefit Insurance Company, Ltd.  
R.G. Hodge Plaza, Main Street  
PO Box 3261  
Road Town, Tortola  
British Virgin Islands  
Tel: 800-388-3722  
Fax: 284-494-3053

This office may be reached between 9:00 AM and 5:00 PM east coast times on Monday through Friday except for certain holidays.

### Premium Contributions

Premium contribution checks should be properly completed, made payable to *xélan* Supplemental Disability Trust, and sent to the attention of the Company's TPA:

Doctors Insurance Services, Inc.  
PO Box 1115  
Stevensville, MD 21666

These will be logged in and then sent by overnight mail on a weekly basis to the Trustee's offices in the British Virgin Islands where they will be deposited and cleared, and reserves invested by Doctors Benefit Insurance Company. Please allow approximately 30 days for complete processing. Premium contribution checks that are made out incorrectly will need to be returned to the payor for resubmission.

The amount of contributions is strictly limited by your established net practice income and by provisions in the policy documents. Please make certain that your premium contributions are within guidelines. Any questions should be addressed to our customer service department.



### Investment of Policy Reserves

Nearly all investments of policy reserves currently are managed and held at Vanguard. These reserves currently are invested according to modern portfolio theory principles. Reserves specifically allocated to pay existing and approved claims currently are invested in fixed income and certain other cash equivalent type of investments. The Company maintains the sole right to determine the investment strategy of its reserves.

The statements that you will receive periodically from Johnson Lambert & Co., the Company's accountants, are approximations only of the total benefits that you would receive in the event that you filed (and were approved for) an "own occupation" claim benefit. These amounts will be adjusted at the time of a claim or at the time of an experience adjusted refund, based on an actuarial calculation that takes into consideration the actual experience of the entire pool of insureds.

### Claims

Any and all inquiries regarding eligibility for a claim or the status of a claim should be addressed to the Company's claims officer in the British Virgin Islands. These inquiries will be responded to promptly.

Claim forms may be obtained from our offices in the British Virgin Islands. Claim forms should be sent directly to our offices in the British Virgin Islands. The Claims Committee meets monthly to review and make a proper determination of all claim requests. A claimant will be notified in writing by the Claims Committee concerning his or her claim. Once a claim is approved, an insured should receive his or her initial check from the Company within 45 days.

In order to ensure prompt response and to comply with insurance regulations, it is important that claim forms be completed in their entirety.

Monthly Benefits are always limited by an insured's Net Practice Income. Annually, an insured can receive no more than 40% of Net Practice Income. To the extent that no violation of the Net Practice Income restriction occurs, Monthly Benefits are based on current Certificate Values as follows:

\$300,000 or less:	\$5,000 per month
\$300,001 to \$700,000:	\$10,000 per month
\$700,001 to \$1,100,000:	\$15,000 per month
Over \$1,100,000:	Maximum Monthly Benefit (based on information you provided at the time of enrollment)

### Forfeitures

While no one likes to think about forfeitures, they are unfortunately a necessary part of this and every other insurance program. Your disability insurance program requires at least minimum premium contributions (\$4000 per year) for normally at least seven years. Participants who fail to meet these minimum guidelines will forfeit all benefits. You will be notified in writing of any forfeiture and a 30-day grace period will be afforded to you to reinstate your coverage. After this grace period expires, no additional extensions are available.

### Complaints

Any complaints should be directed to our office in the British Virgin Islands. All written inquiries and complaints will be responded to in writing. A qualified company representative will respond to all verbal questions or complaints cordially and professionally.



# Exhibit 7

ECKERT SEAMANS CHERIN & MELLOTT

~~CONFIDENTIAL~~

February 5, 1997

One South Market Sq Building  
213 Market Street  
Post Office Box 1248  
Harrisburg, PA 17108  
Telephone 717/237-6000  
Facsimile 717/237-6019

Dr. Thomas W. Pettinger  
Range and River Radiology, PC  
West Part Hospital  
Department of Radiology  
707 Sheridan Avenue  
Cody, WY 82414

Re: *The Xelan Disability Equity Trust*

Dear Dr. Pettinger:

Eckert Seamans Cherin & Mellott ("ESC&M") has acted as counsel for Xelan, The Economic Association of Health Professionals ("Xelan") in connection with the development of the Xelan Disability Equity Trust ("Trust"). As a result of this representation, we have rendered certain legal opinions concerning issuance of a disability income insurance policy on a group basis to the Trust and the federal tax consequences of participation in the Trust to Xelan in a letter dated October 25, 1996. Pursuant to our arrangement with Xelan, we are pleased to send you a separate opinion letter directed to your firm and to you dealing with these same issues.

The opinions rendered in this letter (the "Opinions") are directed solely to you and your corporation and may be relied upon only by you.

The Opinions are based solely on the documents which have been furnished to us and the Statement of Facts and Assumptions set forth below. We have made such independent investigation of the accuracy of the facts and assumptions as we deem necessary and we believe them to be reasonable. Nothing has come to our attention which indicates such facts and assumptions are incorrect or unreasonable.

If the Trust, the Insurance Policy or any of the documents are subsequently modified, the Opinions shall be of no further force or effect until such amendments have been received and reviewed by us and this letter is updated accordingly.

We have examined such matters of law as we have deemed necessary or appropriate for purposes of the Opinions. We note that the Opinions are based on existing provisions of the insurance laws of the several United States and Canada and the Internal Revenue Code of 1986, as amended (the "Code") and Treasury Regulations thereunder (the "Regulations") and on current Internal Revenue Service ("IRS") published rulings and existing court decisions, any of which can be changed at any

Harrisburg  
Pittsburgh  
Allentown  
Philadelphia  
Boston  
Fort Lauderdale  
Boon Raton  
Minmi  
Tallahassee  
Washington, DC

G. THOMAS ROBERTS  
717/ 237-6028

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# ECKERT SEAMANS CHERIN & MELLOTT

~~CONFIDENTIAL~~

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Dr. Thomas W. Pettinger  
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time. Any such changes may be retroactive and could significantly modify the Opinions expressed herein.

We express no opinion on issues not discussed in this letter.

## STATEMENT OF FACTS

The following numbered paragraphs set forth facts that describe the basic characteristics of the Trust and the mechanics of its implementation:

### The Parties

1. Xelan Disability Insurance Company Limited (the "Insurance Company" or the "Insurer"), a British Virgin Islands Insurance Company, is the insurance company that will provide the insurance coverage to the Trust.
2. The Trust is a Canadian trust established by Xelan, Inc. The Trust has applied for and is the policy owner of a master group disability income insurance policy insuring participating employees.
3. Your corporation (the "Employer") is taxed as a C-corporation and is a regular dues-paying member of Xelan.
4. The individuals who are Insured Participating Employees (the "Insured Participating Employees" or the "employees") are employees of your corporation.

### The Insurance Policy

5. The insurance contract that has been issued to the Trust by the Insurance Company in connection with an employer's participation in the Trust is a group disability income policy (the "Insurance Policy" or the "Policy") with coverages described below. Certain requirements of the Trust pertaining to the Insurance Policy are set forth in the Assumptions below.
6. The Insurance Company will accept scheduled premiums for twenty years or a lesser period of time, as determined by the Insurer (the "Scheduled Premiums"). These Scheduled Premiums will be paid by the employer in the form of contributions to the Trust. The Trust, in turn, will pay these as insurance premiums to the Insurance Company.

## ECKERT SEAMANS CHERIN & MELLOTT

~~Attorneys at Law~~

February 5, 1997

Dr. Thomas W. Pettinger,  
Page 3

7. The Policy provides coverage for total and permanent disability of an Insured Participating Employee and, to a lesser extent, for disability preventing an Insured Participating Employee from performing each and every duty of the employee's own occupation. All benefits are stated as a maximum lifetime benefit amount and are shown on the schedule page of the Insured Participating Employee's Certificate of Insurance.
8. After the coverage has been in effect for seven years (or until the insured reaches age 63, whichever comes first), the Policy provides for a refund of premiums upon surrender of the Policy. The Certificate may be surrendered at any time thereafter, at the time chosen by the Insured Participating Employee. The refund amount depends on the claims, if any, which have been made by a covered employee.
9. The Policy permits the insurer to reduce or waive future premiums at any time the Insurance Company believes the experience of the group is such that no future premiums are necessary to provide contractual benefits.
10. The Insurance Company has agreed to invest policy reserves in accordance with any one of three general investment strategy selected by participating employees.

### The Association

11. Xelan is a corporation established on a membership basis in the State of California. Xelan was established in 1974.
12. Xelan has approximately 4000 members, comprised of individuals and corporations who are practicing physicians, dentists and others involved in related fields. All individual members, or their affiliated corporations, pay regular dues to Xelan.

### ASSUMPTIONS

The following numbered paragraphs set forth the assumptions on which our opinions are based:

1. The Employer is a C-corporation within the meaning of Code Section 1361(a)(2) which is duly organized and existing in accordance with applicable state law.
2. The Employee is an employee of the Employer.

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*Dr. Thomas W. Pettinger  
Page 4*

3. The Employer shall make scheduled premium payments for no less than seven complete years or until age 63, whichever comes first.
4. The aggregate amount of insurance under any disability income policies insuring the Employee and the coverage afforded through the Trust does not exceed 100% of the net practice income earned by the Employee during the current year. Further, the amount of insurance purchased from the Trust will increase the amount of coverage provided by the basic policy by at least 2% of the net practice income earned by the employee during the current year.

SUMMARY

The following numbered paragraphs set forth a summary of our opinions:

1. The Trust is a qualified association group trust, meeting the requirements of each of the fifty states of the United States of America, and is therefore able to provide disability insurance coverage to members of Xelan residing in any of the United States.
2. The trust is a valid trust established under the applicable laws of the Province of Ontario, Canada.
3. The group insurance policy issued by Xelan Disability Insurance Company is subject to the insurance laws of the Province of Ontario, Canada and the insurance laws of the British Virgin Islands and not the laws of any state of the United States of America.
4. Contributions made to the Trust are deductible as ordinary and necessary business expenses under Internal Revenue Code Section 162.
5. Benefits received by disabled covered individuals will be taxable as ordinary income in the year the benefits are received by the individuals.
6. Funds received by an insured individual as a refund of premium upon cancellation of the coverage will be taxed as ordinary income in the year the amounts are received by the individual.

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February 5, 1997

ANALYSIS

Dr. Thomas W. Pettinger  
Page 5

1. The Xelan Disability Equity Trust is a Qualified Association Group Trust, eligible to purchase group insurance under the laws of each and every state of the Union.

The Trust is a Canadian trust established by Xelan in 1995. Xelan is a for profit membership organization founded in 1974. The laws of many states set forth the requirements for organizations to qualify to purchase group insurance policies, most commonly employers, labor organizations, trade associations and others. The common concept included in all of these laws is that the entity/policy owner must not be formed "for the purpose of insurance." To simplify matters, many statutes create a presumption that any entity formed during the three year period prior to the purchase of the policy are prohibited from purchasing group policies. Xelan is more than 20 years old and is qualified to purchase insurance coverage for its members.

We have surveyed the Insurance laws of all 50 states and the District of Columbia and have concluded that Xelan qualifies as an association which could purchase group insurance in each state. Similarly, a trust formed by Xelan also qualifies as a purchaser of group insurance in each state.

We have also reviewed the insurance statutes of applicable Canadian jurisdictions and have concluded that the Trust qualifies as a purchaser of group insurance; however, we are not experts as to Canadian law, and therefore qualify this advice accordingly.

2. The Group Disability Income Policy issued to the Trust is subject to Canadian law as to its form and content: filing in the United States is not required.

The Policy and the Certificates of Insurance which will be delivered to Insured Participating Employees contain certain provisions which, *inter alia*, provide for (i) a lifetime limit of benefits for total and permanent disability set as a function of premiums paid; (ii) a lifetime limit of benefits for disability from the insured's own occupation based on a combination of premiums paid and the investment income of the insurance company for certain classes of investments; and (iii) a refund of premium provision which returns to the premium payor a dividend type payment upon termination of the policy (certificate) if claims paid do not exceed total premiums paid.

The Policy is issued by Xelan Disability Insurance Company, a British Virgin Islands domiciled insurance company, to the Trust, a Canadian trust. The Trust does not maintain any offices nor does it have any employees or assets in the United States. The Trust conducts all of its business in the British Virgin Islands and in Canada. The



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application for the Insurance Policy was made at the offices of the Trustee in Toronto Ontario, Canada and all of the negotiations and correspondence from the Trustee to the Insurance Company originated from the Trustee's offices. All personal contacts with Insurance Company representatives occurred in Toronto. The master group policy was delivered to the Trustee in that city.

We are of the opinion that the laws of the Province of Ontario, Canada govern the form and content of the Insurance Policy and that Canadian law, not the laws of the several states of the United States, controls matters relating to insurance issued to the trust. Filing of the group insurance policy is not required in any state in which an insured employee/participant will reside.

3. Premiums paid by an employer for disability income insurance covering an employee of the C-corporation are deductible to the employer as ordinary and necessary business expenses under Internal Revenue Code Section 162.

All premiums for the Group Disability Income Insurance are paid by corporate employers who are Xelan members. Deductibility of disability income insurance premiums is well established.

Generally, pursuant to section 162(a) of the Internal Revenue Code of 1986, as amended (the "Code"), payment of premiums for long-term disability coverage by an employer for the benefit of its employee is deductible provided that such payments are ordinary and necessary expenses of its trade or business. Under section 461 of the Code, such employee would be able to deduct such premium in the year the liability for the premium payment is established and reasonably determined if such employer was an accrual taxpayer. Under section 106 of the Code, the employer's payments of premiums to a long-term disability policy on behalf of its employees are excluded from the employees' gross income.

There is no authority which would indicate that the general method of deduction would not be available under a disability income policy with a premium refund feature. Thus, applying the aforementioned general deduction rule, the Employer should be able to fully deduct the premium paid for a disability income policy with a premium refund feature in the year paid or accrued, depending on whether the Employer is a cash-method or accrual taxpayer.

We are of the opinion that, based upon the assumptions stated above, a participating employer may ~~deduct the full amount of the contributions made to the Trust, the full amount of which are paid by the Trustee as premiums to the Insurer under IRC Section 162 as ordinary and necessary business expenses.~~

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4. Benefits received by employees who are disabled, as defined in the policy, will be ordinary income to the employee in the year of receipt. Refund of premium amounts received by the employee, as provided in the Insurance Policy, will be ordinary income to the employee in the year of receipt.

We believe that employees will incur ordinary income in the year any benefits or premium refunds are received from the Trust. Section 105(a) of the Code generally requires employees to include in gross income benefits received from employer-provided LTD. Two broad exceptions exist under the above-mentioned general rule pertaining to section 105(a) of the Code:

- a. Section 105(b) of the Code provides for non-recognition of gross income to the employee if the employer-provided plan reimburses the employee or his spouse or dependents for medical expenses incurred; and
- b. Section 105(c) of the Code provides for non-recognition of gross income to the employee if the payments from the employer-provided plan are made for permanent loss of or loss of a bodily function, or a permanent disfigurement of such employee, his spouse or his dependents.

Neither of these exceptions will apply to a disabled employee; therefore, we conclude that amounts received as benefits will be includable as ordinary income to the employee as received. This applies to disability income benefits and to amounts received as a premium refund.

IRS PENALTIES

We have an ethical obligation to opine not only on the tax issues related to the Trust, but also to provide information regarding the applicability of any tax penalties.

Code Section 6662(a) provides an accuracy-related penalty to any portion of an underpayment of tax required to be shown on a return in an amount of 20% of the underpayment. Code Section 6662(b) provides that the underpayment penalty shall apply to any of the following:

1. any negligence or disregard of rules and regulations;
2. any substantial understatement of income tax;

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Page 8

3. any substantial valuation misstatement under Chapter 1 of the Code;
4. any substantial overstatement of pension liabilities; and
5. any substantial estate or gift tax valuation understatement.

Code Section 6662(d) provides that there is a substantial understatement of income tax for purposes of Code Section 6662(a) for any taxable year if the amount of the understatement exceeds the greater of (i) 10% of the tax required to be shown on the return for the taxable year, or (ii) \$5,000. In the case of a corporation other than an S corporation or personal holding company, however, the \$5,000 limit shall be replaced with a \$10,000 limit.

Code Section 6662(d)(2)(B) reduces the amount of the understatement by that portion which is attributable to (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or (ii) any item if the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in the statement attached to the return and there is a reasonable basis for the tax treatment of such item by the taxpayer.

For tax years after 1994 with respect to transactions occurring after December 8, 1994, Code Section 6662(d)(2)(C)(ii), as amended by the Uruguay Round Agreements Act (which augments the General Agreement on Tariffs & Trade ("GATT")), provides that the reduction for understatement due to the position of a taxpayer or a disclosed item set forth in Section 6662(d)(2)(B) shall not apply to any item of a corporation which is attributable to a tax shelter. For this purpose, the term "tax shelter" means a partnership or other entity, investment plan or arrangement or any other plan or arrangement if the principal purpose is the avoidance or evasion of federal income tax.

Regulation Section 1.6662-4(g)(2) provides that the principal purpose of an entity, plan or arrangement is to avoid or evade federal income tax if that purpose exceeds any other purpose. The Regulation provides further that the principal purpose of an entity, plan or arrangement is not to avoid or evade federal income tax if the entity, plan or arrangement has as its purpose the claiming of exclusions from income, accelerated deductions or other tax benefits in a manner consistent with the statute and congressional purpose. For example, an entity, plan or arrangement does not have as its principal purpose the avoidance or evasion of federal income tax solely as a result of certain uses provided by the Code, including the establishment of a qualified retirement plan under Code Section 401(a).

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Regulation Section 1.6662-4(d)(2) provides that the substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts. The substantial authority standard is less stringent than the more likely than not standard but is more stringent than the reasonable basis standard. The possibility that a return will not be audited or, if audited, that an item will not be raised on audit is not relevant in determining whether the substantial authority standard is satisfied.

Regulation Section 1.6662-4(d)(3) provides that there is substantial authority for the tax treatment of an item only if the weight of the authority supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. All authorities relevant to the tax treatment of an item, including the authorities contrary are taken into account. There may be substantial authority for more than one position with respect to the same item. Because the substantial authority standard is an objective standard, the taxpayer's belief that there is substantial authority is not relevant. The following types of authority may be used in determining whether there is substantial authority: applicable provisions of the Code and other statutes; proposed, temporary and final regulations; revenue rulings and revenue procedures; tax treaties and regulations thereunder; court cases; congressional intent as reflected in committee reports; private letter rulings; technical advice memoranda; general counsel memoranda; IRS information or press releases; notices and announcements published in the Internal Revenue Bulletin.

Although conclusions reached in legal opinions rendered by tax professionals are not substantial authority, the authorities underlying such expressions of opinions where applicable to a particular case may give rise to substantial authority.

It is our opinion that Trust and the Insurance Policy are not collectively or individually a tax shelter within the meaning of Code Section 6662(d)(2)(C)(iii). This is the case because the benefits provided under the Insurance policy through the Trust are legitimate disability income benefits similar to those offered by many insurers in the United States and the principal purpose of the arrangement is not the avoidance or evasion of federal income tax but to provide certain disability income benefits

Also, it is our opinion that there is substantial authority for all of the opinions expressed in this letter. For this reason, if the IRS were to claim that an employer or employee had an understatement of federal income tax on account of its participation in the Trust, the understatement should not subject the employer or employee to an accuracy-related penalty under Code Section 6662 because there is substantial authority for the Opinions expressed herein.

ECKERT SEAMANS CHERIN & MELLOTT

~~CONFIDENTIAL~~

February 5, 1997

CLOSING

*Dr. Thomas W. Peninger*  
*Page 10*

You may not photocopy, reproduce or disclose the contents of this letter or the Opinions to any person or entity without our prior written consent. We undertake no duty or responsibility to update the Opinions upon a change in the law or in the documents which comprise the Trust, the Insurance Policy or any other documents which have been furnished to us for the purposes of preparing this Opinion.

Very truly yours,



G. Thomas Roberts

*GTR/smn*



# Exhibit 8a

## KEY QUESTIONS AND ANSWERS

**What is it?**

### Relating to the xélan Disability Equity Trust

The xélan Disability Equity Trust is an Association Group Insurance Trust organized under Canadian law.

**Who is Eligible?**

All Trust employer participants must be "C" corporations and a corporate member of xélan, The Economic Association of Health Professionals or xélan, The Economic Association of Business Professionals.

**Who is the Trustee?**

Royal Trust Corporation of Canada, which is a wholly owned subsidiary of the Royal Bank of Canada which has assets of more than \$400 billion.

**What is the  
Purpose of the Trust?**

The purpose of the Trust is to provide supplemental disability insurance benefits to Trust participants. Through the Return of Premium feature, Participants who participate for at least 7 years and who do not have any claims also may receive substantial savings benefits over and above other disability income programs.

**What Coverage is  
Provided by the Trust?**

The policies purchased by the Trust will provide the following potential benefits:

1. Long term "own occupation" benefits;
2. Long term "any occupation" benefits;
3. Return of premium plus interest benefits.

**What is the  
Equity Feature  
of the Trust?**

96% of your premiums may be allocated to "own occupation" and premium refund type coverage. These premiums will be invested by the insurance company in segregated accounts at a major U.S. based institutional trust company or institutional discount brokerage firm. Said investments may include:



**Can this Program Replace my Existing Individual Disability Coverage?**

**What are the Total Costs for Set-up and Annual Administration?**

**What Commissions and Other Costs Exist which can Dilute my Contributions and Earnings?**

**How will Participants Receive Benefits?**

**Who Acts as Tax and Legal Counsel for the Trust?**

- a) Money Market funds and/or
- b) Certain investment grade corporate bond mutual funds and/or
- c) S&P 500 Index Mutual Fund.

