

Section 1297(b)(2)(B) provides an exception to passive income for any income derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business and which would be subject to tax under subchapter L if it were a domestic corporation (the insurance income exception). If FC would not be subject to tax under subchapter L if it were a domestic corporation (for the reasons discussed above), then the insurance income exception to passive income will not apply, and FC will be subject to the general income and assets tests described above. Additionally, even if FC would be subject to tax under subchapter L if it were a domestic corporation, the insurance income exception may not apply to FC because this exception is applicable only to income derived in the *active* conduct of an insurance business.

The Service will scrutinize these arrangements and will apply the PFIC rules where it determines that FC is not an insurance company for federal tax purposes.

#### IV. DRAFTING INFORMATION

The principal authors of this notice are John Glover of the Office of Associate Chief Counsel (Financial Institutions & Products) and Theodore Setzer of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Glover at (202) 622-3970 or Mr. Setzer at (202) 622-3870 (not a toll-free call).

### Organizations Exempt Under Section 501(c)(15)

#### Notice 2003-35

The purpose of this notice is to remind taxpayers that an entity must be an insurance company for federal income tax purposes in order to qualify as exempt from federal income tax as an organization described in § 501(c)(15) of the Internal Revenue Code.

Section 501(a) provides that an organization described in § 501(c) shall be exempt from federal income tax. Section 501(c)(15) provides that an insurance company (other than a life insurance company) is tax-exempt if its net written premiums (or, if greater, direct written premiums) for

the taxable year do not exceed \$350,000. For purposes of this annual test, the company is treated as receiving during the taxable year premiums received during the same year by all other companies within the same controlled group, as defined in § 831(b)(2)(B)(ii).

For an entity to qualify as an insurance company, it must issue insurance contracts or reinsure risks underwritten by insurance companies as its primary and predominant business activity during the taxable year. For a discussion of the analysis applicable to evaluating whether an entity qualifies as an insurance company, see Notice 2003-34, 2003-23 I.R.B. 990 (June 9, 2003) and Notice 2002-70, 2002-44 I.R.B. 765 (November 4, 2002).

The Service is scrutinizing the tax-exempt status of entities claiming to be described in § 501(c)(15) and will challenge the exemption of any entity that does not qualify as an insurance company. The Service will challenge the exemption of the entity, regardless of whether the exemption is claimed pursuant to an existing determination letter or on a return filed with the Service.

Taxpayers claiming exemption pursuant to § 501(c)(15) should also consider whether they are engaged in arrangements described in Notice 2002-70 or substantially similar thereto.

#### DRAFTING INFORMATION

The principal author of this notice is Lee T. Phaup, TE/GE Division, Exempt Organizations. For further information concerning this notice, contact Ms. Phaup at (202) 283-8935 (not a toll-free call).

### Simplified Service Cost Method; Simplified Production Method

#### Notice 2003-36

##### PURPOSE

The Treasury Department and the Internal Revenue Service have become aware that uncertainty exists as to what types of property constitute “eligible property” under §§ 1.263A-1(h)(2)(i)(D) and 1.263A-2(b)(2)(i)(D) of the Income Tax Regulations for purposes of qualifying taxpayers to use the simplified service cost and the simpli-

fied production methods. These sections provide that self-constructed assets produced by the taxpayer on a routine and repetitive basis in the ordinary course of the taxpayer’s trade or business are “eligible property.” There is uncertainty about the proper interpretation and application of the term “routine and repetitive.” Accordingly, the Treasury Department and the Service plan to publish guidance that will clarify the types of property that qualify as eligible property under §§ 1.263A-1(h)(2)(i)(D) and 1.263A-2(b)(2)(i)(D) and, in particular, that will address the interpretation and application of the term “routine and repetitive.” This notice requests comments in connection with the guidance and informs taxpayers of the procedures that the Service will follow in the interim with respect to applications for consent to change to the simplified service cost or simplified production methods for self-constructed assets under §§ 1.263A-1(h)(2)(i)(D) and 1.263A-1(b)(2)(i)(D).

#### BACKGROUND

Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-35 I.R.B. 432, provides procedures by which taxpayers may obtain automatic consent to change to the methods of accounting described in the Appendix of the revenue procedure. Section 4.01(1)(a)(vi) of the Appendix of Rev. Proc. 2002-9 permits certain resellers to use the automatic consent procedures to change from a non-UNICAP method to a UNICAP method specifically described in the regulations. Section 4.02 of the Appendix of Rev. Proc. 2002-9 permits producers of real or tangible personal property to use the automatic consent procedures to change to a UNICAP method specifically described in the regulations. For this purpose, the simplified production method and the simplified service cost method