You will receive a periodic statement directly from this custodian firm giving you the exact value in this account. The remaining 4% of your premiums will be allocated to an "any occupation" type coverage, and a multiple of this amount will be available to cover a totally disabling type of injury or medical condition.

Definitely not. It is supplemental disability coverage only. In fact, in order to qualify for this program, a participant must already have in place existing individual or group disability coverage.

One Time Set-up Fee: \$1,250  
Annual Administration Fee: \$650 per year  
Annual Investment Advisory and Custodian Fee: 1.2%

None.

Trust participants (or their beneficiaries) will receive benefits in possibly three ways:

1. Upon becoming disabled;
2. Upon death;
3. Upon termination of an employer's or employee's participation in the Trust and subsequent cancellation of the insurance certificate.

The law firm of Eckert Seamans Cherin & Mellott located in Pittsburgh, Pennsylvania and other major East Coast cities. As part of your set-up fee, this firm will provide each employer participant with an individual tax opinion letter regarding the Trust and its operations.

**Why is the Contribution Deductible?**

The entire contribution qualifies as a disability insurance premium. As such, it is fully deductible in the year paid under Section 162 of the IRS Code assuming that the payor is a "C" corporation.

**Are Contributions Required for any Staff Employees?**

No. It is perfectly permissible for a business to provide disability coverage only to one principal and not provide coverage for other principals or staff employees.

**Are the Earnings on my Investments Subject to Income Tax Each Year?**

No, since they represent assets inside of an insurance policy and also the reserves necessary to pay certain claims in the event of your disability.

**What about Distributions?**

All distributions from the Trust will be taxable as ordinary income to the insured or the insured's beneficiary when received.

**What are the Maximum Permitted Contributions?**

Participants may contribute amounts to the Trust sufficient to purchase insurance for up to 100% of their average net practice income in recent years, integrated with any existing disability policies. This percentage can be changed annually by the participant.

**What are the Minimum Required Contributions?**

During the first 7 years (or until age 62, whichever comes first), participants must contribute at least \$4,000 annually or forfeit their premium refund plus interest benefits. After 7 years, all contributions are completely voluntary, and these premium refund benefits become fully vested. Participants who are age 60 or more at the time they initiate this program must contribute for at least three consecutive years before their premium refund benefits become fully vested.

**What is the Maximum Age for an Individual to Begin Participating in this Program?**

Age 64.

**May I Contribute More Than Once in a Year?**

Yes.

**What about Asset Protection?**

The policy values held by the Trust and your interest in the Trust assets should not be subject to the potential claims of malpractice or judgment creditors. Each state has different regulations in this area, and you should check with your local attorney for specifics.

**Why Haven't I Heard about this Plan Before?**

xélan and the attorneys at Eckert Seamans Cherin & Mellot designed this program in 1995; it is a proprietary program and should not be found elsewhere.

**Has the IRS Audited this Program?**

No, not specifically; the deduction for the contribution to this program has been looked at by the IRS as part of an audit of a participant's corporate tax return; "no change" was recommended by the IRS agent regarding this deduction.

**Why is the Trust Organized in Canada?**

So that the insurance company issuing the policy and the insurance policy itself does not need to be registered in each of the states where xélan does business.

**What Insurance Company Issues this Type of Policy?**

xélan Insurance Company which is a fully licensed and accredited life and disability insurance company domiciled in the British Virgin Islands. xélan Insurance Company maintains segregated accounts for you and all other participating xélan members with a U.S. based trust company or institutional brokerage firm.

**How Do I Sign Up?**

Simply complete three forms and return with two corporate checks: One for \$1900 made payable to xélan, Inc., and the second made payable to the Royal Bank of Canada, Custodian for XIC for the amount of your initial premium.

For additional information, please contact only a xélan Financial Counselor or the xélan Home Office.

# Exhibit 8b

**WILLIAMS & COULSON**  
ATTORNEYS AT LAW

15TH FLOOR • TWO CHATHAM CENTER • PITTSBURGH, PA 15219  
(412)454-0200 • FAX: (412) 231-6622

FACSIMILE TRANSMITTAL SHEET

DATE: 1/16/01

TIME: 10:00  
(Eastern)

PLEASE DELIVER IMMEDIATELY TO:

NAME: Eric Mead

COMPANY/FIRM: \_\_\_\_\_


CITY-STATE: \_\_\_\_\_

FACSIMILE NUMBER: 303-844-5949

SENT BY: Anthony Tedesco

TOTAL NUMBER OF PAGES INCLUDING THIS COVER SHEET: \_\_\_\_\_

MESSAGE: As you can see, I recently received this letter supporting the treatment of the Xelon Disability Insurance Plan as true insurance in an actuarial sense. I am also awaiting a letter from an insurance industry expert and I am in the process of distinguishing the Neonatology case in the form of a written memorandum. I apologize for the delay and I suggest that we have a conference in February or March to resolve this case.

IF MATERIAL IS NOT CLEARLY TRANSMITTED, PLEASE CONTACT SENDER 

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Actuaries  
Consultants

January 3, 2001

**PERSONAL AND CONFIDENTIAL**

Mr. Anthony M. Tedesco, Esquire  
Williams Coulson  
Suite 1500  
Two Chatham Center  
Pittsburgh, PA 15219

**RE: Insurance Risk Transfer under Xelan Disability Plan**

Dear Mr. Tedesco:

We have reviewed the disability policy issued by Xelan Insurance Company concerning the issue of insurance risk transfer. For the direct writer of insurance, insurance risk transfer is determined at the level of the individual insurance contract. The primary issue is whether it is possible for an individual entity to receive more in disability payments than it has paid in premium. It is our conclusion that under the terms of Xelan's Disability policy, the individual entity may receive more in disability payments than it has paid in premiums. As a result, it is our opinion that there is risk transfer under these contracts of insurance.

Our review indicates that the disability program provides for three benefits:

- "own occupation" disability,
- "any occupation" disability, and
- a return of premium provision.

The insurance risk transferred under the Xelan disability policy centers on the presence of morbidity risk. In one public arena, morbidity risk is defined under the provisions of FASB 97, Paragraph 7, which states:

Mortality or morbidity risk is present if, under the terms of the contract, the enterprise is required to make payments or forego required premiums contingent upon the death or disability (in the case of life insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals.

In accordance with the above description of morbidity risk, the insuring clause of the Group Disability Income Policy requires the Trust to make payments to the insured upon disability due to Accident or Sickness. As a result morbidity risk is present. In addition, under this Disability Income Policy, there are no restrictions in the ultimate amount of payments, limited only to policy limits, nor as to the timing of those payments.

GPW & Associates • 2700 North Third Street • Suite 2000 • Phoenix • Arizona 85004  
Telephone: 602-200-6900 • Fax: 602-200-6901 • Internet: www.gpwa.com  
H:\34897\Tedesco Letter.doc

Mr. Anthony M. Tedesco, Esquire  
Williams Coulson  
January 3, 2001  
Page 2

For the three policy benefits listed above, the individual's right to collect disability benefits is based on the payment of each year's minimum premiums. Upon meeting premium and insured disability contingency requirements, the insured has a right to receive disability payments potentially greater than the combined premiums and investment earnings.

Should you have any additional questions concerning our review of the disability policy issued by Xelan Insurance Company, please do not hesitate to contact us at your convenience.

Sincerely,



James E. Rech, ACAS, ASA, MAAA  
Vice President

# Exhibit 8c



**WILLIAMS & COULSON**  
ATTORNEYS AT LAW

15TH FLOOR • TWO CHATHAM CENTER • PITTSBURGH, PA 15219  
(412) 454-0200 • FAX: (412) 281-6622

**FACSIMILE TRANSMITTAL SHEET**

DATE: March 20, 2001

TIME: 4:06 PM

**PLEASE DELIVER IMMEDIATELY TO:**

NAME: Eric Mead

COMPANY/FIRM:

CITY-STATE:

FACSIMILE NUMBER: 303-844-5949

SENT BY: Anthony M. Tedesco, Esq.

TOTAL NUMBER OF PAGES INCLUDING THIS COVER SHEET: 3

MESSAGE:

Please review. Northwestern policies will accompany the mailed letter.

**IF MATERIAL IS NOT CLEARLY TRANSMITTED, PLEASE CONTACT SENDER**

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**WILLIAMS COULSON**  
ATTORNEYS AT LAW

15TH FLOOR • TWO CHATHAM CENTER • PITTSBURGH, PA 15219  
(412) 454-0200 • FAX: (412) 281-6622

ANTHONY M. TEDESCO  
(412) 454-0227

March 20, 2001

*Via certified mail and facsimile*

Mr. Eric Mead  
Appeals Officer  
Appeals Area 8-SB/SE  
1244 Speer Blvd  
Suite 400  
Denver, CO 80204-3581

Re: Thomas and Laurie Pettinger/Range and River Radiology, P.C.

Dear Mr. Mead:

I am in receipt of your memo dated March 2<sup>nd</sup>.

I have enclosed a copy of Dr. Pettinger's two Northwestern Mutual Disability Insurance Policies. The first policy contains a benefit of \$4,000 per month payable to Dr. Pettinger through age 65 in the event of his "own occupation" disability (unable to perform the principal duties of the regular occupation).

The Xelan policy is a group policy and the individual insured and/or employer receives only a certificate of insurance. The premiums for this coverage are flexible (within certain limits), and the benefits are determined by the amount of the premiums. However, the maximum monthly benefit is \$10,000.

The Northwestern Mutual and Xelan disability insurance coverages are very different. The Northwestern Mutual policies were taken out in 1994 and 1996, and they represent very typical primary disability insurance coverage. However, together they would replace only approximately 25% of Dr. Pettinger's expected annual income if he were disabled today. Additional primary coverage like this is unavailable to Dr. Pettinger today as evidenced by the letters from Northwestern Mutual to Dr. Pettinger (enclosed) denying him additional primary coverage.

March 20, 2001  
Page 2

The Xelan supplemental coverage disability program (evidenced by the enclosed certificates) would provide Dr. Pettinger with the benefits illustrated on the insurance certificates. These benefits are provided by the supplemental carrier (Xelan Insurance Company) in addition to and with full knowledge of the Northwestern Mutual coverage. There are few options available for physicians who remain underinsured under the industry standard coverage limits for primary coverage. Through their supplemental disability insurance program, Xelan is able to offer a partial solution to the underinsurance problem. From the insurer's perspective, the premiums must be higher than the typical primary coverage to account for the significant risk associated with large aggregate monthly benefits (the possible incentive for fraudulent claims associated with large monthly benefits is the reason for the industry limits on primary coverage). From the insured's or employer's perspective, the relatively expensive premium is economically viable because it provides some of the required additional insurance, along with a potential prospective experience adjustment (refund) feature.

Since Dr. Pettinger is 37 years old today and earns \$500,000 per year, his total potential income from today through age 65 is approximately \$14,000,000. Even after combining all of his disability coverages, Dr. Pettinger's total benefits in the event of his disability today would be approximately \$4,500,000. Consequently, Dr. Pettinger believes today that he is still significantly underinsured for disability. The Xelan supplemental disability insurance program was designed specifically for doctors such as Dr. Pettinger to address this underinsured condition.

Finally, I have been advised by insurance professionals that the premium refund model and concept has been a disability insurance industry standard for more than 25 years. To my knowledge, the Internal Revenue Service has never challenged the deductibility of insurance premiums paid on disability income policies containing a refund of premium feature. I have been advised that major insurance companies such as Paul Revere, Royal Maccabees, Ohio National and Pan-American Life have been issuing premium refund type disability policies for many years. A financial planner recently indicated to me that he recently reviewed refund type disability policies offered by Ohio National and Pan-American Life Insurance Company. I am fairly certain that the commercial insurers would be very interested in any litigation related to Dr. Pettinger's case and would likely participate, either directly or indirectly, in the defense of refund type disability insurance.

I hope this letter addresses the issues raised in your memo. I am also working on a response to your more recent memo.

Sincerely yours,

  
Anthony M. Tedesco

AMT/slm

cc: Dr. Thomas Pettinger

(WC103350.1)

# Exhibit 8d

**JOINDER AND PARTICIPATION AGREEMENT  
TO THE  
XÉLAN DISABILITY EQUITY TRUST**

A group insurance trust with the **ROYAL TRUST CORPORATION OF CANADA** Trustee, dated October, 1995 exists for the purpose of making available a group insurance plan providing disability income protection to corporate members of **XÉLAN, THE ECONOMIC ASSOCIATION OF HEALTH PROFESSIONALS**. The trust is named the **XÉLAN DISABILITY EQUITY TRUST**.

The undersigned who is a corporate member in good standing of **XÉLAN, THE ECONOMIC ASSOCIATION OF HEALTH PROFESSIONALS** desires to and does hereby join in and become a Participant in the said trust. The undersigned agrees to be bound by the terms and conditions of the aforesaid trust and by any group insurance policy held by said trust. Furthermore, the undersigned agrees to furnish any records or information which may be required by the Trustee or by the Administrator of the Trust in connection with the administration of the Trust. This Agreement is made this 31<sup>st</sup> day of December, 1996.

Corporate Participant: Range E. River Ra  
Thomas W. Pettinger  
By: [Signature]

Accepted by: **Xélan Disability Equity Trust**

by: [Signature]

Corporate Address: West Park Hospital  
Dept. of Radiology  
707 Sheridan Ave.  
Cody WY 82414

Corporate Phone Number:

(307) 578-2370

7/18/96

# Exhibit 8e

**ADOPTION AGREEMENT**

By resolution of the Board of Directors the Range E River Radiology, P.C.  
a corporation organized in the state of Wyoming, hereby elects to  
participate in the Xélan Disability Equity Trust ("the Trust") as described in the Trust  
Agreement.

Corporate Participant:

Thomas W. Pettinger

By: Thomas W. Pettinger  
Corporate Officer

Name of Individual to to be Insured: Thomas W. Pettinger

Does the individual named above  
currently have a disability  
policy/policies? (yes or no)

yes

If yes, please list the name of  
the insurance company/companies  
and the amount of monthly benefit  
available under the policy/policies.

Northwestern Mutual Life  
Insurance Company/Companies

10,000+  
Monthly Benefit

Is the individual named above  
currently disabled or currently  
collecting disability benefits from  
any source? (yes or no)

No

If yes, please describe the type  
of disability, the amount of  
benefits received and any other  
relevant information.

N/A

# Exhibit 8f



10/24/01 10:00 FAX

002



Actuaries  
Consultants

October 24, 2001

Anthony M. Tedesco, Esq.  
Williams Coulson  
Two Chatham Center, Suite 1500  
Pittsburgh, PA 15219

RE: Xelan Disability Income Group Policy

Dear Mr. Tedesco:

This letter is to summarize our conclusions as to the Group Disability Income Policy issued by Xelan Insurance Company (BVI) to the Xelan Disability Equity Trust. We have conducted several actuarial studies on this product. These studies have been furnished to you under separate cover.

We believe that this product is an insurance policy which involves risk transfer and risk distribution according to commonly accepted actuarial principles.

Please contact me if you have any questions.

GPW and Associates, Inc.

By

A handwritten signature in cursive script that reads "James H. Gordon".

James H. Gordon, F.S.A.  
Direct Line: (602) 200-6922

GPW & Associates • 2700 North Third Street • Suite 2000 • Phoenix • Arizona 85004  
Telephone: 602-200-6900 • Fax: 602-200-6901 • Internet: [www.gpwa.com](http://www.gpwa.com)

Exhibit 8g

# NiiS/APEX

October 18, 2001

Anthony Tedesco, Esq  
Williams Coulson Johnson Lloyd & Tedesco  
Two Chatham Center, 15<sup>th</sup> Floor  
Pittsburgh, PA 15219

Dear Mr Tedesco,

We have enclosed for your review of a copy of our underlying actuarial model for the Xelan Group Disability Product.

We believe that this product contains adequate risk transfer and risk distribution to qualify as legitimate insurance, when measured against nearly all NAIC standards. Moreover, for an average participant, who is age 50, the expected loss ratio for the insurance company for this product is approximately 75%.

Sincerely,



David Wilson, FSA

DW/ct  
Enclosure

October 18, 2001

From: Tim Robinson, FSA, MAAA  
To: File  
RE: Xélan Disability Model Documentation

In September of 2001, NiiS/APEX developed for Xélan an asset share model to assess the financial and risk parameters of a proposed individual disability product. This model incorporates certain assumptions - provided by Xélan - as to premium parameters, minimum benefits, expected benefit levels, age limitations, investment returns, overall disability incidence rates, and lapse rates. In addition to these assumptions, NiiS/APEX contributed assumptions as to benefit levels, age/gender-specific disability and lapse rates, and mortality rates. The model addresses three types of benefits: own occupation disability, any occupation disability, and withdrawal.

For each age/gender cell and at each duration, the asset share model determines an expected benefit payout, which is dependent upon rates of disability, withdrawal and mortality. The model also determines an expected account value, which is dependent upon assumed premium levels. An overall expected gain as of each duration is produced by taking the difference between the expected account value and the expected benefit payout. A probability-weighted (by duration) overall expected gain is calculated for each age/gender cell, and the overall loss ratio is determined by comparing the overall expected gain to the total premium. The asset share model allows inspection of each of these values at each duration.

Following is a brief summary of each variable (column heading) in the asset share model. Data sources are noted where applicable.

- $t$  is duration since inception
- $age$  is policyholder age at duration  $t$
- $qm_{x,t}$  is the mortality rate at age  $x$  duration  $t$  (source: *1996 US Annuity 2000 Basic, Male and 1996 US Annuity 2000 Basic, Female, Transactions of the Society of Actuaries XLVII, pp 236-249*)
- $qw_{x,t}$  is the withdrawal (lapse) rate at age  $x$  duration  $t$
- $qd-o_{x,t}$  is the own-occupation disability rate at age  $x$  duration  $t$  (source: *Society of Actuaries Report of the Committee on Individual Disability Income Experience, Experience Under Individual Disability Loss-of-Time Policies, 1986-91, Table 9, adjusted to reflect Xélan parameters for overall own-occupation incidence rates*)
- $qd-a_{x,t}$  is the any-occupation disability rate at age  $x$  duration  $t$  (source: *Society of Actuaries Report of the Committee on Individual Disability Income Experience, Experience Under Individual Disability Loss-of-Time Policies, 1986-91, Table 9, adjusted to reflect Xélan parameters for overall any-occupation incidence rates*)
- $p_{x,t}$  is the persistency rate at age  $x$  duration  $t$

- $NPI_{x,t}$  is net practice income for the policyholder at duration  $t$  (premium is dependent upon NPI)
- $Prem_{x,t}$  is premium at age  $x$  for duration  $t$
- $EAA_{x,t}$  is the experience adjusted account at age  $x$  duration  $t$  (premium payments accumulated with interest)
- $EAB_{x,t}$  is the experience adjusted benefit at age  $x$  duration  $t$  (defined as a fixed percentage of the experience adjusted account)
- $MOO_{x,t}$  is the minimum own-occupation disability benefit at age  $x$  duration  $t$  (a fixed percentage of total premiums paid as of duration  $t$ )
- $BOO_{x,t}$  is the own-occupation disability benefit at age  $x$  duration  $t$  (maximum of  $EAB$  and  $MOO$ )
- $BAO_{x,t}$  is the any-occupation disability benefit at age  $x$  duration  $t$  (a fixed percentage of total premiums paid as of duration  $t$ , until age 65, afterward equivalent to  $BOO$ )
- $WB_{x,t}$  is the withdrawal benefit at age  $x$  duration  $t$  (equal to  $EAB$  after a specified duration)
- $SBP-OO_{x,t}$  is the benefit period (in years) over which a policyholder age  $x$  duration  $t$  would amortize own-occupation benefit payments
- $ABOO_{x,t}$  is the annual own-occupation benefit at age  $x$  duration  $t$  ( $BOO$  divided by  $SBP-OO$ )
- $PV-BOO_{x,t}$  is the present value of total own-occupation benefits for a policyholder who becomes disabled at age  $x$  duration  $t$

Note: *Conditional* values are used to adjust the Own Occupation benefit for claimants who incur an Any Occupation claim subsequent to their Own Occupation claim.

- *Conditional*  $qd-a_{x,t}$  is  $qd-a_{x,t}$  adjusted for extra morbidity given that the policyholder age  $x$  duration  $t$  is already an own-occupation claimant
- *Conditional*  $qm_{x,t}$  is  $qm_{x,t}$  adjusted for extra mortality given that a policyholder age  $x$  duration  $t$  is an any-occupation claimant
- *Conditional*  $BOO$  wts and *Conditional*  $WtdBOO_{x,t}$  are interim steps needed to calculate *Conditional*  $AdjBAO_{x,t}$
- *Conditional*  $AdjBAO_{x,t}$  is the any-occupation disability benefit for a policyholder age  $x$  duration  $t$ , reduced by expected own-occupation disability payments already made at duration  $t$
- *Conditional*  $SBP-AO_{x,t}$  is the benefit period (in years) over which a policyholder age  $x$  duration  $t$  would amortize any-occupation benefit payments
- *Conditional*  $ABAO_{x,t}$  is the annual any-occupation benefit at age  $x$  duration  $t$  (*Conditional*  $AdjBAO$  divided by *Conditional*  $SBP-AO$ )
- *Conditional*  $PV-BAO_{x,t}$  is the present value of total any-occupation benefits for a policyholder who becomes disabled at age  $x$  duration  $t$
- *Conditional*  $BAO$  wts is an interim step in the calculation of  $PV-NBOO_{x,t}$

- $PV-NBOO_{x,t}$  is the present value of the net own-occupation benefit (net after adding in *Conditional* any-occupation claims adjusted for own-occupation payments already made) for a policyholder who becomes disabled at age  $x$  duration  $t$
- $SBP-AO_{x,t}$  is the benefit period (in years) over which a policyholder age  $x$  duration  $t$  would amortize any-occupation benefit payments
- $ABAO_{x,t}$  is the annual any-occupation benefit at age  $x$  duration  $t$  ( $AdjBAO$  divided by  $SBP-AO$ )
- $PV-BAO_{x,t}$  is the present value of total any-occupation benefits for a policyholder who becomes disabled at age  $x$  duration  $t$
- $DG_{x,t}$  is gain to the Plan from a policyholder's account when the policyholder dies at age  $x$  duration  $t$  (excess of  $EAA$  over the death benefit)
- $WG_{x,t}$  is the gain to the Plan from a policyholder's account when the policyholder withdraws at age  $x$  duration  $t$  (excess of  $EAA$  over  $WB$ )
- $OOG_{x,t}$  is the gain to the Plan from a policyholder's account when the policyholder incurs an own-occupation disability claim at age  $x$  duration  $t$  (excess of  $EAA$  over  $PV-NBOO$ )
- $AOG_{x,t}$  is the gain to the Plan from a policyholder's account when the policyholder incurs an any-occupation disability claim at age  $x$  duration  $t$  (excess of  $EAA$  over  $PV-BAO$ )
- $TG_{x,t}$  is the probability-weighted total gain on a policyholder at age  $x$  duration  $t$
- $P(G)_{x,t}$  is the likelihood of a gain to the Plan (due to death, withdrawal or disability) at policyholder age  $x$  duration  $t$
- $Lives_{x,t+1}$  is the expected number of lives remaining in the age/gender cell as of duration  $t+1$
- $TotGain_{x,t}$  is the total gain for the age/gender cell at duration  $t$
- $CumPrem_{x,t}$  is the cumulative premium paid for a policyholder as of age  $x$  duration  $t$

The attached exhibits are all included in the model "Xélan Disability ASM v01.xls." They demonstrate the benefit and interest assumptions; population assumptions; mortality, disability and withdrawal rate assumptions; net premium income assumptions; summary results for a sample age/gender cell (Male age 50); constant variables used in the asset share calculations; and the asset share model itself (actual calculations and results for each of the above-mentioned variables, at each age and duration).



Variables Constant for All Age/Gender Cells this Scenario

Variable	Constant
$i_t$	5.00%
$\delta_t$	0.0488
max annual premium	40% of established net practice income
min annual premium	\$4,000 per year
age 50 net practice income	\$300,000
annual incr in npi	3.0%
avg percent of max premium	100.0%
(already scaled linearly by age from 35 to 75)	
min own occ benefit	110% of premiums paid
own occ benefit	95% of experience adjusted benefit
any occ benefit	300% of premiums paid less own occ benefits
any occ extra mortality	5.0
own occ extra any occ morbidity	5.0
start distributing gains in year	4
percent of gains to distribute	13.25%



Calc for Male Age at Entry 50

Variable  
 Age x at t=0      Constant  
 Gender              50      M  
 n = population in cell      42

	per Policy	per Cohort
Expected Gain	\$293,632	\$12,332,555
Total Expected Premium	\$1,019,121	\$42,803,070
Expected Loss Ratio	71.2%	71.2%

i	age	$q_{i+1}$	$q_{i+1}^*$	$q_{i+1}^{**}$	$q_{i+1}^{***}$	$q_{i+1}^{****}$	$P_{i+1}$	NPL <sub>i</sub>	Prem <sub>i</sub>
0	50	0.0033	0.0100	0.0172	0.0001	0.9693	\$300,000	\$45,000	
1	51	0.0036	0.0200	0.0108	0.0001	0.9574	\$309,000	\$49,440	
2	52	0.0040	0.0300	0.0205	0.0001	0.9454	\$318,270	\$54,106	
3	53	0.0043	0.0400	0.0229	0.0001	0.9326	\$327,018	\$59,007	
4	54	0.0047	0.0500	0.0254	0.0002	0.9197	\$337,653	\$64,154	
5	55	0.0051	0.0700	0.0279	0.0002	0.9469	\$347,702	\$69,556	
6	56	0.0055	0.0100	0.0303	0.0002	0.9540	\$358,216	\$75,225	
7	57	0.0059	0.0900	0.0328	0.0002	0.8685	\$368,962	\$81,172	
8	58	0.0063	0.0900	0.0350	0.0002	0.8758	\$380,031	\$87,407	
9	59	0.0067	0.0800	0.0373	0.0002	0.8831	\$391,432	\$93,944	
10	60	0.0072	0.0700	0.0395	0.0002	0.8903	\$403,175	\$100,794	
11	61	0.0077	0.0600	0.0417	0.0003	0.8974	\$415,270	\$107,970	
12	62	0.0083	0.0500	0.0439	0.0003	0.8960	\$427,728	\$115,487	
13	63	0.0091	0.0500	0.0446	0.0003	0.8960	\$440,560	\$123,357	
14	64	0.0100	0.0500	0.0453	0.0003	0.8944	\$453,777	\$131,595	
15	65	0.0110	0.0500	0.0461	0.0003	0.8908	\$467,390	\$140,217	
16	66	0.0122	0.0500	0.0468	0.0003	0.8887	\$481,412	\$149,238	
17	67	0.0136	0.0500	0.0475	0.0003	0.8864	\$495,854	\$158,673	
18	68	0.0152	0.0500	0.0482	0.0003	0.8839	\$510,730	\$168,541	
19	69	0.0169	0.0500	0.0489	0.0003	0.8812	\$526,052	\$178,858	
20	70	0.0189	0.0500	0.0496	0.0003	0.8783	\$541,833	\$109,642	
21	71	0.0211	0.0500	0.0503	0.0003	0.8753	\$558,088	\$200,912	
22	72	0.0234	0.0500	0.0510	0.0003	0.8721	\$574,831	\$212,687	
23	73	0.0259	0.0500	0.0517	0.0003	0.8687	\$592,076	\$224,989	
24	74	0.0286	0.0500	0.0524	0.0003	0.8667	\$609,838	\$237,837	
25	75	0.0315	0.9151	0.0531	0.0003	0.0000	\$628,133	\$251,253	
26	76	0.0347	.	.	.	.	\$0	\$0	
27	77	0.0382	.	.	.	.	\$0	\$0	
28	78	0.0421	.	.	.	.	\$0	\$0	
29	79	0.0464	.	.	.	.	\$0	\$0	
30	80	0.0511	.	.	.	.	\$0	\$0	
31	81	0.0563	.	.	.	.	\$0	\$0	
32	82	0.0618	.	.	.	.	\$0	\$0	
33	83	0.0678	.	.	.	.	\$0	\$0	
34	84	0.0743	.	.	.	.	\$0	\$0	
35	85	0.0813	.	.	.	.	\$0	\$0	
36	86	0.0889	.	.	.	.	\$0	\$0	
37	87	0.0970	.	.	.	.	\$0	\$0	
38	88	0.1056	.	.	.	.	\$0	\$0	
39	89	0.1149	.	.	.	.	\$0	\$0	
40	90	0.1246	.	.	.	.	\$0	\$0	
91	0.1349	.	.	.	.	.	\$0	\$0	
92	0.1456	.	.	.	.	.	\$0	\$0	
93	0.1567	.	.	.	.	.	\$0	\$0	
94	0.1683	.	.	.	.	.	\$0	\$0	
95	0.1802	.	.	.	.	.	\$0	\$0	
96	0.1926	.	.	.	.	.	\$0	\$0	
97	0.2052	.	.	.	.	.	\$0	\$0	
98	0.2187	.	.	.	.	.	\$0	\$0	
99	0.2334	.	.	.	.	.	\$0	\$0	
100	0.2497	.	.	.	.	.	\$0	\$0	
101	0.2682	.	.	.	.	.	\$0	\$0	
102	0.2893	.	.	.	.	.	\$0	\$0	
103	0.3134	.	.	.	.	.	\$0	\$0	
104	0.3409	.	.	.	.	.	\$0	\$0	
105	0.3724	.	.	.	.	.	\$0	\$0	
106	0.4082	.	.	.	.	.	\$0	\$0	
107	0.4488	.	.	.	.	.	\$0	\$0	
108	0.4947	.	.	.	.	.	\$0	\$0	
109	0.5462	.	.	.	.	.	\$0	\$0	
110	0.6039	.	.	.	.	.	\$0	\$0	
111	0.6682	.	.	.	.	.	\$0	\$0	
112	0.7395	.	.	.	.	.	\$0	\$0	
113	0.8183	.	.	.	.	.	\$0	\$0	
114	0.9049	.	.	.	.	.	\$0	\$0	
115	1.0000	.	.	.	.	.	\$0	\$0	

l	age	EAA <sub>t-1</sub>	EAB <sub>t-1</sub>	HCO <sub>t-1</sub>	BOO <sub>t-1</sub>	BAO <sub>t-1</sub>	WB <sub>t-1</sub>
0	50	\$46,116	\$43,810	\$49,500	\$49,500	\$135,000	\$0
1	51	\$99,088	\$94,133	\$103,884	\$103,884	\$283,320	\$0
2	52	\$159,490	\$151,515	\$163,400	\$163,400	\$445,638	\$0
3	53	\$227,934	\$216,538	\$228,308	\$228,308	\$622,659	\$0
4	54	\$305,076	\$289,822	\$298,878	\$298,878	\$815,122	\$0
5	55	\$391,611	\$372,030	\$375,390	\$375,390	\$1,023,791	\$0
6	56	\$488,282	\$463,868	\$458,138	\$463,868	\$1,249,467	\$0
7	57	\$595,881	\$566,087	\$547,427	\$566,087	\$1,492,982	\$566,087
8	58	\$715,249	\$679,487	\$643,575	\$679,487	\$1,755,203	\$679,487
9	59	\$847,285	\$804,921	\$746,913	\$804,921	\$2,037,034	\$804,921
10	60	\$992,942	\$943,295	\$857,786	\$943,295	\$2,339,416	\$943,295
11	61	\$1,153,237	\$1,095,575	\$976,553	\$1,095,575	\$2,663,326	\$1,095,575
12	62	\$1,329,249	\$1,262,787	\$1,103,588	\$1,262,787	\$3,009,786	\$1,262,787
13	63	\$1,522,127	\$1,446,021	\$1,239,281	\$1,446,021	\$3,379,856	\$1,446,021
14	64	\$1,733,092	\$1,646,437	\$1,384,035	\$1,646,437	\$3,774,542	\$1,646,437
15	65	\$1,963,441	\$1,865,269	\$1,538,274	\$1,865,269	\$4,185,269	\$1,865,269
16	66	\$2,214,551	\$2,103,823	\$1,702,436	\$2,103,823	\$4,613,823	\$2,103,823
17	67	\$2,487,886	\$2,363,492	\$1,876,976	\$2,363,492	\$5,063,492	\$2,363,492
18	68	\$2,785,001	\$2,645,751	\$2,062,371	\$2,645,751	\$5,533,492	\$2,645,751
19	69	\$3,107,544	\$2,952,166	\$2,259,115	\$2,952,166	\$6,023,166	\$2,952,166
20	70	\$3,457,265	\$3,284,402	\$2,467,720	\$3,284,402	\$6,533,166	\$3,284,402
21	71	\$3,836,022	\$3,644,221	\$2,688,723	\$3,644,221	\$7,064,221	\$3,644,221
22	72	\$4,245,784	\$4,033,495	\$2,922,679	\$4,033,495	\$7,614,221	\$4,033,495
23	73	\$4,688,641	\$4,454,209	\$3,170,167	\$4,454,209	\$8,184,209	\$4,454,209
24	74	\$5,166,808	\$4,908,467	\$3,431,788	\$4,908,467	\$8,774,209	\$4,908,467
25	75	\$5,682,632	\$5,398,500	\$3,708,166	\$5,398,500	\$9,384,209	\$5,398,500
26	76	\$5,966,763	\$5,668,425	\$3,708,166	\$5,668,425	\$9,994,209	\$5,668,425
27	77	\$6,265,101	\$5,951,846	\$3,708,166	\$5,951,846	\$10,614,209	\$5,951,846
28	78	\$6,578,356	\$6,249,438	\$3,708,166	\$6,249,438	\$11,244,209	\$6,249,438
29	79	\$6,907,274	\$6,561,910	\$3,708,166	\$6,561,910	\$11,884,209	\$6,561,910
30	80	\$7,252,638	\$6,890,006	\$3,708,166	\$6,890,006	\$12,534,209	\$6,890,006
31	81	\$7,615,270	\$7,234,506	\$3,708,166	\$7,234,506	\$13,194,209	\$7,234,506
32	82	\$7,996,033	\$7,596,232	\$3,708,166	\$7,596,232	\$13,864,209	\$7,596,232
33	83	\$8,395,835	\$7,976,043	\$3,708,166	\$7,976,043	\$14,544,209	\$7,976,043
34	84	\$8,815,627	\$8,374,845	\$3,708,166	\$8,374,845	\$15,234,209	\$8,374,845
35	85	\$9,256,408	\$8,793,500	\$3,708,166	\$8,793,500	\$15,934,209	\$8,793,500
36	86	\$9,719,228	\$9,233,267	\$3,708,166	\$9,233,267	\$16,644,209	\$9,233,267
37	87	\$10,205,190	\$9,694,930	\$3,708,166	\$9,694,930	\$17,364,209	\$9,694,930
38	88	\$10,715,449	\$10,179,677	\$3,708,166	\$10,179,677	\$18,094,209	\$10,179,677
39	89	\$11,251,222	\$10,688,661	\$3,708,166	\$10,688,661	\$18,834,209	\$10,688,661
40	90	\$11,813,783	\$11,223,094	\$3,708,166	\$11,223,094	\$19,584,209	\$11,223,094
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Age	SUP-AO <sub>t-1</sub>	AGAO <sub>t</sub>	I-qt <sub>t-1</sub>	PV-BAO <sub>t-1</sub>	
0	50	1	\$135,000	0.9834	\$135,000
1	51	1	\$283,320	0.9818	\$283,320
2	52	1	\$445,638	0.9801	\$445,638
3	53	2	\$311,330	0.9783	\$601,413
4	54	2	\$407,561	0.9765	\$786,596
5	55	3	\$341,264	0.9746	\$951,461
6	56	3	\$416,489	0.9727	\$1,158,984
7	57	4	\$373,245	0.9707	\$1,329,653
8	58	4	\$430,801	0.9687	\$1,558,416
9	59	5	\$407,407	0.9665	\$1,729,856
10	60	5	\$467,803	0.9642	\$1,976,292
11	61	6	\$443,888	0.9614	\$2,138,258
12	62	6	\$501,631	0.9583	\$2,394,325
13	63	6	\$563,309	0.9545	\$2,660,030
14	64	6	\$629,107	0.9502	\$2,933,886
15	65	5	\$373,054	0.9450	\$1,510,319
16	66	5	\$420,765	0.9391	\$1,681,498
17	67	4	\$590,873	0.9321	\$1,979,583
18	68	4	\$661,438	0.9242	\$2,188,716
19	69	3	\$984,055	0.9153	\$2,581,500
20	70	3	\$1,094,801	0.9054	\$2,843,186
21	71	3	\$1,214,740	0.8946	\$3,120,205
22	72	3	\$1,344,498	0.8831	\$3,412,824
23	73	3	\$1,484,736	0.8706	\$3,720,970
24	74	3	\$1,636,156	0.8572	\$4,043,902
25	75	3	\$1,799,500	0.8426	\$4,380,376
26	76	3	\$1,889,475	0.8266	\$4,722,727
27	77	3	\$1,983,949	0.8089	\$4,661,238
28	78	3	\$2,003,146	0.7893	\$4,794,379
29	79	3	\$2,187,303	0.7679	\$4,920,840
30	80	3	\$2,296,669	0.7444	\$5,039,311
31	81	3	\$2,411,502	0.7188	\$5,148,500
32	82	3	\$2,532,077	0.6910	\$5,247,048
33	83	3	\$2,658,681	0.6609	\$5,333,513
34	84	3	\$2,791,615	0.6284	\$5,406,434
35	85	3	\$2,931,196	0.5934	\$5,464,295
36	86	3	\$3,077,756	0.5557	\$5,505,801
37	87	3	\$3,231,643	0.5152	\$5,529,905
38	88	3	\$3,393,226	0.4718	\$5,536,286
39	89	3	\$3,562,007	0.4257	\$5,525,989
40	90	3	\$3,741,031	0.3769	\$5,500,604
91			0.3757		
92			0.2721		
93			0.2164		
94			0.1586		
95			0.0988		
96			0.0372		
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Age	DC <sub>t</sub>	WG <sub>t</sub>	OG <sub>t</sub>	AOG <sub>t</sub>	TG <sub>t</sub>	P(G <sub>t</sub> )	Lives <sub>t</sub>	TotGain <sub>t</sub>	CumPrem <sub>t</sub>
0	50	\$46,116	\$46,116	-\$51,492	-\$10,307	0.0307	40.7	-\$13,771	\$45,000
1	51	\$99,088	\$99,088	-\$54,859	\$30,237	0.0413	39.0	\$52,442	\$94,440
2	52	\$159,490	\$159,490	-\$53,852	\$78,473	0.0506	36.9	\$166,884	\$148,546
3	53	\$227,934	\$227,934	-\$38,465	\$136,040	0.0591	34.4	\$337,897	\$207,553
4	54	\$305,076	\$305,076	-\$20,543	\$165,743	0.0493	32.3	\$341,238	\$271,707
5	55	\$391,611	\$391,611	\$4,928	\$185,600	0.0409	30.6	\$318,454	\$341,264
6	56	\$488,282	\$488,282	\$33,771	\$183,656	0.0335	29.2	\$258,378	\$416,489
7	57	\$595,801	\$29,794	\$66,110	\$61,137	0.0965	25.1	\$247,726	\$497,661
8	58	\$715,249	\$35,762	\$105,872	\$85,344	0.0787	21.8	\$282,004	\$585,068
9	59	\$847,205	\$42,364	\$154,213	\$117,577	0.0645	19.1	\$318,593	\$679,011
10	60	\$992,942	\$49,647	\$212,418	\$160,202	0.0532	16.9	\$350,092	\$779,805
11	61	\$1,153,237	\$57,662	\$282,135	\$217,596	0.0441	15.0	\$402,743	\$887,775
12	62	\$1,329,249	\$66,462	\$365,086	\$294,149	0.0367	13.5	\$453,207	\$1,003,262
13	63	\$1,522,127	\$76,106	\$432,705	\$352,311	0.0334	12.1	\$494,067	\$1,126,619
14	64	\$1,733,092	\$86,655	\$472,336	\$404,238	0.0304	10.8	\$515,672	\$1,258,214
15	65	\$1,963,441	\$98,172	\$509,072	\$466,465	0.0276	9.6	\$540,966	\$1,398,431
16	66	\$2,214,551	\$110,728	\$538,935	\$529,875	0.0251	8.6	\$556,289	\$1,547,669
17	67	\$2,487,886	\$124,394	\$562,279	\$600,218	0.0228	7.6	\$574,124	\$1,705,342
18	68	\$2,785,001	\$139,250	\$576,804	\$678,922	0.0207	6.8	\$589,022	\$1,874,883
19	69	\$3,107,544	\$155,377	\$579,411	\$765,607	0.0187	6.0	\$601,686	\$2,053,741
20	70	\$3,457,265	\$172,863	\$566,521	\$861,293	0.0169	5.3	\$612,110	\$2,243,382
21	71	\$3,836,022	\$191,801	\$547,597	\$715,817	0.0153	4.6	\$649,414	\$2,444,294
22	72	\$4,245,784	\$212,289	\$536,395	\$832,960	0.0137	4.1	\$684,388	\$2,656,981
23	73	\$4,688,641	\$234,432	\$840,153	\$1,185,476	0.0123	3.5	\$716,290	\$2,881,970
24	74	\$5,166,808	\$258,340	\$954,403	\$1,382,114	0.0110	3.1	\$745,015	\$3,119,807
25	75	\$5,682,632	\$284,132	\$1,082,947	\$1,605,785	0.0731	0.0	\$1,525,126	\$3,371,060
26	76	\$5,966,763	\$298,338	\$1,174,317	\$1,302,255	0.0000		\$0	\$3,371,060
27	77	\$6,265,101	\$313,255	\$1,270,045	\$1,444,036			\$0	\$3,371,060
28	78	\$6,578,356	\$328,918	\$1,375,893	\$1,603,863			\$0	\$3,371,060
29	79	\$6,907,274	\$345,364	\$1,492,892	\$1,783,977			\$0	\$3,371,060
30	80	\$7,252,638	\$362,632	\$1,622,134	\$1,986,434			\$0	\$3,371,060
31	81	\$7,615,270	\$380,763	\$1,764,795	\$2,213,337			\$0	\$3,371,060
32	82	\$7,996,033	\$399,802	\$1,922,159	\$2,466,770			\$0	\$3,371,060
33	83	\$8,395,835	\$419,792	\$2,095,638	\$2,748,906			\$0	\$3,371,060
34	84	\$8,815,677	\$440,781	\$2,286,758	\$3,062,322			\$0	\$3,371,060
35	85	\$9,256,400	\$462,820	\$2,497,164	\$3,409,193			\$0	\$3,371,060
36	86	\$9,719,228	\$485,961	\$2,728,524	\$3,792,113			\$0	\$3,371,060
37	87	\$10,205,190	\$510,259	\$2,982,463	\$4,213,427			\$0	\$3,371,060
38	88	\$10,715,449	\$535,772	\$3,260,464	\$4,675,284			\$0	\$3,371,060
39	89	\$11,251,222	\$562,561	\$3,563,766	\$5,179,163			\$0	\$3,371,060
40	90	\$11,813,783	\$590,689	\$3,893,593	\$5,725,232			\$0	\$3,371,060
91				\$6,311,179	\$11,813,783			\$0	\$3,371,060
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WILLIAMS  COULSON  
ATTORNEYS AT LAW

15TH FLOOR • TWO CHATHAM CENTER • PITTSBURGH, PA 15219  
(412) 454-0200 • FAX: (412) 281-6622

ANTHONY M. TEDESCO  
(412) 454-0227

June 14, 2001

FEDERAL EXPRESS

Mr. Eric Mead  
Appeals Officer  
Appeals Area 8 – SB/SE  
1244 Speer Boulevard  
Suite 400  
Denver, Colorado 80204-3581

Re: Thomas and Laurie Pettinger – Range & River Radiology, P.C.

Dear Mr. Mead:

Enclosed with this letter is a copy of a letter dated May 9, 2001 that was sent to GPW & Associates, the actuarial firm that supports the Xelan Supplemental Disability Income Insurance Program. Also enclosed is a copy of their response to my letter. I apologize for the delay in getting this information to you but, as you can see, I just received the response.

I have also enclosed copies of two cases involving the utilization of so-called "captive" insurance. Although the cases are not directly relevant to Dr. Pettinger's situation, each contains a discussion of mutual and/or retrospectively rated insurance. These cases indicate that the Seventh and Ninth Circuit Courts of Appeal clearly recognize the viability and legitimacy of insurance programs that are analogous to the Xelan Supplemental Disability Income Insurance Program. I have highlighted the relevant text in each case. I would ask that you please review at least the highlighted portion of each case.

*In reviewing the response from GPW & Associates, you will note that a disability claim by an insured under the Xelan Supplemental Disability Income policy will result in payments to the insured much greater than the aggregate premiums paid by the insured. This has an obvious effect on any claims for refund of premium in that it diminishes the assets available to pay such*

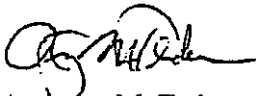
June 14, 2001

Page 2

claims to any and all of the pool of insured individuals. In fact, as we have previously discussed, one of the major variables in determining the amount of any refund of premium is the overall experience of the pool of insureds, as well as the investment performance of the underlying assets of the insurance company. I point this out because in our last conversation you stated that Dr. Pettinger would ultimately receive back all of his premiums paid. This is simply not true because of the pooling of risk that naturally occurs in this insurance program. In addition, I recently spoke with another advisor who indicated to me that his client, also a physician, received a 1997 return of premium check from Royal Macabees Life Insurance Company with respect to his disability income policy. Royal Macabees is a large life insurance company and this is just an example that illustrates that a return of premium feature is not unusual in a disability income insurance contract.

Please review this letter and call me at (412) 454-0227 if you have any questions or to further discuss a resolution of this case.

Sincerely yours,



Anthony M. Tedesco

AMT/slm

Enclosures

cc: Dr. Thomas Pettinger



WILLIAMS  COULSON  
ATTORNEYS AT LAW

15TH FLOOR • TWO CHATHAM CENTER • PITTSBURGH, PA 15219  
(412) 454-0200 • FAX: (412) 281-6622

ANTHONY M. TEDESCO  
(412) 454-0227

May 9, 2001

*Via fax 602-200-6901 and regular mail*

Mr. James H. Gordon, F.S.A.  
GPW & Associates  
2700 North Third Street  
Suite 2000  
Phoenix, AZ 85004

Re: Xelan Disability Equity Trust – Information for Internal Revenue Service

Dear Jim:

As you are aware, I represent Dr. Thomas Pettinger in an income tax case arising from an Internal Revenue Service audit (individual and corporate) encompassing tax years 1996 and 1997. The case is now at the administrative appeals level and I am in the process of supplying additional factual information to the appeals officer, Mr. Eric Mead.

The tax case revolves around Dr. Pettinger's supplemental disability insurance coverage under the Xelan supplemental disability program, as provided to him by his employer, Range and River Radiology, P.C. I have attached hereto copies of insurance certificates provided to Dr. Pettinger for 1996 and 1997.

As I understand the mechanics of the group insurance policy, there is no segregation of assets of the various insureds and no "firewall" or other protection that would insulate the premiums paid by one insured from the claims of the other insureds. It has been explained to me that a hypothetical "account" is tracked for each insured and that this accounting device is necessary for determination of any refund of premium that may ultimately be due an insured. Please confirm that my understanding is correct and provide a written summary of the accounting system. Also, please confirm that the payment of any disability claim or premium refund under

May 9, 2001

Page 2

the program is contingent on the availability of sufficient assets in the insurance company, which in turn is a function of investment performance and claims experience.

My next area of inquiry is specific to Dr. Pettinger. I must demonstrate to Eric Mead that a disability claim by Dr. Pettinger (assume that it is an "any occupation" claim) will result in disability payments to him in excess of premiums paid. Could you prepare a spreadsheet or summary based on the attached certificates under the following scenarios:

1. Dr. Pettinger files an "any occupation" claim during the first year of the policy after his employer has paid the \$100,000 premium. No further premiums are paid and Dr. Pettinger remains disabled until his benefits are exhausted. Please illustrate the disability benefits that would be paid.
2. Dr. Pettinger files an "any occupation" claim occurring after his employer has paid the second premium. No further premiums are paid and Dr. Pettinger remains disabled until his benefits are exhausted. Please illustrate the disability benefits that would be paid.

Please call me at (412) 454-0227 if you have any questions.

Sincerely yours,

  
Anthony M. Tedesco

AMT/slm

Enclosures

cc: Dr. Thomas Pettinger

# Exhibit 8h

NUMBER: 1158

EFFECTIVE DATE: DECEMBER 31, 1996

MEMBER/INSURED: RANGE AND RIVER RADIOLOGY, PC/  
THOMAS W. PETTINGER

ISSUE AGE: 33  
GENDER: MALE

OWNER: XELAN DISABILITY EQUITY TRUST

TRUSTEE: ROYAL TRUST CORPORATION OF CANADA, TORONTO, CANADA

PREMIUM: \$100,000 PER YEAR

BASIC PREMIUM PAYMENT PERIOD: 7 YEARS

NOTE: IF PREMIUM PAYMENTS ARE SUSPENDED, MODIFIED OR TERMINATED, THE COMPANY WILL RECALCULATE THE BENEFITS REFLECTED ON THIS CERTIFICATE.

DISABILITY INCOME POLICY - "OWN OCCUPATION" COVERAGE

- MONTHLY BENEFIT: \$10,000
- AGGREGATE LIFETIME BENEFIT: \$830,786 PLUS EXPERIENCE ADJUSTMENT FACTOR (1)

DISABILITY INCOME POLICY - "ANY OCCUPATION" COVERAGE

- MONTHLY BENEFIT: \$10,000
- AGGREGATE LIFETIME BENEFIT: \$336,000 (1)

ELIMINATION PERIOD: 120 DAYS FOR BOTH "OWN OCCUPATION" AND "ANY OCCUPATION" BENEFITS

RETURN OF PREMIUM FEATURE: UPON ELECTION BY THE INSURED, ALL MONIES CONTAINED IN THE INSURED'S "OWN OCCUPATION" ACCOUNT WILL BE REFUNDED TO THE INSURED AT ANY TIME AFTER 7 YEARS.

IF DISABILITY OCCURS UNDER BOTH THE "OWN OCCUPATION" SECTION AND THE "ANY OCCUPATION" SECTION OF THE POLICY, THEN BENEFITS SHALL BE PAID FIRST UNDER THE "OWN OCCUPATION" COVERAGE SECTION OF THIS POLICY UNTIL THE AGGREGATE LIFETIME BENEFIT HAS BEEN PAID, AND THEN UNDER THE "ANY OCCUPATION" COVERAGE SECTION.

DESIGNATED BENEFICIARY ON THE EVENT OF THE DEATH OF THE MEMBER/INSURED: ESTATE

(1) THE BENEFITS SHOWN ARE CALCULATED ASSUMING THE PREMIUMS WILL BE PAID DURING THE POLICY PERIOD. THE COMPANY SHALL ISSUE AN AMENDED CERTIFICATE AS OF THE ANNUAL ANNIVERSARY DATE OF COVERAGE TO REFLECT THE BENEFITS PAYABLE BASED ON THE THEN CURRENT PREMIUM PAYMENTS ON AN INCEPTION TO DATE BASIS. BENEFITS WILL BE PAYABLE UNDER THIS POLICY AND CERTIFICATE ONLY ON THE BASIS REFLECTED IN THE MOST RECENT AMENDMENT ISSUED BY THE COMPANY AS OF EACH POLICY OR CERTIFICATE ANNIVERSARY DATE.

APPROVED: XELAN DISABILITY INSURANCE COMPANY

  
by: EDWARD M. KLEIST, JR, VICE PRESIDENT

MEMBER'S CERTIFICATE OF INSURANCE  
XÉLAN DISABILITY INSURANCE COMPANY

NUMBER: 1158

EFFECTIVE DATE: DECEMBER 31, 1997

MEMBER/INSURED: RANGE AND RIVER RADIOLOGY, PC/  
THOMAS W. PETTINGER

ISSUE AGE: 34  
GENDER: MALE

OWNER: XÉLAN DISABILITY EQUITY TRUST

TRUSTEE: ROYAL TRUST CORPORATION OF CANADA, TORONTO, CANADA

PREMIUM: \$104,000 PER YEAR

BASIC PREMIUM PAYMENT PERIOD: 7 YEARS

NOTE: IF PREMIUM PAYMENTS ARE SUSPENDED, MODIFIED OR TERMINATED, THE COMPANY WILL  
RECALCULATE THE BENEFITS REFLECTED ON THIS CERTIFICATE.

DISABILITY INCOME POLICY - "OWN OCCUPATION" COVERAGE

- MONTHLY BENEFIT: \$10,000
- AGGREGATE LIFETIME BENEFIT: \$858,255 PLUS EXPERIENCE ADJUSTMENT FACTOR (1)

DISABILITY INCOME POLICY - "ANY OCCUPATION" COVERAGE

- MONTHLY BENEFIT: \$10,000
- AGGREGATE LIFETIME BENEFIT: \$347,520 (1)

ELIMINATION PERIOD: 120 DAYS FOR BOTH "OWN OCCUPATION" AND "ANY  
OCCUPATION" BENEFITS

RETURN OF PREMIUM FEATURE: UPON ELECTION BY THE INSURED, ALL MONIES  
CONTAINED IN THE INSURED'S "OWN OCCUPATION"  
ACCOUNT WILL BE REFUNDED TO THE INSURED AT  
ANY TIME AFTER 7 YEARS.

IF DISABILITY OCCURS UNDER BOTH THE "OWN OCCUPATION" SECTION AND THE "ANY OCCUPATION"  
SECTION OF THE POLICY, THEN BENEFITS SHALL BE PAID FIRST UNDER THE "OWN OCCUPATION"  
COVERAGE SECTION OF THIS POLICY UNTIL THE AGGREGATE LIFETIME BENEFIT HAS BEEN PAID, AND THEN  
UNDER THE "ANY OCCUPATION" COVERAGE SECTION.

DESIGNATED BENEFICIARY ON THE EVENT OF THE DEATH OF THE  
MEMBER/INSURED: ESTATE

(1) THE BENEFITS SHOWN ARE CALCULATED ASSUMING THE PREMIUMS WILL BE PAID DURING THE POLICY  
PERIOD. THE COMPANY SHALL ISSUE AN AMENDED CERTIFICATE AS OF THE ANNUAL ANNIVERSARY DATE  
OF COVERAGE TO REFLECT THE BENEFITS PAYABLE BASED ON THE THEN CURRENT PREMIUM PAYMENTS  
ON AN INCEPTION TO DATE BASIS. BENEFITS WILL BE PAYABLE UNDER THIS POLICY AND CERTIFICATE  
ONLY ON THE BASIS REFLECTED IN THE MOST RECENT AMENDMENT ISSUED BY THE COMPANY AS OF EACH  
POLICY OR CERTIFICATE ANNIVERSARY DATE.

APPROVED: XÉLAN DISABILITY INSURANCE COMPANY

by: Leslie S. Buck  
LESLIE S. BUCK, PRESIDENT

# Exhibit 8i

June 12, 2001



Actuaries  
Consultants

Mr. Anthony M. Tedesco, Esquire  
Williams Coulson  
Attorneys at Law  
Two Chatham Center, 15<sup>th</sup> Floor  
Pittsburgh, PA 15219

**Re: Xelan Disability Equity Trust – Information for Internal Revenue Service**

Dear Mr. Tedesco:

This letter is in response to your letter of May 9, 2001. You requested confirmation as to the accounting system used by Xelan Disability Insurance Company and two examples of the cash flows under two specific claim scenarios for Dr. Pettinger. It is our understanding that this information will be provided to the Internal Revenue Service in response to the tax case revolving around Dr. Pettinger's supplemental disability insurance coverage, as provided by his employer, Range and River Radiology, P.C., under the Xelan supplemental disability program. The purpose of this letter is to provide you with the information you requested.

#### **I. Mechanics of the Xelan Disability Group Policy**

The economic incentive for an individual or business entity to purchase insurance is the transfer of a fortuitous risk. Insurance represents an aggregation or pooling of individual exposures that provides for improved predictability of future outcomes. This pooling of individual risks reduces total risk through the statistical process known as the "law of large numbers."

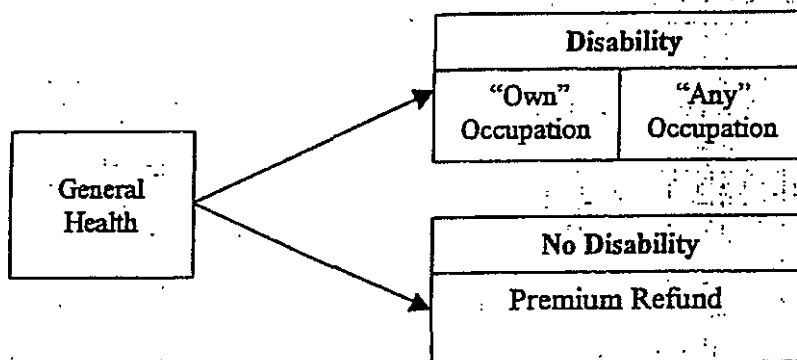
The Xelan Disability Group Policy (the Policy) supports these basic insurance concepts. In this case, the risk is disability. For the individual, the Policy covers the risk of economic loss that may arise from accident or sickness. The insurance process aggregates these individual risks and spreads disability losses across the entire participant base. The mechanism for this spreading of loss over all insureds is accomplished by loss pooling, i.e. allocating a portion of actual losses to each insured.

Not everyone purchases the same benefit levels. Unique benefit levels require maintenance of individual statistics for accounting purposes. Maintaining policy details such as premiums paid, interest accrued, and losses paid are common insurance practice. Xelan retains this level of accounting detail. Such data are needed for internal calculation and are used for the purpose of determining Xelan liabilities for policy benefits. The maintenance of such accounting detail does not indicate that the individual participants have legal rights to accumulating assets supporting policy liabilities; the participants only legal rights are to receive the benefits as provided under

the Policy. Policy benefits inure to the participants only upon meeting certain predetermined contingencies.

The benefits under the Xelan Disability policy present (1) disability benefits, and (2) return of premium benefits. The pricing for this coverage is based on an indivisible premium. The insured cannot purchase the policy without paying a premium for all contractual benefits and the policy benefits cannot be bifurcated. The benefits of this policy are displayed in the following graphic.

Graph 1  
Xelan Disability Benefits



**i. Disability Benefits**

As displayed in Graph 1 above, disability benefits are provided under one of two states of disability: "own" occupation and "any" occupation. Each benefit state includes morbidity risk and must be entered consecutively. This sequential "own/any" classification for disability continuance presents a standard insurance industry approach in long term disability contracts.

The first state, "own" occupation, requires the claimant to be unable to work at their "own" occupation. The purpose of the disability coverage is to provide the claimant with an immediate financial cushion upon the occurrence of a disabling event. The minimum "own" occupation coverage is 110% of all premiums paid. After some time period, the transfer to the second state ("any" occupation) requires that for the claimant to remain on disability the claimant must be unable to work in "any" occupation. The design of this secondary contingency requirement is to encourage the claimant to re-enter the workforce. Once the "any" occupation state is entered, the minimum "total" (combined "own" and "any" benefits) coverage is 144% of all premiums paid.

**ii. Return of Premium Benefit**

At the end of seven years of insurance coverage, an insured may receive a refund of premiums. This refund is based on a percentage of premiums, the experience of the insured, and the overall experience of the insurer.



Mr. Anthony M. Tedesco, Esquire  
Williams Coulson  
June 12, 2001  
Page 3 of 3

## II. "Any" Occupation Disability Claim Examples

Two examples of the financial cash flows for disability claims are attached. The first example (Exhibit I) displays the cash flows under an "any" occupation claim during the first year of coverage; the second example (Exhibit II) assumes an "any" occupation claim during the second year of coverage.

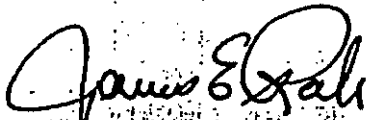
In Exhibit I, the claimant receives total benefits of \$158,000 with a premium of \$100,000. Monthly payments of \$10,000 are made for 15 months, with a final payment of \$8,000 in the 16<sup>th</sup> month. It is assumed that the reserve will be accreted interest at the nominal rate of 7% per annum.

Under the second example, Exhibit II displays the cash flow for coverage under an "any" occupation claim occurring during the second year. In this example, the claimant will receive monthly payments of \$10,000 for 32 months with a final payment of \$3,010 in the 33<sup>rd</sup> month or a total benefit of \$323,010. In this example, the premium paid is \$204,000. Again it is assumed that interest will be credited at the 7% nominal rate of interest.

\* \* \* \* \*

Should you have any additional questions please do not hesitate to contact us at your convenience.

Sincerely,



James E. Rech, ACAS, ASA, MAAA  
Vice President

Enclosures

EXHIBIT 8I - pg 57

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**Exhibit I**

**Xelan Insurance Company**

Member/Insured: Range and River Radiology, PC

Thomas W Pettinger

Issue Age: 33

Effective Date: December 31, 1996

Gender: Male

Annual Premium: \$100,000

"Own"

"Any"

Monthly Disability Benefit \$10,000

\$10,000

\$10,000

**Example; Only the first years premium has been paid.**

Date of Disability:	5/10/97		
Waiting Period (Days):	120	Benefits begin:	9/7/97
Disability Benefits	"Own"	"Any"	Combined
Monthly Disability Benefit	\$10,000	\$10,000	
Minimum Benefits	\$110,000		\$144,000
Total Disability Benefits	\$110,000	\$48,000	\$158,000
Benefit Period in Months	11	5	16

Transaction Month	"Any and Own Occupation" Disability Total Premium	7.00% Earned Interest Rate <sup>1</sup>	Beginning Balance <sup>2</sup>	Minimum "Own" Occupation Benefits	Policy Benefits		Ending Balance
					48% "Own" Occupation	"Any" Occupation	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
31-Dec-96	\$100,000	\$0	\$96,000	\$110,000	\$0	\$0	\$96,000
31-Jan-97		452	96,452	110,000	0	0	96,452
28-Feb-97		454	96,906	110,000	0	0	96,906
31-Mar-97		456	97,363	110,000	0	0	97,363
30-Apr-97		459	97,821	110,000	0	0	97,821
31-May-97		461	98,282	110,000	Waiting Period	0	98,282
30-Jun-97		463	98,745	110,000	Waiting Period	0	98,745
31-Jul-97		465	99,210	110,000	Waiting Period	0	99,210
31-Aug-97		467	99,677	110,000	Waiting Period	0	99,677
30-Sep-97		469	100,146	110,000	10,000	0	90,146
31-Oct-97		425	90,571	100,000	10,000	0	80,571
30-Nov-97		379	80,950	90,000	10,000	0	70,950
31-Dec-97		334	71,285	80,000	10,000	0	61,285
31-Jan-98		289	61,573	70,000	10,000	0	51,573
28-Feb-98		243	51,816	60,000	10,000	0	41,816
31-Mar-98		197	42,013	50,000	10,000	0	32,013
30-Apr-98		151	32,164	40,000	10,000	0	22,164
31-May-98		104	22,268	30,000	10,000	0	12,268
30-Jun-98		58	12,326	20,000	10,000	0	2,326
31-Jul-98		11	2,337	10,000	10,000	0	(7,663)
31-Aug-98		(36)	(7,699)	0	0	10,000	(17,699)
30-Sep-98		(83)	(17,783)	0	0	10,000	(27,783)
31-Oct-98		(131)	(27,913)	0	0	10,000	(37,913)
30-Nov-98		(179)	(38,092)	0	0	10,000	(48,092)
31-Dec-98		(226)	(48,318)	0	0	8,000	(56,318)
31-Jan-99		(285)	(56,584)	0	0	0	(56,584)

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Benefit Example 1

06/12/01  
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Accountants  
Consultants

Transaction Month	"Any and Own Occupation" Disability Total Premium (2)	7.00% Earned Interest Rate <sup>1</sup> (3)	Beginning Balance <sup>2</sup> (4)	Minimum "Own" Occupation Benefits (5)	Policy Benefits		Ending Balance (8)
					Benefits "Own" Occupation (6)	48% "Any" Occupation (7)	
28-Feb-99		0	(56,584)	0	0	0	(56,584)
Totals	\$100,000	\$5,416			\$110,000	\$48,000	(\$52,584)

## Notes:

<sup>1</sup> The gross interest rate, 7%, is reduced 1.2% for Annual Fees.

<sup>2</sup> 96% of the premium paid is credited to the beginning balance.

**Xelan Insurance Company**

**Exhibit II**

Member/Insured: Range and River Radiology, PC  
 Thomas W Pettinger Issue Age: 33  
 Effective Date: December 31, 1996 Gender: Male  
 Annual Premium: \$100,000  
 Monthly Disability Benefit "Own" \$10,000 "Any" \$10,000

**Example; Only the first years premium has been paid.**

Date of Disability: 9/10/98  
 Waiting Period (Days): 120 Benefits begin: 1/8/99  
 Disability Benefits "Own" "Any" Combined  
 Monthly Disability Benefit \$10,000 \$10,000  
 Minimum Benefits \$224,400 \$293,760  
 Total Disability Benefits \$225,090 \$97,920 \$323,010  
 Benefit Period in Months 23 10 33

Transaction Month (1)	"Any and Own Occupation" Disability		Beginning Balance <sup>2</sup> (4)	Minimum "Own" Occupation Benefits (5)	Policy Benefits		Ending Balance (8)
	Total Premium (2)	7.00% Earned Interest Rate <sup>1</sup> (3)			"Own" Benefits Occupation (6)	"Any" Benefits Occupation (7)	
31-Dec-96	\$100,000	\$0	\$96,000	\$224,400	\$0	\$0	\$96,000
31-Jan-97		452	96,452	224,400	0	0	96,452
28-Feb-97		454	96,906	224,400	0	0	96,906
31-Mar-97		456	97,363	224,400	0	0	97,363
30-Apr-97		459	97,821	224,400	0	0	97,821
31-May-97		461	98,282	224,400	0	0	98,282
30-Jun-97		463	98,745	224,400	0	0	98,745
31-Jul-97		465	99,210	224,400	0	0	99,210
31-Aug-97		467	99,677	224,400	0	0	99,677
30-Sep-97		469	100,146	224,400	0	0	100,146
31-Oct-97		472	100,618	224,400	0	0	100,618
30-Nov-97		474	101,092	224,400	0	0	101,092
31-Dec-97	104,000	476	201,408	224,400	0	0	201,408
31-Jan-98		949	202,357	224,400	0	0	202,357
28-Feb-98		953	203,309	224,400	0	0	203,309
31-Mar-98		957	204,267	224,400	0	0	204,267
30-Apr-98		962	205,229	224,400	0	0	205,229
31-May-98		967	206,195	224,400	0	0	206,195
30-Jun-98		971	207,167	224,400	0	0	207,167
31-Jul-98		976	208,142	224,400	0	0	208,142
31-Aug-98		980	209,122	224,400	0	0	209,122
30-Sep-98		985	210,107	224,400	Waiting Period	0	210,107
31-Oct-98		989	211,097	224,400	Waiting Period	0	211,097
30-Nov-98		994	212,091	224,400	Waiting Period	0	212,091
31-Dec-98		999	213,090	224,400	Waiting Period	0	213,090
31-Jan-99		1,004	214,093	224,400	10,000	0	204,093

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 Benefit Example 2

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06/12/01

Transaction Month	"Any and Own Occupation" Disability Total Premium	7.00% Earned Interest Rate <sup>1</sup>	Beginning Balance <sup>2</sup>	Minimum "Own" Occupation Benefits	Policy Benefits		Ending Balance
					Benefits "Own" Occupation	48% "Any" Occupation	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
28-Feb-99		961	205,054	214,400	10,000	0	195,054
15-Mar-99		919	195,973	204,400	10,000	0	185,973
15-Apr-99		876	186,849	194,400	10,000	0	176,849
15-May-99		833	177,682	184,400	10,000	0	167,682
15-Jun-99		790	168,471	174,400	10,000	0	158,471
15-Jul-99		746	159,218	164,400	10,000	0	149,218
15-Aug-99		703	149,920	154,400	10,000	0	139,920
15-Sep-99		659	140,579	144,400	10,000	0	130,579
15-Oct-99		615	131,194	134,400	10,000	0	121,194
15-Nov-99		571	121,765	124,400	10,000	0	111,765
15-Dec-99		526	112,291	114,400	10,000	0	102,291
15-Jan-00		482	102,773	104,400	10,000	0	92,773
15-Feb-00		437	93,210	94,400	10,000	0	83,210
15-Mar-00		392	83,602	84,400	10,000	0	73,602
15-Apr-00		347	73,948	74,400	10,000	0	63,948
15-May-00		301	64,250	64,400	10,000	0	54,250
15-Jun-00		255	54,505	54,400	10,000	0	44,505
15-Jul-00		210	44,715	44,400	10,000	0	34,715
15-Aug-00		163	34,878	34,400	10,000	0	24,878
15-Sep-00		117	24,995	24,400	10,000	0	14,995
15-Oct-00		71	15,066	14,400	10,000	0	5,066
15-Nov-00		24	5,090	4,400	5,090	4,910	(4,910)
15-Dec-00		(23)	(4,933)	0	0	10,000	(14,933)
15-Jan-01		(70)	(15,004)	0	0	10,000	(25,004)
15-Feb-01		(118)	(25,121)	0	0	10,000	(35,121)
15-Mar-01		(165)	(35,287)	0	0	10,000	(45,287)
15-Apr-01		(213)	(45,500)	0	0	10,000	(55,500)
15-May-01		(261)	(55,761)	0	0	10,000	(65,761)
15-Jun-01		(310)	(66,071)	0	0	10,000	(76,071)
15-Jul-01		(358)	(76,429)	0	0	10,000	(86,429)
15-Aug-01		(407)	(86,836)	0	0	10,000	(96,836)
15-Sep-01		(456)	(97,292)	0	0	3,010	(100,302)
15-Oct-01		(472)	(100,775)	0	0	0	(100,775)
15-Nov-01		0	(100,775)	0	0	0	(100,775)
Totals	\$204,000	\$26,395			\$225,090	\$97,920	(\$92,615)

## Notes:

<sup>1</sup> The gross interest rate, 7%, is reduced 1.2% for Annual Fees.

<sup>2</sup> 98% of the premium paid is credited to the beginning balance.

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Benefit Example 2

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06/12/01  
Armenia  
Cambodia



# Exhibit 9

Internal Revenue Service  
Western Region

Department of the Treasury  
Appeals Office

Date: **DEC 21 2001**

RANGE AND RIVER RADIOLOGY, P.C.  
63 SAGE CREEK ROAD  
CODY, WYOMING 82414  
AND  
RANGE AND RIVER RADIOLOGY, P.C.  
707 SHERIDAN AVENUE  
CODY, WYOMING 82414

Telephone Number: (303) 844-1957  
(Not Toll Free)  
Refer Reply to: AP:SB:DEN:EAM:KGN  
Person to Contact: ERIC A. MEAD  
Employee ID Number: 84-00298  
SSN/EIN Number: 83-0315035  
Type of Tax: Income

Last date to file a Tax Court  
petition:

**MAR 21 2002**

CERTIFIED MAIL

**NOTICE OF DEFICIENCY**

<u>TAX YEAR ENDED</u>	<u>Deficiency</u>
DECEMBER 31, 1996	\$31,002.00
DECEMBER 31, 1997	\$27,189.00

Sir:

We have determined that you owe additional tax or other amounts, or both, for the tax year(s) identified above. This letter is your NOTICE OF DEFICIENCY as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this determination in court before making any payment, you have 90 days from the date of this letter (150 days if this letter is addressed to you outside of the United States) to file a petition with the United States (U.S.) Tax Court for a redetermination of the deficiency. You can get a copy of the rules for filing a petition and a petition form you can use by writing to the address below:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

The Tax Court has a simplified procedure for small tax cases when the amount in dispute is \$50,000 or less for any one tax year. You also can get information about this procedure by writing to the Tax Court. You should write promptly if you intend to file a petition with the Tax Court.

Send the completed petition form, a copy of this letter, and copies of all statements and/or schedules you received with this letter to the Tax Court at the above address. The court cannot consider your case if you file the petition late. The petition is considered timely filed if the postmark date falls within the prescribed 90 or 150 day period and the envelope containing the petition is properly addressed with the correct postage.

The time you have to file a petition with the court is set by law and cannot be extended or suspended. Thus, contacting the Internal Revenue Service (IRS) for more information, or receiving other correspondence from the IRS won't change the allowable period for filing a petition with the Tax Court.

As required by law, separate notices are sent to husbands and wives. If this letter is addressed to both husband and wife, and both want to petition the Tax Court, both must sign and file the petition or each must file a separate, signed

EXHIBIT 9 - pg 62



petition. If only one spouse petitions the Tax Court, the full amount of the deficiency will be assessed against the non-petitioning spouse. If more than one tax year is shown above, you may file one petition form showing all of the years you are contesting.

You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before the Tax Court.

If you decide not to file a petition with the Tax Court, please sign the enclosed waiver form and return it to us at the IRS address on the top of the first page of this letter. This will permit us to assess the deficiency quickly and can help limit the accumulation of interest. The enclosed envelope is for your convenience.

If you decide not to sign and return the waiver, and you don't file a petition with the Tax Court within the time limit, the law requires us to assess and bill you for the deficiency after 90 days from the date of this letter (150 days if this letter is addressed to you outside the United States).

If you are a C corporation, under Internal Revenue Code Section 6621(c), large corporate underpayments may be subject to a higher rate of interest than the normal rate of interest for underpayments.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency by calling (208) 334-1324 or writing to the Taxpayer Advocate, 550 West Fort Street, Box 041, Boise, ID 83724. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

Thank you for your cooperation.

Sincerely,

Charles O. Rossotti  
Commissioner

By

  
Appeals Team Manager

Enclosures  
Copy of this letter  
Envelope  
Form 4089  
Statement  
c: S.V. MC SWANE  
A.M. TEDESCO

Department of the Treasury - Internal Revenue Service  
Notice of Deficiency - Waiver

63 SAGE CREEK ROAD RANGE AND RIVER RADIOLOGY, P.C. 707 SHERIDAN AVENUE  
CODY, WYOMING 82414 AND CODY, WYOMING 82414

Kind of Tax - Income	Deficiency
Tax Year Ended	
DECEMBER 31, 1996	\$31,002.00
DECEMBER 31, 1997	\$27,189.00

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies (increase in tax and penalties) shown above, plus any interest provided by law.

Taxpayer's Representative Sign Here \_\_\_\_\_ Date \_\_\_\_\_

Corporate Officer's Signature \_\_\_\_\_ Date \_\_\_\_\_

Note: If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are so entitled. It will not prevent us from later determining, if necessary, that you owe additional tax; nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

WHO MUST SIGN

If this waiver is for any year(s) for which you filed a joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if one was not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if one was not previously filed.

For a corporation, enter the name of the corporation followed by the signatures and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

Copy to:

A.M. TEDESCO TWO CHATHAM CENTER, #1500 AND S.V. MC SWANE 1225 W CALIFORNIA LN  
PITTSBURGH, PA 15219 ARLINGTON, TEXAS 76015

## STATEMENT - INCOME TAX CHANGES

SCHEDULE 1

NAME(S) OF TAXPAYERS	TAX YEAR(S) ENDED	
	DECEMBER 31, 1996	DECEMBER 31, 1997
RANGE AND RIVER RADIOLOGY, PC		
1. ADJUSTMENTS TO INCOME		
a. DISABILITY TRUST EXPENSE	\$96,000.00	\$114,240.00
b. NET OPERATING LOSS DEDUCTION	-	7,423.00
c.		
d.		
e.		
2. TOTAL ADJUSTMENTS- SEE SCHEDULE 2 FOR EXPLANATIONS	\$96,000.00	\$121,663.00
3. TAXABLE INCOME AS SHOWN IN TF RETURN	(7,423.00)	(43,981.00)
4. TAXABLE INCOME AS REVISED	\$88,577.00	\$77,682.00
5. TAX - SEE SCHEDULE 2	31,002.00	27,189.00
6. LESS CREDITS		
a.		
b.		
c.		
7. BALANCE	\$31,002.00	\$27,189.00
8. PLUS		
a.		
b.		
c.		
9. TOTAL CORRECTED INCOME TAX LIABILITY	\$31,002.00	\$27,189.00
10. LESS TAX SHOWN ON THE RETURN OR AS PREVIOUSLY ADJUSTED	NONE	NONE
11.		
12. INCREASE IN TAX	\$31,002.00	\$27,189.00

EXPLANATION OF ADJUSTMENTS

TAXABLE YEARS ENDED DECEMBER 31, 1996 AND DECEMBER 31, 1997

(a) The 1996 and 1997 deductions for disability trust payments are reduced \$96,000.00 for 1996 and \$114,240.00 for 1997 because it has not been established that any of these amounts was for ordinary and necessary business expenses, was expended for the purpose designated or that any of these amounts met the requirements of Section 162 of the Internal Revenue Code. Therefore, taxable income is increased \$96,000.00 for 1996 and \$114,240.00 for 1997.

(b) The \$7,723.00 shown on the 1997 return as a net operating loss deduction carried from 1996 is not allowed because it has not been established that any amount of deductible loss was sustained in 1996. Therefore, taxable income for 1997 is increased \$7,423.00.

TAX COMPUTATION

Since the principal activity of the corporation consists of the performance of personal services that are performed by the employee-owner of the corporation, the corporation is a personal service corporation. Therefore, the tax liability of the corporation is computed using a flat rate of thirty-five percent of taxable income, as determined.

Internal Revenue Service  
Western Region

Date: DEC 21 2001

THOMAS W. PETTINGER AND LAURIE D. PETTINGER  
63 SAGE CREEK ROAD  
CODY, WYOMING 82414-9672

Department of the Treasury  
Appeals Office  
1244 Speer Boulevard, Suite 400  
Denver, Colorado 80204-3581

Telephone Number: (303) 844-1957  
(Not Toll Free)  
Refer Reply to: AP:SB:DEN:EAM:KGN  
Person to Contact: ERIC A. MEAD  
Employee I.D. Number: 84-00298  
SSN/EIN Number: 466-27-7529  
Type of Tax: Income

Last date to file a Tax Court  
petition:

MAR 21 2002

CERTIFIED MAIL

NOTICE OF DEFICIENCY

<u>TAX YEAR ENDED</u>	<u>Deficiency</u>
DECEMBER 31, 1996	\$38,259.00
DECEMBER 31, 1997	\$45,254.00

Mr. and Mrs. Pettinger:

We have determined that you owe additional tax or other amounts, or both, for the tax year(s) identified above. This letter is your NOTICE OF DEFICIENCY as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this determination in court before making any payment, you have 90 days from the date of this letter (150 days if this letter is addressed to you outside of the United States) to file a petition with the United States (U.S.) Tax Court for a redetermination of the deficiency. You can get a copy of the rules for filing a petition and a petition form you can use by writing to the address below:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

The Tax Court has a simplified procedure for small tax cases when the amount in dispute is \$50,000 or less for any one tax year. You also can get information about this procedure by writing to the Tax Court. You should write promptly if you intend to file a petition with the Tax Court.

Send the completed petition form, a copy of this letter, and copies of all statements and/or schedules you received with this letter to the Tax Court at the above address. The court cannot consider your case if you file the petition late. The petition is considered timely filed if the postmark date falls within the prescribed 90 or 150 day period and the envelope containing the petition is properly addressed with the correct postage.

The time you have to file a petition with the court is set by law and cannot be extended or suspended. Thus, contacting the Internal Revenue Service (IRS) for more information, or receiving other correspondence from the IRS won't change the allowable period for filing a petition with the Tax Court.

As required by law, separate notices are sent to husbands and wives. If this letter is addressed to both husband and wife, and both want to petition the Tax Court, both must sign and file the petition or each must file a separate, signed petition. If only one spouse petitions the Tax Court, the full amount of the deficiency will be assessed against the non-petitioning spouse. If more than one tax year is shown above, you may file one petition form showing all of the years you are contesting.

You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before the Tax Court.

If you decide not to file a petition with the Tax Court, please sign the enclosed waiver form and return it to us at the IRS address on the top of the first page of this letter. This will permit us to assess the deficiency quickly and can help limit the accumulation of interest. The enclosed envelope is for your convenience.

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The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency by calling or writing to the Taxpayer Advocate, 600 17<sup>th</sup> Street, Stop 1005, Denver, Co 80202. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

Thank you for your cooperation.

Sincerely,

Charles D. Rossotti  
Commissioner

By



Appeals Team Manager

Enclosures

Copy of this letter  
Envelope  
Form 4089  
Statement

c: A.M. TEDESCO  
S.V. MC SWANE

Department of the Treasury - Internal Revenue Service  
Notice of Deficiency - Waiver

THOMAS W. PETTINGER AND LAURIE D. PETTINGER  
63 SAGE CREEK ROAD  
CODY, WYOMING 82414-9672

Kind of Tax - Income	Deficiency
Tax Year Ended	
DECEMBER 31, 1996	\$38,259.00
DECEMBER 31, 1997	\$45,254.00

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies (increase in tax and penalties) shown above, plus any interest provided by law.

Your  
Signature \_\_\_\_\_ Date \_\_\_\_\_  
If A Joint Return Was Filed

Spouse's  
Signature \_\_\_\_\_ Date \_\_\_\_\_

Taxpayer's  
Representative  
Sign Here \_\_\_\_\_ Date \_\_\_\_\_

Note: If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are so entitled. It will not prevent us from later determining, if necessary, that you owe additional tax; nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

**WHO MUST SIGN**

If this waiver is for any year(s) for which you filed a joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if one was not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if one was not previously filed.

For a corporation, enter the name of the corporation followed by the signatures and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

Copy to:

A.M. TEDESCO  
TWO CHATHAM CENTER, #1500  
PITTSBURGH, PA 15219

AND

S.V. MC SWANE  
1225 W. CALIFORNIA LN  
ARLINGTON, TX 76015

## STATEMENT - INCOME TAX CHANGES

SCHEDULE 1

NAME(S) OF TAXPAYERS	TAX YEAR(S) ENDED	
	DECEMBER 31, 1996	DECEMBER 31, 1997
THOMAS W. PETTINGER AND LAURIE D. PETTINGER		
1. ADJUSTMENTS TO INCOME		
a. GROSS INCOME FROM DIVIDENDS	\$96,000.00	\$114,240.00
b. DEDUCTION FOR PERSONAL EXEMPTIONS	612.00	
c.		
d.		
e.		
2. TOTAL ADJUSTMENTS- SEE SCHEDULE 2 FOR EXPLANATIONS	\$96,612.00	\$114,240.00
3. TAXABLE INCOME AS SHOWN IN TF RETURN	287,397.00	355,404.00
4. TAXABLE INCOME AS REVISED	\$384,009.00	\$469,644.00
5. TAX	127,068.00	160,290.00
6. LESS CREDITS		
a.		
b.		
c.		
7. BALANCE	\$127,068.00	\$160,290.00
8. PLUS		
a.		
b.		
c.		
9. TOTAL CORRECTED INCOME TAX LIABILITY	\$127,068.00	\$160,290.00
10. LESS TAX SHOWN ON THE RETURN OR AS PREVIOUSLY ADJUSTED	88,809.00	115,036.00
11. ADJUSTMENT TO THE EARNED INCOME CREDIT		
12. INCREASE IN TAX	\$38,259.00	\$45,254.00



**EXPLANATION OF ADJUSTMENTS**

**TAXABLE YEARS ENDED DECEMBER 31, 1996, AND DECEMBER 31, 1997.**

(a) During 1996 and 1997, Range and River Radiology, P.C. made payments to you, or for your benefit. These items constitute dividend income under Sections 301 and 316 of the Internal Revenue Code and are includable in gross income in the amounts of \$96,000.00 for 1996 and \$114,240.00 for 1997.

(b) Due to an increase in the amount of adjusted gross income, the 1996 deduction for personal exemptions is decreased as shown and taxable income is increased accordingly.



Vertical line of text or markings on the right side of the page.

# Exhibit 11

FILED  
U.S. DISTRICT COURT  
DISTRICT OF WYOMING

OCT 21 2004

Betty A. Grless, Clerk  
Cheyenne

*Thomas N. Long  
D. Scott Robinson  
Thomas N. Long, P.C.  
P.O. Box 87  
Cheyenne, WY 82003-0087  
(307) 635-0710  
(307) 635-0413 fax*

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF WYOMING

<p>RANGE &amp; RIVER RADIOLOGY, P.C. a Wyoming professional corporation, and THOMAS W. and LAURIE D. PETTINGER,  Plaintiffs,  vs.  UNITED STATES OF AMERICA,  Defendant.</p>	<p>Civil Action No. <u>04CV0299-D</u></p>
--	---

COMPLAINT

Plaintiffs, RANGE & RIVER RADIOLOGY, P.C., and THOMAS W. and LAURIE D. PETTINGER, by and through their undersigned counsel, for their Complaint for Refund of Taxes against Defendant United States of America allege as follows:

## I. PARTIES

1. Plaintiff RANGE & RIVER RADIOLOGY, P.C., is a professional corporation incorporated in and licensed to do business as a medical practice in the State of Wyoming, with its offices and principal place of business at 63 Sage Creek Road, Cody, Wyoming 82414. The Plaintiff has an EIN number of 83-0315035.

2. Plaintiffs THOMAS W. and LAURIE D. PETTINGER are residents of Wyoming, with their address at 63 Sage Creek Road, Cody, Wyoming 82414. Thomas W. and Laurie D. Pettinger have social security numbers of 466-27-7529 and 204-56-0087, respectively.

3. The Defendant is the United States of America, and is the proper party of interest for this action seeking refund of money paid to the Internal Revenue Service.

## II. JURISDICTION AND VENUE

4. This is a suit arising under the Internal Revenue Code of 1986, asserting claims for refund of taxes erroneously assessed against, collected from, and paid by Plaintiffs.

5. Jurisdiction over this action is conferred upon this Court by 28 U.S.C. §§ 1331, 1340, and 1346(a)(1) and 26 U.S.C. §§ 6532(a), 7402, and 7422.

6. Venue is proper in this Court under 28 U.S.C. §§ 1391(e) and 1402 for the reasons that a substantial part of the events or omissions giving rise to Plaintiffs' claims

occurred in the judicial district of Wyoming and that Plaintiff Range & River Radiology, P.C., has its principal place of business in Wyoming, and Plaintiffs Thomas W. and Laurie D. Pettinger have their residence in Wyoming.

### **III. STATEMENT OF CLAIMS**

7. By this reference, paragraphs 1-6 above are fully incorporated as though the same were set forth fully herein.

8. On or about December 21, 2001, the Internal Revenue Service issued two Notices of Deficiency, one to Plaintiff Range & River Radiology, P.C., and one to Plaintiffs Thomas W. and Laurie D. Pettinger.

9. The Notice of Deficiency issued to Plaintiff Range & River Radiology, P.C. asserted additional income taxes in the amount of \$31,002 for the calendar year ending 1996 and \$27,189 for the calendar year ending December 31, 1997. A true and correct copy of this Notice of Deficiency is attached hereto, and incorporated by reference as Exhibit A.

10. The Notice of Deficiency issued to Plaintiffs Thomas W. and Laurie D. Pettinger asserted additional income taxes in the amount of \$38,259 for the calendar year ending 1996 and \$45,254 for the calendar year ending December 31, 1997. A true and correct copy of this Notice of Deficiency is attached hereto, and incorporated by reference as Exhibit B.

11. These asserted deficiencies for the 1996 and 1997 years were subsequently assessed against Plaintiff Range & River Radiology, P.C. and Plaintiffs Thomas W. and Laurie D. Pettinger.

12. On or about June 11, 2002, Plaintiff Range & River Radiology, P.C. paid to the United States Treasury the entire asserted deficiency in tax for the calendar year 1996, plus interest, for a total payment of \$48,003, which was applied to the assessment made against Plaintiff Range & River Radiology, P.C.

13. On or about June 11, 2002, Plaintiff Range & River Radiology, P.C. paid to the United States Treasury the entire asserted deficiency in tax for the calendar year 1997, plus interest, for a total payment of \$37,674.63, which was applied to the assessment made against Plaintiff Range & River Radiology, P.C.

14. On or about June 11, 2002, Plaintiffs Thomas W. and Laurie D. Pettinger paid to the United States Treasury the entire asserted deficiency in tax for the calendar year 1996, plus interest, for a total payment of \$58,166.20, which was applied to the assessment made against Plaintiffs Thomas W. and Laurie D. Pettinger for 1996.

15. On or about June 11, 2002, Plaintiffs Thomas W. and Laurie D. Pettinger paid to the United States Treasury the entire asserted deficiency in tax for the calendar year 1997, plus interest, for a total payment of \$62,925.22, which was applied to the assessment made against Plaintiffs Thomas W. and Laurie D. Pettinger for 1997.

16. On or about January 16, 2004, Plaintiff Range & River Radiology, P.C. filed a Claim for Refund, Form 1120X, claiming a refund of the payment it made of the assessment made against it for the calendar year ending December 31, 1996. This claim was mailed to the IRS Service Center at Ogden, Utah 84201-0013. A true and correct copy of said Claim for Refund is attached hereto as Exhibit C.

17. The IRS has not allowed Plaintiff Range & River Radiology, P.C.'s claim with respect to its 1996 taxable year, and more than six months have expired since the claim was filed with the IRS.

18. On or about January 16, 2004, Plaintiff Range & River Radiology, P.C. filed a Claim for Refund, Form 1120X, claiming a refund of the payment it made of the assessment made against it for the calendar year ending December 31, 1997. This claim was mailed to the IRS Service Center at Ogden, Utah 84201-0013. A true and correct copy of said Claim for Refund is attached hereto as Exhibit D.

19. On March 1, 2004, the Internal Revenue Service issued a Notice of Disallowance to Plaintiff Range & River Radiology, P.C. with respect to the Claim for Refund for the 1997 taxable year, denying the claim in its entirety. A true and correct copy of said Notice of Disallowance is attached hereto as Exhibit E.

20. On or about January 16, 2004, Plaintiffs Thomas W. and Laurie D. Pettinger filed a Claim for Refund, Form 1040X, claiming a refund of the payment they made of the



assessment made against them for the calendar year ending December 31, 1996. This claim was mailed to the IRS Service Center at Fresno, California 93888. A true and correct copy of said Claim for Refund is attached hereto as Exhibit F.

21. On or about January 16, 2004, Plaintiffs Thomas W. and Laurie D. Pettinger filed a Claim for Refund, Form 1040X, claiming a refund of the payment they made of the assessment made against them for the calendar year ending December 31, 1997. This claim was mailed to the IRS Service Center at Fresno, California 93888. A true and correct copy of said Claim for Refund is attached hereto as Exhibit G.

22. On May 7, 2004, the Internal Revenue Service issued a Notice of Disallowance with respect to the Claims for Refund made by Plaintiffs Thomas W. and Laurie D. Pettinger for the years 1996 and 1997, denying the claims in their entirety. A true and correct copy of said Notice of Disallowance is attached hereto as Exhibit H.

23. As grounds for recovery, Plaintiffs incorporate by reference the averments contained in the attached Claims for Refund.

24. The assessment and collection of the additional taxes from Plaintiffs were erroneous and illegal.

25. Plaintiff Range & River Radiology, P.C. is entitled to a refund from Defendant for all monies paid to the United States Treasury in the amount of \$85,677.82, plus statutory interest thereon, no part of which has been repaid to Plaintiff.

26. Plaintiffs Thomas W. and Laurie D. Pettinger are entitled to a refund from Defendant for all monies paid to the United States Treasury in the amount of \$121,091.44, plus statutory interest thereon, no part of which has been repaid to Plaintiffs.

27. Plaintiffs are the sole owners of their claims against the Defendant and have made no assignment of said claims.

#### IV. PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray:

28. For judgment against the Defendant in the amount of \$85,677.82 in favor of Plaintiff Range & River Radiology, P.C., together with interest, costs, and attorneys fees as provided by law.

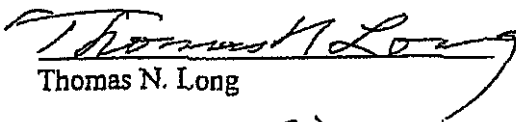
29. For judgment against the Defendant in the amount of \$121,091.44 in favor of Plaintiffs Thomas W. and Laurie D. Pettinger, together with interest, costs, and attorneys fees as provided by law.


30. For a determination that the assessment made against Plaintiffs Range River Radiology, P.C. and Thomas W. and Laurie D. Pettinger for the calendar years ending December 31, 1996 and December 31, 1997, is erroneous and illegal.

31. For such other and further relief as the Court may deem appropriate.

DATED this 21<sup>st</sup> day of October, 2004.

Attorneys for Plaintiffs,

  
Thomas N. Long

  
D. Scott Robinson

**Thomas N. Long, P.C.**  
2120 Carey Avenue, Suite 300  
P.O. Box 87  
Cheyenne, WY 82003-0087  
(307) 635-0710  
(307) 635-0413 fax

**Plaintiffs' Address:**  
Range & River Radiology, P.C.  
Thomas W. and Laurie D. Pettinger  
63 Sage Creek Road,  
Cody, Wyoming 82414

Internal Revenue Service  
Western Region

Department of the Treasury  
Appeals Office

Date: **DEC 21 2001**  
RANGE AND RIVER RADIOLOGY, P.C.  
63 SAGE CREEK ROAD  
CODY, WYOMING 82414  
AND  
RANGE AND RIVER RADIOLOGY, P.C.  
707 SHERIDAN AVENUE  
CODY, WYOMING 82414

Telephone Number: (303) 844-1957  
(Not Toll Free)  
Refer Reply to: AP:SB:DEN:EAM:KGN  
Person to Contact: ERIC A. MEAD  
Employee ID Number: 84-0029B  
SSN/EIN Number: 83-0315035  
Type of Tax: Income

Last date to file a Tax Court  
petition:

**MAR 21 2002**

CERTIFIED MAIL

**NOTICE OF DEFICIENCY**

TAX YEAR ENDED  
DECEMBER 31, 1996  
DECEMBER 31, 1997

Deficiency  
\$31,002.00  
\$27,189.00

Sir:

We have determined that you owe additional tax or other amounts, or both, for the tax year(s) identified above. This letter is your NOTICE OF DEFICIENCY as required by law. The enclosed statement shows how we figured the deficiency.

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Washington, DC 20217

The Tax Court has a simplified procedure for small tax cases when the amount in dispute is \$50,000 or less for any one tax year. You also can get information about this procedure by writing to the Tax Court. You should write promptly if you intend to file a petition with the Tax Court.

Send the completed petition form, a copy of this letter, and copies of all statements and/or schedules you received with this letter to the Tax Court at the above address. The court cannot consider your case if you file the petition late. The petition is considered timely filed if the postmark date falls within the prescribed 90 or 150 day period and the envelope containing the petition is properly addressed with the correct postage.

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petition. If only one spouse petitions the Tax Court, the full amount of the deficiency will be assessed against the non-petitioning spouse. If more than one tax year is shown above, you may file one petition form showing all of the years you are contesting.

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If you are a C corporation, under Internal Revenue Code Section 6621(c), large corporate underpayments may be subject to a higher rate of interest than the normal rate of interest for underpayments.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency by calling (208) 334-1324 or writing to the Taxpayer Advocate, 550 West Fort Street, Box 041, Boise, ID 83724. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

Thank you for your cooperation.

Sincerely,

Charles O. Rossotti  
Commissioner

By

  
Appeals Team Manager

Enclosures  
Copy of this letter  
Envelope  
Form 4089  
Statement  
cc: S.V. MC SWANE  
A.M. TEDESCO

Department of the Treasury - Internal Revenue Service  
Notice of Deficiency - Waiver

63 SAGE CREEK ROAD  
CODY, WYOMING 82414

RANGE AND RIVER RADIOLOGY, P.C.  
AND

707 SHERIDAN AVENUE  
CODY, WYOMING 82414

Kind of Tax - Income	Deficiency
Tax Year Ended	
DECEMBER 31, 1996	\$31,002.00
DECEMBER 31, 1997	\$27,189.00

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies (increase in tax and penalties) shown above, plus any interest provided by law.

Taxpayer's  
Representative

Sign Here  
Corporate  
Name

Date

Corporate  
Officer's  
Signature

Date

Note: If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are so entitled. It will not prevent us from later determining, if necessary, that you owe additional tax, nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

WHO MUST SIGN

If this waiver is for any year(s) for which you filed a joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if one was not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if one was not previously filed.

For a corporation, enter the name of the corporation followed by the signature and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

Copy to:

A.M. TEDESCO  
TWO CHATHAM CENTER, #1500  
PITTSBURGH, PA 15219

AND

S.V. MC SWANE  
1225 W CALIFORNIA LN  
ARLINGTON, TEXAS 76015

## STATEMENT - INCOME TAX CHANGES

SCHEDULE 1

NAME(S) OF TAXPAYERS	TAX YEAR(S) ENDED	
	DECEMBER 31, 1998	DECEMBER 31, 1997
RANGE AND RIVER RADIOLOGY, PC		
<b>1. ADJUSTMENTS TO INCOME</b>		
a. DISABILITY TRUST EXPENSE	\$96,000.00	\$114,240.00
b. NET OPERATING LOSS DEDUCTION	-	7,423.00
c.		
d.		
e.		
<b>2. TOTAL ADJUSTMENTS- SEE SCHEDULE 2 FOR EXPLANATIONS</b>	\$96,000.00	\$121,663.00
<b>3. TAXABLE INCOME AS SHOWN IN THE RETURN</b>	(7,423.00)	(43,981.00)
<b>4. TAXABLE INCOME AS REVISED</b>	\$88,577.00	\$77,682.00
<b>5. TAX - SEE SCHEDULE 2</b>	31,002.00	27,189.00
<b>6. LESS CREDITS</b>		
a.		
b.		
c.		
<b>7. BALANCE</b>	\$31,002.00	\$27,189.00
<b>8. PLUS</b>		
a.		
b.		
c.		
<b>9. TOTAL CORRECTED INCOME TAX LIABILITY</b>	\$31,002.00	\$27,189.00
<b>10. LESS TAX SHOWN ON THE RETURN OR AS PREVIOUSLY ADJUSTED</b>	NONE	NONE
<b>11.</b>		
<b>12. INCREASE IN TAX</b>	\$31,002.00	\$27,189.00

Internal Revenue Service  
Western Region

Date: DEC 21 2001

THOMAS W. PETTINGER AND LAURIE D. PETTINGER  
63 SAGE CREEK ROAD  
CODY, WYOMING 82414-9672

Department of the Treasury  
Appeals Office  
1244 Speer Boulevard, Suite 400  
Denver, Colorado 80204-3581

Telephone Number: (303) 844-1957  
(Not Toll Free)  
Refer Reply to: AP:SB:DEN:EAM:KGN  
Person to Contact: ERIC A. MEAD  
Employee I.D. Number: 84-00298  
SSN/EIN Number: 465-27-7529  
Type of Tax: Income

Last date to file a Tax Court  
petition:

MAR 21 2002

CERTIFIED MAIL

NOTICE OF DEFICIENCY

TAX YEAR ENDED  
DECEMBER 31, 1996  
DECEMBER 31, 1997

Deficiency  
\$38,259.00  
\$45,254.00

Mr. and Mrs. Pettinger:

We have determined that you owe additional tax or other amounts, or both, for the tax year(s) identified above. This letter is your NOTICE OF DEFICIENCY as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this determination in court before making any payment, you have 90 days from the date of this letter (150 days if this letter is addressed to you outside of the United States) to file a petition with the United States (U.S.) Tax Court for a redetermination of the deficiency. You can get a copy of the rules for filing a petition and a petition form you can use by writing to the address below:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

The Tax Court has a simplified procedure for small tax cases when the amount in dispute is \$50,000 or less for any one tax year. You also can get information about this procedure by writing to the Tax Court. You should write promptly if you intend to file a petition with the Tax Court.

Send the completed petition form, a copy of this letter, and copies of all statements and/or schedules you received with this letter to the Tax Court at the above address. The court cannot consider your case if you file the petition late. The petition is considered timely filed if the postmark date falls within the prescribed 90 or 150 day period and the envelope containing the petition is properly addressed with the correct postage.

The time you have to file a petition with the court is set by law and cannot be extended or suspended. Thus, contacting the Internal Revenue Service (IRS) for more information, or receiving other correspondence from the IRS won't change the allowable period for filing a petition with the Tax Court.



As required by law, separate notices are sent to husbands and wives. If this letter is addressed to both husband and wife, and both want to petition the Tax Court, both must sign and file the petition or each must file a separate, signed petition. If only one spouse petitions the Tax Court, the full amount of the deficiency will be assessed against the non-petitioning spouse. If more than one tax year is shown above, you may file one petition form showing all of the years you are contesting.

You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before the Tax Court.

If you decide not to file a petition with the Tax Court, please sign the enclosed waiver form and return it to us at the IRS address on the top of the first page of this letter. This will permit us to assess the deficiency quickly and can help limit the accumulation of interest. The enclosed envelope is for your convenience.

If you decide not to sign and return the waiver, and you don't file a petition with the Tax Court within the time limit, the law requires us to assess and bill you for the deficiency after 90 days from the date of this letter (150 days if this letter is addressed to you outside the United States).

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency by calling or writing to the Taxpayer Advocate, 600 17<sup>th</sup> Street, Stop 1005, Denver, Co 80202. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

Thank you for your cooperation.

Sincerely,

Charles O. Rossotti  
Commissioner

By



Appeals Team Manager

Enclosures

Copy of this letter  
Envelope  
Form 4089  
Statement

c: A.M. TEDESCO  
S.V. MC SWANE

Form 4089

AP:SB:DEN:EAM:KGN

Department of the Treasury - Internal Revenue Service  
Notice of Deficiency - Waiver

THOMAS W. PETTINGER AND LAURIE D. PETTINGER  
63 SAGE CREEK ROAD  
CODY, WYOMING 82414-9672

Kind of Tax - Income	Deficiency
Tax Year Ended	
DECEMBER 31, 1996	\$38,259.00
DECEMBER 31, 1997	\$45,254.00

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies (increase in tax and penalties) shown above, plus any interest provided by law.

Your  
Signature \_\_\_\_\_ Date \_\_\_\_\_  
If A Joint Return Was Filed  
Spouse's  
Signature \_\_\_\_\_ Date \_\_\_\_\_  
Taxpayer's  
Representative  
Sign Here \_\_\_\_\_ Date \_\_\_\_\_

Note: If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are so entitled. It will not prevent us from later determining, if necessary, that you owe additional tax; nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

WHO MUST SIGN

If this waiver is for any year(s) for which you filed a joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if one was not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if one was not previously filed.

For a corporation, enter the name of the corporation followed by the signatures and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

Copy to:

A.M. TEDESCO  
TWO CHATHAM CENTER, #1500 AND  
PITTSBURGH, PA 15219  
S.V. MC SWANE  
1225 W. CALIFORNIA LN  
ARLINGTON, TX 76015

Form 4089

## STATEMENT - INCOME TAX CHANGES

SCHEDULE 1

NAME(S) OF TAXPAYERS	TAX YEAR(S) ENDED	
	DECEMBER 31, 1996	DECEMBER 31, 1997
THOMAS W. PETTINGER AND LAURIE D. PETTINGER		
<b>1. ADJUSTMENTS TO INCOME</b>		
a. GROSS INCOME FROM DIVIDENDS	\$96,000.00	\$114,240.00
b. DEDUCTION FOR PERSONAL EXEMPTIONS	612.00	-
c.		
d.		
e.		
<b>2. TOTAL ADJUSTMENTS- SEE SCHEDULE 2 FOR EXPLANATIONS</b>	\$96,612.00	\$114,240.00
<b>3. TAXABLE INCOME AS SHOWN IN TF RETURN</b>	287,397.00	355,404.00
<b>4. TAXABLE INCOME AS REVISED</b>	\$384,009.00	\$469,644.00
<b>5. TAX</b>	127,068.00	160,290.00
<b>6. LESS CREDITS</b>		
a.		
b.		
c.		
<b>7. BALANCE</b>	\$127,068.00	\$160,290.00
<b>8. PLUS</b>		
a.		
b.		
c.		
<b>9. TOTAL CORRECTED INCOME TAX LIABILITY</b>	\$127,068.00	\$160,290.00
<b>10. LESS TAX SHOWN ON THE RETURN OR AS PREVIOUSLY ADJUSTED</b>	88,809.00	115,036.00
<b>11. ADJUSTMENT TO THE EARNED INCOME CREDIT</b>		
<b>12. INCREASE IN TAX</b>	\$38,259.00	\$45,254.00

THOMAS W. PETTINGER AND LAURIE D. PETTINGER

SCHEDULE 2

**EXPLANATION OF ADJUSTMENTS**

**TAXABLE YEARS ENDED DECEMBER 31, 1996, AND DECEMBER 31, 1997.**

(a) During 1996 and 1997, Range and River Radiology, P.C. made payments to you, or for your benefit. These items constitute dividend income under Sections 301 and 316 of the Internal Revenue Code and are includable in gross income in the amounts of \$95,000.00 for 1996 and \$114,240.00 for 1997.

(b) Due to an increase in the amount of adjusted gross income, the 1996 deduction for personal exemptions is decreased as shown and taxable income is increased accordingly.

Form **1120X**  
 (Rev. December 2001)  
 Department of the Treasury  
 Internal Revenue Service

**Amended U.S. Corporation  
 Income Tax Return**

OMB No 1545-0132

For tax year ending  
**12/31/1996**  
 (Enter month and year.)

Employer identification number  
**83 031503S**

Name  
**RANGE AND RIVER RADIOLOGY, PC**  
 Number, street, and room or suite no. (if a P.O. box, see instructions)  
**707 SHERIDAN AVE**  
 City or town, state, and ZIP code  
**CODY, WY 82414-3409**  
 Telephone number (optional)

Enter name and address used on original return (if same as above, write "Same")  
**SAME**

Internal Revenue Service Center where original return was filed  
**OGDEN, UT**

**Fill in Applicable Items and Use Part II To Explain Any Changes**

Part I	Income and Deductions (see instructions)	(a) As originally reported or as previously adjusted	(b) Net change— increase or (decrease)— explain in Part II	(c) Correct amount
1	Total income (Form 1120 or 1120-A, line 11)	554,727	(96,000)	458,727
2	Total deductions (total of lines 27 and 29c, Form 1120, or lines 23 and 25c, Form 1120-A)	466,150		466,150
3	Taxable income. Subtract line 2 from line 1	88,577	(96,000)	(7,423)
4	Tax (Form 1120, line 31, or Form 1120-A, line 27)	31,002	(31,002)	0

**Payments and Credits (see instructions)**

5a	Overpayment in prior year allowed as a credit			
b	Estimated tax payments			
c	Refund applied for on Form 4466			
d	Subtract line 5c from the sum of lines 5a and 5b			
e	Tax deposited with Form 7004			
f	Credit from Form 2439			
g	Credit for Federal tax on fuels			
6	Tax deposited or paid with (or after) the filing of the original return			31,002
7	Add lines 5d through 6, column (c)			31,002
8	Overpayment, if any, as shown on original return or as later adjusted			
9	Subtract line 8 from line 7			31,002

**Tax Due or Overpayment (see instructions)**

10	Tax due. Subtract line 9 from line 4, column (c). If paying by check, make it payable to the "United States Treasury."			
11	Overpayment. Subtract line 4, column (c), from line 9			31,002
12	Enter the amount of line 11 you want: Credited to 20__ estimated tax <input type="checkbox"/> Refunded <input type="checkbox"/>			31,002

Under penalties of perjury I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief this amended return is true, correct and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here: *[Signature]* Date: **12/25/03** Title: **President**

Paid Preparer's Use Only: Preparer's signature: \_\_\_\_\_ Date: \_\_\_\_\_ Check if self-employed  Preparer's SSN or PTIN: \_\_\_\_\_  
 Firm's name (or yours if self-employed), address, and ZIP code: \_\_\_\_\_ EIN: \_\_\_\_\_ Phone no. ( ): \_\_\_\_\_

**Part II** Explanation of Changes to Items in Part I (Enter the line number from page 1 for the items you are changing, and give the reason for each change. Show any computation in detail. Also, see What To Attach on page 3 of the instructions.)

If the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback, see Carryback Claims on page 3, and check here

SEE ATTACHED

Range and River Radiology, P.C.  
1996 & 1997 Form 1120X, Amended U.S. Corporation Income Tax Return  
Schedule I

Part II Explanation of Changes to Income, Deductions, and Credits

Following an examination of the 1996 and 1997 Federal Income Tax Returns filed by Range & River Radiology, P.C., the IRS issued a Notice of Deficiency, asserting a deficiency in tax of for the years 1996 and 1997 of \$31,002 and \$27,189

A copy of the Notice of Deficiency is attached hereto as exhibit A. On or about May 13, 2002, the IRS assessed the following deficiencies, plus interest, in the following amounts:

	<u>1996</u>		<u>1997</u>
Tax	\$31,002	Tax	\$27,189
Interest	\$16,111.50	Interest	\$10,574.05
Total	\$47,113.50	Total	\$37,763.05

On or about June 11, 2002, the taxpayer paid the assessed tax plus interest in the total amount \$85,677.82.

The deficiencies and interest were erroneously assessed and collected because it was based upon the IRS' erroneous disallowance of deductions claimed in 1996 and 1997 of \$96,000 and \$114,240 respectively, for group supplemental insurance coverage. The IRS also erroneously disallowed a net operating loss deduction of \$7,423.

Line 1

Thomas W. Pettinger ("Pettinger"), is a physician specializing in radiology. His practice is conducted through a personal service corporation, Range and River Radiology, P.C. ("Range & River"): Pettinger is an employee of Range & River.

Pettinger is a member of xélan, the Economic Association of Health Professionals, Inc. This organization, together with various other entities commonly called the "xélan family of companies" ("xélan"), provides advisory, educational, and administrative services for doctors, dentists, and their families and employees. These services include making available insurance programs of particular interest to health care professionals. xélan has been assisting doctors and dentists in meeting their financial, investment, and insurance needs for over 30 years.

Prior to the 1990s, xélan routinely arranged for disability insurance policies on its members. These policies were sold by various independent insurance companies.

They provided benefits in the event of a member's disability equal to a percentage of his earnings. Many policies also contained a premium refund feature, which provided the potential for refund of premiums paid over a period of time, depending on the retrospectively-rated experience of the insured and the insurance company.

In the early and mid 1990s, xélan members were faced with a cutback in available disability insurance coverage. For highly productive doctors and dentists, their annual net practice income could not be adequately protected by the coverage offered through the available policies of commercial insurance companies. Moreover, "own occupation" type coverage for specialists (which provides payments in the event that the insured become unable to perform their particular specialty rather than unable to perform "any occupation") had been curtailed even further. In response to this situation, xélan developed the Supplemental Disability Insurance Program.

Pettinger has been a participant in the program since 1996. He was then in his early 30s, and was generating substantial income from his practice. Because of the caps on maximum monthly benefits, commercially available disability policies would replace only a relatively small percentage of his expected income in the event of a disability.

By joining xélan, Pettinger became eligible to participate in the Supplemental Disability Insurance Program. Significant aspects of the program were as follows:

1. xélan Group Disability Trust ("the Trust") was formed to obtain and maintain a group supplemental disability policy ("the Policy") for the benefit of xélan members;
2. The Policy was obtained from the xélan Insurance Company Ltd. ("the Insurance Company"), a licensed British Virgin Islands insurance company;
3. The Policy provided the following benefits:
  - a. Own Occupation Disability. A member is considered eligible for this benefit, if he or she is not able to perform the duties of his or her regular occupation or specialty for a full forty-hours per week, at least fifty weeks a year. The condition must have existed for at least 120 consecutive days, and the member must be less than seventy-six years of age.
  - b. Any Occupation Disability. A member is eligible if he or she cannot perform the duties of any occupation for any period of time, when he or she is less than sixty-five years of age.
  - c. Experience Refund. A member's premium payor is eligible for a refund after premiums have been paid for the member's insurance for a seven-year period (for members 62 or older, premiums must be paid for at least three-years).
4. Other material provisions of the Policy include the following:
  - a. Amount of disability benefits. The "own occupation" benefit is the greater of 110% of premiums paid for the coverage, or the amount



shown in the member's experience adjusted account. The experience adjusted account reflects a percentage of premiums paid on behalf of the insured,<sup>1</sup> the claims experience of all of the insured members, the investment experience of the insurance company, and forfeitures of other members' benefits. The "any occupation" benefit is the greater of 144% of premiums paid, or the experience adjusted account<sup>2</sup>.

- b. Amount of experience refund. The experience refund is based upon the member's experience adjusted account.
- c. Premiums. Premiums are variable, depending upon the amount of coverage provided the insured, with a minimum of \$4,000 annually, and a maximum of the member's established net practice income. Contributions on behalf of the members are made to the trust. The entire amounts of the contributions are paid to the insurance company as premiums for the group coverage.
- d. Forfeitures. Failure to pay at least the minimum annual premium for a member causes forfeiture of that member's benefits. A forfeited benefit of that one member increases the benefits available to all remaining members.
- e. Reserves. All premiums go into insurance company reserve accounts. Actual insurance company expenses are deducted from the reserves. The percentage that is not allocated to the experience adjusted accounts represents estimates of these expenses, including monies that will be necessary to provide capital and surplus for the insurance company, and to pay claims. All reserves are available to pay claims.
- f. Coverage. Coverage was renewable (guaranteed), subject to the insurance company's right to increase premium rates uniformly for all insured based upon experience.

#### The Tax Returns

On the Federal Income Tax returns filed by Pettinger and his wife for 1996 and 1997, they excluded from gross income contributions made by Range & River for the supplemental disability coverage pursuant to § 106 of the Internal Revenue Code of 1986 ("the Code").

#### The Notice of Deficiency

The IRS disallowed \$96,000 and \$114,240 respectively, of the amounts claimed as deductions on Range & River's 1996 and 1997 tax returns with respect to contributions made to the trust "because it has not been established that any of the amounts was for ordinary and necessary business expenses, was expended for the purposes designated, or that any of these amounts met the requirements of § 162 of [the Code]." The

<sup>1</sup> Initially, the percentage was 96%. It was amended retroactively to 94% in 2001

<sup>2</sup> This amount was retroactively amended to 400% in 2001

disallowance of the deductions for 1996 resulted in the disallowance of the net operating loss deduction carried from 1996 to 1997, which was not allowed for "because it has not been established that any amount of deductible loss was sustained in 1996."

The IRS determined the payments were made to Pettinger or for his benefit, and that the payments constitute dividend income under §§ 301 and 316 of the Code, and are includable in Pettinger's gross income in the amounts of \$96,000 and \$114,240 for 1996 and 1997, respectively.

Grounds Relied Upon by the Taxpayer

The amounts paid by Range & River to the Trust constitute insurance premiums. They are deductible as ordinary and necessary business expenses under § 162 of the Code and Treasury Regulations § 1.162-1(a). They are excludable from Pettinger's gross income under § 106 of the Code and Treasury Regulations § 1.106-1.

Contrary to the IRS's assertion that it has not been demonstrated that the payments in question were "expended for the purposes designated," the payments, in fact, were made to the insurance company as premiums on a group supplemental disability policy providing the benefits to xélan members in the event of their disability. The amounts were maintained by the insurance company as invested reserves, and used by the company to pay operating expenses and benefit claims.

Neither the Code nor the Treasury Regulations define the term "insurance;" however, court cases and IRS rulings dealing with the issue as to what constitutes "insurance," establish that the arrangement with the Insurance Company, the Trust, xélan members, and premium payors constitutes the payment of premiums for insurance, qualifying under the Code for the tax treatment claimed on the returns.

In *Helvering v. LeGierse*, 312 U.S. 531, 539 (1941), the court held that "historically and commonly insurance involves risk shifting and risk distributing." Risk shifting occurs where a person with an identifiable possibility of economic loss transfers some or all of the financial consequences of the loss to the insurer. The focus is upon the insured and the insurer. See *Humana Inc., v. Commissioner*, 881 F.2d 247 (6<sup>th</sup> Cir. 1989).

Risk distribution involves shifting to a group the identifiable risk of a particular person. The focus is broader than risk shifting, and looks more to the insurer to determine whether the risk insured against can be distributed over a larger group. Risk distribution brings in to play the "law of large numbers," reducing the risk that a single costly claim will exceed the amount taken in as premiums and set aside as payment for the claim. See *Humana*, supra; *Cloughery Packing Company v. Commissioner*, 811 F.2d 1297, 1300 (9<sup>th</sup> Cir. 1987).

In the case of the xélan Supplemental Disability Program ("the Disability Program"), there is risk shifting. xélan members have an identifiable risk of lost earnings

due to their reduced capacity to work. That risk is transferred to the insurance company. If the insured becomes disabled and remains disabled, the benefits to him or her will exceed the premiums paid. The insurance company has set aside statutory reserves actuarially determined to cover claims, and therefore has the financial capacity to accept the risk of loss.

There is also risk distribution. The total of the premiums collected from each member is available to pay any other insured member's benefits. It has been actuarially confirmed that the xélan policy provides pooling of risk, since the policy has a sufficient number of exposures for the law of averages to take effect, the group of insureds is a homogeneous population, and there is a statistical independence between the potential disability events insured.

The Disability Program provides benefits in the event of a member's complete or partial disability. Additionally, after seven years of participation, or upon reaching a specific age, the program provides a potential for the participant to obtain a retrospectively rated refund. The refund is dependent upon the amount of premiums paid on behalf of the member, the investment experience of the insurance company's reserves, any forfeiture of other participants' past contributions, and claims filed by other participants.

It is a common and accepted practice in the insurance industry for insurance policies to contain a premium refund feature. The IRS has admitted that a premium refund feature does not disqualify an arrangement that otherwise is treated as insurance for tax purposes from being so treated.

In this respect, twenty-years ago the IRS ruled favorably for the taxpayer with respect to a program that provided medical malpractice liability coverage, where the policy involved provided for a refund of premium after five years of participation. Rev. Rul. 83-66, 1983-1C.B.43. There, as here, doctors were members of a medical association, which purchased group insurance for the doctors' benefit. The doctors could obtain a refund of a portion of the premiums paid on their behalf, dependent upon the loss experience of the group as a whole. Premiums paid became part of the insurance company's reserves, although separate records were maintained for each insured for purposes of determining their pro rata share of any refund. The IRS ruled that, despite the refund feature, the premiums paid qualified as ordinary and necessary business expenses under § 162 of the Code. The IRS is bound by its own Revenue Ruling, and the Ruling may be relied upon by others, including *Pettinger*. *Rauenhorst v. Commissioner*, 119 T.C. 157, 173 (2002).

The IRS has, in fact, treated premiums paid to the xélan insurance company for the group's supplemental disability coverage as insurance. In this respect, § 4374 of the Code imposes an excise tax upon the payment of premiums on insurance by U.S. persons to a foreign insurance company. The xélan Insurance Company (Doctor's Benefit) has paid these excise taxes on the premiums paid to it for the supplemental disability policy, and the payments have been accepted and the taxes assessed. Principles of estoppel and the

duty of consistency preclude the IRS from taking the inconsistent position in the cases of Range & River and Pettinger that the xelan disability program does not constitute insurance, and that the amounts paid by Range & River constitute constructive dividends to Pettinger. *Alamo Nat. Bank of San Antonio v. Commissioner*, 95 F 2d 622 (5<sup>th</sup> Cir. 1938); *Orange Securities Corp. v. Commissioner*, 131 F 2d 662 (5<sup>th</sup> Cir. 1942).

Premiums paid by Range & River were not in fact constructive dividends to Pettinger, as the IRS has determined. They are not includable in gross income. They are specifically excluded from Pettinger's gross income under § 106 of the Code.

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Form **1120X**  
 (Rev. December 2001)  
 Department of the Treasury  
 Internal Revenue Service

**Amended U.S. Corporation  
 Income Tax Return**

OMB No. 1545-0132

For tax year ending  
**12/31/1997**  
 (Enter month and year.)

Please  
 Type  
 or  
 Print

Name  
**RANGE AND RIVER RADIOLOGY, PC**  
 Number street, and room or suite no. (if a P.O. box see instructions)  
**707 SHERIDAN AVE**  
 City or town, state, and ZIP code  
**CODY, WY 82414-3409**

Employer identification number  
**83 0315035**

Telephone number (optional)  
 ( )

Enter name and address used on original return (if same as above write "Same")  
**SAME**

Internal Revenue Service Center where original return was filed  
**OGDEN, UT**

**Fill in Applicable Items and Use Part II To Explain Any Changes**

Part I	Income and Deductions (see instructions)	(a) AS originally reported or as previously adjusted	(b) Net change— increase or (decrease)— explain in Part II	(c) Correct amount
1	Total income (Form 1120 or 1120-A, line 11)	808,148	(114,240)	693,908
2	Total deductions (total of lines 27 and 29c, Form 1120, or lines 23 and 25c, Form 1120-A)	730,466	7,423	737,889
3	Taxable income Subtract line 2 from line 1	77,682	(121,663)	(43,981)
4	Tax (Form 1120, line 31, or Form 1120-A, line 27)	27,189	(27,189)	0

**Payments and Credits (see instructions)**

5a	Overpayment in prior year allowed as a credit			
b	Estimated tax payments			
c	Refund applied for on Form 4466			
d	Subtract line 5c from the sum of lines 5a and 5b			
e	Tax deposited with Form 7004			
f	Credit from Form 2439			
g	Credit for Federal tax on fuels			
6	Tax deposited or paid with (or after) the filing of the original return			27,189
7	Add lines 5d through 5g column (c)			27,189
8	Overpayment, if any, as shown on original return or as later adjusted			
9	Subtract line 8 from line 7			27,189

**Tax Due or Overpayment (see instructions)**

10	Tax due. Subtract line 9 from line 4, column (c). If paying by check, make it payable to the "United States Treasury."	10	
11	Overpayment. Subtract line 4, column (c), from line 9	11	27,189
12	Enter the amount of line 11 you want: Credited to 20 estimated tax Refunded	12	27,189

Under penalties of perjury I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here  
 Signature of officer *[Signature]* Date *1/2/04* Title *President*

Paid Preparer's Use Only  
 Preparer's signature \_\_\_\_\_ Date \_\_\_\_\_ Check if self-employed  Preparer's SSN or PTIN \_\_\_\_\_  
 Firm's name (or yours if self-employed), address, and ZIP code \_\_\_\_\_ EIN \_\_\_\_\_  
 Phone no. ( ) \_\_\_\_\_

For Paperwork Reduction Act Notice, see page 4.

Cat No 11530Z

Form 1120X (Rev. 12-2001)

**Part III** Explanation of Changes to Items in Part I (Enter the line number from page 1 for the items you are changing, and give the reason for each change. Show any computation in detail. Also, see What To Attach on page 3 of the instructions.)

If the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback, see Carryback Claims on page 3, and check here

SEE ATTACHED

Range and River Radiology, P.C.  
1996 & 1997 Form 1120X, Amended U.S. Corporation Income Tax Return  
Schedule I

Part II Explanation of Changes to Income, Deductions, and Credits

Following an examination of the 1996 and 1997 Federal Income Tax Returns filed by Range & River Radiology, P.C., the IRS issued a Notice of Deficiency, asserting a deficiency in tax of for the years 1996 and 1997 of \$31,002 and \$27,189.

A copy of the Notice of Deficiency is attached hereto as exhibit A. On or about May 13, 2002, the IRS assessed the following deficiencies, plus interest, in the following amounts:

	<u>1996</u>		<u>1997</u>
Tax	\$31,002	Tax	\$27,189
Interest	\$16,111.50	Interest	\$10,574.05
Total	\$47,113.50	Total	\$37,763.05

On or about June 11, 2002, the taxpayer paid the assessed tax plus interest in the total amount \$85,677.82.

The deficiencies and interest were erroneously assessed and collected because it was based upon the IRS' erroneous disallowance of deductions claimed in 1996 and 1997 of \$96,000 and \$114,240 respectively, for group supplemental insurance coverage. The IRS also erroneously disallowed a net operating loss deduction of \$7,423.

Line 1

Thomas W. Pettinger ("Pettinger"), is a physician specializing in radiology. His practice is conducted through a personal service corporation, Range and River Radiology, P.C. ("Range & River"). Pettinger is an employee of Range & River.

Pettinger is a member of xélan, the Economic Association of Health Professionals, Inc. This organization, together with various other entities commonly called the "xélan family of companies" ("xélan"), provides advisory, educational, and administrative services for doctors, dentists, and their families and employees. These services include making available insurance programs of particular interest to health care professionals. xélan has been assisting doctors and dentists in meeting their financial, investment, and insurance needs for over 30 years.

Prior to the 1990s, xélan routinely arranged for disability insurance policies on its members. These policies were sold by various independent insurance companies.

They provided benefits in the event of a member's disability equal to a percentage of his earnings. Many policies also contained a premium refund feature, which provided the potential for refund of premiums paid over a period of time, depending on the retrospectively-rated experience of the insured and the insurance company.

In the early and mid 1990s, xélan members were faced with a cutback in available disability insurance coverage. For highly productive doctors and dentists, their annual net practice income could not be adequately protected by the coverage offered through the available policies of commercial insurance companies. Moreover, "own occupation" type coverage for specialists (which provides payments in the event that the insured become unable to perform their particular specialty rather than unable to perform "any occupation") had been curtailed even further. In response to this situation, xélan developed the Supplemental Disability Insurance Program.

Pettinger has been a participant in the program since 1996. He was then in his early 30s, and was generating substantial income from his practice. Because of the caps on maximum monthly benefits, commercially available disability policies would replace only a relatively small percentage of his expected income in the event of a disability.

By joining xélan, Pettinger became eligible to participate in the Supplemental Disability Insurance Program. Significant aspects of the program were as follows:

1. xélan Group Disability Trust ("the Trust") was formed to obtain and maintain a group supplemental disability policy ("the Policy") for the benefit of xélan members;
2. The Policy was obtained from the xélan Insurance Company Ltd. ("the Insurance Company"), a licensed British Virgin Islands insurance company;
3. The Policy provided the following benefits:
  - a. Own Occupation Disability. A member is considered eligible for this benefit, if he or she is not able to perform the duties of his or her regular occupation or specialty for a full forty-hours per week, at least fifty weeks a year. The condition must have existed for at least 120 consecutive days, and the member must be less than seventy-six years of age.
  - b. Any Occupation Disability. A member is eligible if he or she cannot perform the duties of any occupation for any period of time, when he or she is less than sixty-five years of age.
  - c. Experience Refund. A member's premium payor is eligible for a refund after premiums have been paid for the member's insurance for a seven-year period (for members 62 or older, premiums must be paid for at least three-years).
4. Other material provisions of the Policy include the following:
  - a. Amount of disability benefits. The "own occupation" benefit is the greater of 110% of premiums paid for the coverage, or the amount



shown in the member's experience adjusted account. The experience adjusted account reflects a percentage of premiums paid on behalf of the insured,<sup>1</sup> the claims experience of all of the insured members, the investment experience of the insurance company, and forfeitures of other members' benefits. The "any occupation" benefit is the greater of 144% of premiums paid, or the experience adjusted account<sup>2</sup>.

- b. Amount of experience refund. The experience refund is based upon the member's experience adjusted account.
- c. Premiums. Premiums are variable, depending upon the amount of coverage provided the insured, with a minimum of \$4,000 annually, and a maximum of the member's established net practice income. Contributions on behalf of the members are made to the trust. The entire amounts of the contributions are paid to the insurance company as premiums for the group coverage.
- d. Forfeitures. Failure to pay at least the minimum annual premium for a member causes forfeiture of that member's benefits. A forfeited benefit of that one member increases the benefits available to all remaining members.
- e. Reserves. All premiums go into insurance company reserve accounts. Actual insurance company expenses are deducted from the reserves. The percentage that is not allocated to the experience adjusted accounts represents estimates of these expenses, including monies that will be necessary to provide capital and surplus for the insurance company, and to pay claims. All reserves are available to pay claims.
- f. Coverage. Coverage was renewable (guaranteed), subject to the insurance company's right to increase premium rates uniformly for all insured based upon experience.

#### The Tax Returns

On the Federal Income Tax returns filed by Pettinger and his wife for 1996 and 1997, they excluded from gross income contributions made by Range & River for the supplemental disability coverage pursuant to § 106 of the Internal Revenue Code of 1986 ("the Code").

#### The Notice of Deficiency

The IRS disallowed \$96,000 and \$114,240 respectively, of the amounts claimed as deductions on Range & River's 1996 and 1997 tax returns with respect to contributions made to the trust "because it has not been established that any of the amounts was for ordinary and necessary business expenses, was expended for the purposes designated, or that any of these amounts met the requirements of § 162 of [the Code]." The

<sup>1</sup> Initially, the percentage was 96%. It was amended retroactively to 94% in 2001

<sup>2</sup> This amount was retroactively amended to 400% in 2001

disallowance of the deductions for 1996 resulted in the disallowance of the net operating loss deduction carried from 1996 to 1997, which was not allowed for "because it has not been established that any amount of deductible loss was sustained in 1996."

The IRS determined the payments were made to Pettinger or for his benefit, and that the payments constitute dividend income under §§ 301 and 316 of the Code, and are includable in Pettinger's gross income in the amounts of \$96,000 and \$114,240 for 1996 and 1997, respectively.

#### Grounds Relied Upon by the Taxpayer

The amounts paid by Range & River to the Trust constitute insurance premiums. They are deductible as ordinary and necessary business expenses under § 162 of the Code and Treasury Regulations § 1.162-1(a). They are excludable from Pettinger's gross income under § 106 of the Code and Treasury Regulations § 1.106-1.

Contrary to the IRS's assertion that it has not been demonstrated that the payments in question were "expended for the purposes designated," the payments, in fact, were made to the insurance company as premiums on a group supplemental disability policy providing the benefits to xélan members in the event of their disability. The amounts were maintained by the insurance company as invested reserves, and used by the company to pay operating expenses and benefit claims.

Neither the Code nor the Treasury Regulations define the term "insurance;" however, court cases and IRS rulings dealing with the issue as to what constitutes "insurance," establish that the arrangement with the Insurance Company, the Trust, xélan members, and premium payors constitutes the payment of premiums for insurance, qualifying under the Code for the tax treatment claimed on the returns.

In *Helvering v. LeGlerse*, 312 U.S. 531, 539 (1941), the court held that "historically and commonly insurance involves risk shifting and risk distributing." Risk shifting occurs where a person with an identifiable possibility of economic loss transfers some or all of the financial consequences of the loss to the insurer. The focus is upon the insured and the insurer. See *Humana Inc., v. Commissioner*, 881 F.2d 247 (6<sup>th</sup> Cir. 1989).

Risk distribution involves shifting to a group the identifiable risk of a particular person. The focus is broader than risk shifting, and looks more to the insurer to determine whether the risk insured against can be distributed over a larger group. Risk distribution brings in to play the "law of large numbers," reducing the risk that a single costly claim will exceed the amount taken in as premiums and set aside as payment for the claim. See *Humana, supra*; *Clougherty Packing Company v. Commissioner*, 811 F.2d 1297, 1300 (9<sup>th</sup> Cir. 1987).

In the case of the xélan Supplemental Disability Program ("the Disability Program"), there is risk shifting. xélan members have an identifiable risk of lost earnings

due to their reduced capacity to work. That risk is transferred to the insurance company. If the insured becomes disabled and remains disabled, the benefits to him or her will exceed the premiums paid. The insurance company has set aside statutory reserves actuarially determined to cover claims, and therefore has the financial capacity to accept the risk of loss.

There is also risk distribution. The total of the premiums collected from each member is available to pay any other insured member's benefits. It has been actuarially confirmed that the xelan policy provides pooling of risk, since the policy has a sufficient number of exposures for the law of averages to take effect, the group of insureds is a homogeneous population, and there is a statistical independence between the potential disability events insured.

The Disability Program provides benefits in the event of a member's complete or partial disability. Additionally, after seven years of participation, or upon reaching a specific age, the program provides a potential for the participant to obtain a retrospectively rated refund. The refund is dependent upon the amount of premiums paid on behalf of the member, the investment experience of the insurance company's reserves, any forfeiture of other participants' past contributions, and claims filed by other participants.

It is a common and accepted practice in the insurance industry for insurance policies to contain a premium refund feature. The IRS has admitted that a premium refund feature does not disqualify an arrangement that otherwise is treated as insurance for tax purposes from being so treated.

In this respect, twenty-years ago the IRS ruled favorably for the taxpayer with respect to a program that provided medical malpractice liability coverage, where the policy involved provided for a refund of premium after five years of participation. Rev. Rul. 83-66, 1983-1C.B.43. There, as here, doctors were members of a medical association, which purchased group insurance for the doctors' benefit. The doctors could obtain a refund of a portion of the premiums paid on their behalf, dependent upon the loss experience of the group as a whole. Premiums paid became part of the insurance company's reserves, although separate records were maintained for each insured for purposes of determining their pro rata share of any refund. The IRS ruled that, despite the refund feature, the premiums paid qualified as ordinary and necessary business expenses under § 162 of the Code. The IRS is bound by its own Revenue Ruling, and the Ruling may be relied upon by others, including *Pettinger. Rauenhorst v. Commissioner*, 119 T.C. 157, 173 (2002).

The IRS has, in fact, treated premiums paid to the xelan insurance company for the group's supplemental disability coverage as insurance. In this respect, § 4374 of the Code imposes an excise tax upon the payment of premiums on insurance by U.S. persons to a foreign insurance company. The xelan Insurance Company (Doctor's Benefit) has paid these excise taxes on the premiums paid to it for the supplemental disability policy, and the payments have been accepted and the taxes assessed. Principles of estoppel and the

duty of consistency preclude the IRS from taking the inconsistent position in the cases of Range & River and Pettinger that the xelan disability program does not constitute insurance, and that the amounts paid by Range & River constitute constructive dividends to Pettinger. *Alamo Nat. Bank of San Antonio v. Commissioner*, 95 F.2d 622 (5<sup>th</sup> Cir. 1938); *Orange Securities Corp. v. Commissioner*, 131 F 2d 662 (5<sup>th</sup> Cir. 1942).

Premiums paid by Range & River were not in fact constructive dividends to Pettinger, as the IRS has determined. They are not includable in gross income. They are specifically excluded from Pettinger's gross income under § 106 of the Code.

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OGDEN UT 84201-0038

RANGE & RIVER RADIOLOGY P C  
PETTINGER THOMAS W  
63 SAGE CREEK RD  
CODY WY 82414-967263B

CUT OUT AND RETURN THE VOUCHER AT THE BOTTOM OF THIS PAGE IF YOU ARE MAKING A PAYMENT,  
EVEN IF YOU ALSO HAVE AN INQUIRY.

The IRS address must appear in the window.

Use for payments

80DCD-SB

0441406B20

Letter Number: LTR0105C  
Letter Date : 2004-03-01  
Tax Period : 199712



\*830315035\*

INTERNAL REVENUE SERVICE  
OGDEN UT 84201-0038

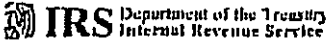


RANGE & RIVER RADIOLOGY P C  
PETTINGER THOMAS W  
63 SAGE CREEK RD  
CODY WY 82414-967263B

830315035 SH

02 2 199712 000 0000000000000000

EXHIBIT 11 - pg 105



OGDEN UT 84201-0038

In reply refer to: 0441406820  
Mar. 01, 2004 LTR 105C  
83-0315035 199712 02 000 1  
00900

BODC: SB

RANGE & RIVER RADIOLOGY P C  
PETTINGER THOMAS W  
% DARRELL D HALLETT ATTY  
1011 WESTERN AVE STE 803  
SEATTLE WA 98101

CERTIFIED MAIL

Taxpayer Identification Number: 83-0315035  
Kind of Tax: Form 1120X Corporate  
Amount of Claim(s): \$ 27,189.00

Date Claim(s) Received: Jan. 22, 2004  
Tax Period(s): Dec. 31, 1997

Dear Taxpayer:

This letter is your legal notice that we have disallowed your claim(s). We can't allow your claim(s) for refund or credit for the period(s) shown above for the reason(s) listed below.

The claim has been to appeals, and they upheld the tax. You have not provided any new information.

If you have any questions, please call us toll free at 1-800-829-0115.

If you prefer, you may write to us at the address shown at the top of the first page of this letter.

Whenever you write, please include this letter and, in the spaces below, give us your telephone number with the hours we can reach you. Also, you may want to keep a copy of this letter for your records.

Telephone Number ( ) \_\_\_\_\_ Hours \_\_\_\_\_

▶ See separate instructions.

This return is for calendar year ▶ 1996, or fiscal year ended ▶

Please print or type	Your first name and initial <b>THOMAS W.</b>	Last name <b>PETTINGER</b>	Your social security number <b>466 ; 27 ; 7529</b>
	If a joint return, spouse's first name and initial <b>LAURIE D.</b>	Last name <b>PETTINGER</b>	Spouse's social security number <b>204 ; 56 ; 0087</b>
	Home address (no. and street) or P O box if mail is not delivered to your home <b>63 SAGE CREEK RD</b>	Apt no	Phone number ( )
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 2 of the instructions <b>CODY, WY 82414-9572</b>		For Paperwork Reduction Act Notice, see page 5.

- A If the name or address shown above is different from that shown on the original return, check here . . . . .
- B Has the original return been changed or audited by the IRS or have you been notified that it will be? . . . . .  Yes  No
- C Filing status. Be sure to complete this line. Note. You cannot change from joint to separate returns after the due date.  
 On original return ▶  Single  Married filing jointly  Married filing separately  Head of household  Qualifying widow(er)  
 On this return ▶  Single  Married filing jointly  Married filing separately  Head of household\*  Qualifying widow(er)  
 \* If the qualifying person is a child but not your dependent, see page 2.

Use Part II on the back to explain any changes

		A. Original amount or as previously adjusted (see page 2)	B. Net change—amount of increase or (decrease)—explain in Part II	C. Correct amount
<b>Income and Deductions (see pages 2-6)</b>				
	1 Adjusted gross income (see page 3)	1 390,709	(96,000)	294,709
	2 Itemized deductions or standard deduction (see page 3)	2 6,700		6,700
	3 Subtract line 2 from line 1	3 384,009	(96,000)	288,009
	4 Exemptions. If changing, fill in Parts I and II on the back	4	612	612
	5 Taxable income. Subtract line 4 from line 3	5 384,009	(96,612)	287,397
Tax Liability	6 Tax (see page 4). Method used in col. C.	6 127,068	(38,259)	88,809
	7 Credits (see page 4)	7		
	8 Subtract line 7 from line 6. Enter the result but not less than zero	8 127,068		88,809
	9 Other taxes (see page 4)	9		
	10 Total tax. Add lines 8 and 9	10 127,068		88,809
Payments	11 Federal income tax withheld and excess social security and tier 1 RRTA tax withheld. If changing, see page 4	11 80,916		80,916
	12 Estimated tax payments, including amount applied from prior year's return	12		
	13 Earned income credit (EIC)	13		
	14 Additional child tax credit from Form 8812	14		
	15 Credits from Form 2439, Form 4136, or Form 8885	15		
	16 Amount paid with request for extension of time to file (see page 4)	16		
	17 Amount of tax paid with original return plus additional tax paid after it was filed	17 46,152		
	18 Total payments. Add lines 11 through 17 in column C	18 127,068		
<b>Refund or Amount You Owe</b>				
	19 Overpayment, if any, as shown on original return or as previously adjusted by the IRS	19 0		
	20 Subtract line 19 from line 18 (see page 5)	20 127,068		
	21 Amount you owe. If line 10, column C, is more than line 20, enter the difference and see page 5	21		
	22 If line 10, column C, is less than line 20, enter the difference	22 38,259		
	23 Amount of line 22 you want refunded to you	23 38,259		
	24 Amount of line 22 you want applied to your estimated tax	24		

**Sign Here**

Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and in the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which the preparer has any knowledge.

Joint return? See page 2. Keep a copy for your records.	Your signature	Date	Spouse's signature. If a joint return, both must sign.	Date
	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Paid Preparer's Use Only	Firm's name (or yours if self-employed), address, and ZIP code	EIN	Phone no. ( )	

**Part I Exemptions.** See Form 1040 or 1040A instructions.

If you are not changing your exemptions, do not complete this part  
 If claiming more exemptions, complete lines 25-31.  
 If claiming fewer exemptions, complete lines 25-30

	A. Original number of exemptions reported or as previously adjusted	B. Net change	C. Correct number of exemptions
25 Yourself and spouse <i>Caution. If your parents (or someone else) can claim you as a dependent (even if they chose not to), you cannot claim an exemption for yourself.</i>	25		
26 Your dependent children who lived with you	26		
27 Your dependent children who did not live with you due to divorce or separation	27		
28 Other dependents	28		
29 Total number of exemptions. Add lines 25 through 28	29		
30 Multiply the number of exemptions claimed on line 29 by the amount listed below for the tax year you are amending. Enter the result here and on line 4. <i>But see the instructions for line 4 on page 3 if the amount on line 1 is over:</i>	30		

Tax year	Exemption amount	But see the instructions for line 4 on page 3 if the amount on line 1 is over:
2003	\$3,050	\$104,625
2002	3,000	103,000
2001	2,900	99,725
2000	2,800	96,700

31 Dependents (children and other) not claimed on original (or adjusted) return:

(a) First name	Last name	(b) Dependent's social security number	(c) Dependent's relationship to you	(d) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 5)	No. of your children on line 31 who:
				<input type="checkbox"/>	• lived with you <input type="checkbox"/>
				<input type="checkbox"/>	• did not live with you due to divorce or separation (see page 5) <input type="checkbox"/>
				<input type="checkbox"/>	Dependents on line 31 not entered above <input type="checkbox"/>

**Part II Explanation of Changes to Income, Deductions, and Credits**

Enter the line number from the front of the form for each item you are changing and give the reason for each change. Attach only the supporting forms and schedules for the items changed. If you do not attach the required information, your Form 1040X may be returned. Be sure to include your name and social security number on any attachments.

If the change relates to a net operating loss carryback or a general business credit carryback, attach the schedule or form that shows the year in which the loss or credit occurred. See page 2 of the instructions. Also, check here

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**Part III Presidential Election Campaign Fund.** Checking below will not increase your tax or reduce your refund.

If you did not previously want \$3 to go to the fund but now want to, check here

If a joint return and your spouse did not previously want \$3 to go to the fund but now wants to, check here



This return is for calendar year ▶ 1997, or fiscal year ended ▶

Please print or type	Your first name and initial <b>THOMAS W.</b>	Last name <b>PETTINGER</b>	Your social security number <b>466 ; 27 ; 7529</b>
	If a joint return, spouse's first name and initial <b>LAURIE D.</b>	Last name <b>PETTINGER</b>	Spouse's social security number <b>204 ; 56 ; 0087</b>
	Home address (no. and street) or P.O. box if mail is not delivered to your home <b>63 SAGE CREEK RD</b>	Apt. no.	Phone number ( )
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 2 of the instructions <b>CODY, WY 82414-9672</b>		For Paperwork Reduction Act Notice, see page 6.

- A** If the name or address shown above is different from that shown on the original return, check here  **B** Has the original return been changed or audited by the IRS or have you been notified that it will be?  Yes  No
- C** Filing status. Be sure to complete this line. Note. You cannot change from joint to separate returns after the due date.  
 On original return ▶  Single  Married filing jointly  Married filing separately  Head of household  Qualifying widow(er)  
 On this return ▶  Single  Married filing jointly  Married filing separately  Head of household\*  Qualifying widow(er)  
 \* If the qualifying person is a child but not your dependent, see page 2.

Use Part II on the back to explain any changes		A. Original amount or as previously adjusted (see page 2)	B. Net change—amount of increase or (decrease)—explain in Part II	C. Correct amount
<b>Income and Deductions (see pages 2-6)</b>				
	1 Adjusted gross income (see page 3)	476,544	(114,240)	382,304
	2 Itemized deductions or standard deduction (see page 3)	6,900		6,900
	3 Subtract line 2 from line 1	469,644	(114,240)	355,404
	4 Exemptions. If changing, fill in Parts I and II on the back			
	5 Taxable income. Subtract line 4 from line 3	469,644	(114,240)	355,404
Tax Liability	6 Tax (see page 4). Method used in col. C	160,290	(45,254)	115,036
	7 Credits (see page 4)			
	8 Subtract line 7 from line 6. Enter the result but not less than zero	160,290		115,036
	9 Other taxes (see page 4)			
	10 Total tax. Add lines 8 and 9	160,290		115,036
Payments	11 Federal income tax withheld and excess social security and tier 1 RRTA tax withheld. If changing, see page 4	102,615		102,615
	12 Estimated tax payments, including amount applied from prior year's return			
	13 Earned income credit (EIC)			
	14 Additional child tax credit from Form 8812			
	15 Credits from Form 2439, Form 4136, or Form 8885			
	16 Amount paid with request for extension of time to file (see page 4)			
	17 Amount of tax paid with original return plus additional tax paid after it was filed			57,675
	18 Total payments. Add lines 11 through 17 in column C			160,290
<b>Refund or Amount You Owe</b>				
	19 Overpayment, if any, as shown on original return or as previously adjusted by the IRS			0
	20 Subtract line 19 from line 18 (see page 5)			160,290
	21 Amount you owe. If line 10, column C, is more than line 20, enter the difference and see page 5			
	22 If line 10, column C, is less than line 20, enter the difference			45,254
	23 Amount of line 22 you want refunded to you			45,254
	24 Amount of line 22 you want applied to your estimated tax			

**Sign Here** Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which the preparer has any knowledge.

Joint return? See page 2. Keep a copy for your records.	Your signature	Date	Spouse's signature. If a joint return, both must sign.	Date
	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Paid Preparer's Use Only	Firm's name (or yours if self-employed), address, and ZIP code	EIN	Phone no. ( )	

**Part I Exemptions.** See Form 1040 or 1040A instructions.

If you are not changing your exemptions, do not complete this part.  
 If claiming more exemptions, complete lines 25-31.  
 If claiming fewer exemptions, complete lines 25-30

	A. Original number of exemptions reported or as previously adjusted	B. Net change	C. Correct number of exemptions
<b>25</b> Yourself and spouse <i>Caution.</i> If your parents (or someone else) can claim you as a dependent (even if they chose not to), you cannot claim an exemption for yourself	25		
<b>26</b> Your dependent children who lived with you	26		
<b>27</b> Your dependent children who did not live with you due to divorce or separation	27		
<b>28</b> Other dependents	28		
<b>29</b> Total number of exemptions. Add lines 25 through 28	29		
<b>30</b> Multiply the number of exemptions claimed on line 29 by the amount listed below for the tax year you are amending. Enter the result here and on line 4 But see the instructions for line 4 on page 3 if the amount on line 1 is over:	30		

Tax year	Exemption amount	But see the instructions for line 4 on page 3 if the amount on line 1 is over:
2003	\$3,050	\$104,625
2002	3,000	103,000
2001	2,900	99,725
2000	2,900	96,700

**31 Dependents (children and other) not claimed on original (or adjusted) return:**

(a) First name	Last name	(b) Dependent's social security number	(c) Dependent's relationship to you	(d) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 5)	No. of your children on line 31 who:
				<input type="checkbox"/>	• lived with you <input type="checkbox"/>
				<input type="checkbox"/>	• did not live with you due to divorce or separation (see page 5) <input type="checkbox"/>
				<input type="checkbox"/>	Dependents on line 31 not entered above <input type="checkbox"/>

**Part II Explanation of Changes to Income, Deductions, and Credits**

Enter the line number from the front of the form for each item you are changing and give the reason for each change. Attach only the supporting forms and schedules for the items changed. If you do not attach the required information, your Form 1040X may be returned. Be sure to include your name and social security number on any attachments.

If the change relates to a net operating loss carryback or a general business credit carryback, attach the schedule or form that shows the year in which the loss or credit occurred. See page 2 of the instructions. Also, check here

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**Part III Presidential Election Campaign Fund.** Checking below will not increase your tax or reduce your refund.

If you did not previously want \$3 to go to the fund but now want to, check here   
 If a joint return and your spouse did not previously want \$3 to go to the fund but now wants to, check here





OGDEN UT 84201-0049

THOMAS W & LAURIE D PETTINGER  
63 SAGE CREEK RD  
CODY WY 82414-9672638

CUT OUT AND RETURN THE VOUCHER AT THE BOTTOM OF THIS PAGE IF YOU ARE MAKING A PAYMENT,  
EVEN IF YOU ALSO HAVE AN INQUIRY.

The IRS address must appear in the window.

Use for payments

80DCB-SB

0461320110

Letter Number: LTRD105C  
Letter Date : 2004-05-07  
Tax Period : 199612



\*466277529\*

THOMAS W & LAURIE D PETTINGER  
63 SAGE CREEK RD  
CODY WY 82414-9672638

INTERNAL REVENUE SERVICE  
OGDEN UT 84201-0049



6277529 BX

30 0 199612 000 0000000000000000

EXHIBIT 11 - pg 111

OGDEN UT 84201-0049

In reply refer to: 0461320110  
May 07, 2004 LTR 105C  
466-27-7529 199612 30 000 1

10442  
IRS  
Calk

01619

BODC: SB

**RECEIVED**  
MAY 10 2004

CHICOINE & HALLETT

THOMAS W & LAURIE D PETTINGER  
% DARRELL D HALLETT ATTY  
1011 WESTERN AVE STE 803  
SEATTLE WA 98104-1083

**CERTIFIED MAIL**

Taxpayer Identification Number: 466-27-7529  
Kind of Tax: Income  
Amount of Claim(s): \$ 38,259.00 45,254.00  
Date Claim(s) Received: Jan. 26, 2004  
Tax Period(s): Dec. 31, 1996 Dec. 31, 1997

Dear Taxpayer:

This letter is your legal notice that we have disallowed your claim(s). We can't allow your claim(s) for refund or credit for the period(s) shown above for the reason(s) listed below.

To appeal your claim you need to be prepared to provide the documentation to back up the changes you are making on your return.

If you want to appeal our decision to disallow your claim, you must provide a brief written statement of the issues you don't agree with. The facts contained in the written statement should be detailed and complete, including names, amounts, locations, etc.

You should include the following:

1. A statement that you want to appeal the disallowance.
2. Your name, address, and a telephone number where you can be contacted during the day.
3. A statement of facts supporting your reasons for disputing the disallowance.
4. A statement outlining the law or other authority that supports your claim.

You must declare that the statement of facts is true under penalties of perjury. You may do this by adding the following statement and signing it:

"Under penalties of perjury, I declare that the facts

0461320110  
May 07, 2004 LTR 105C  
466-27-7529 199612 30 000 1  
01621

THOMAS W & LAURIE D PETTINGER  
% DARRELL D HALLETT ATTY  
1011 WESTERN AVE STE 803  
SEATTLE WA 98104-1083

Sincerely yours,

*Thomas D Mathews*

Thomas D. Mathews  
Field Dir., Compliance Svcs.

Enclosure(s):  
Publication 1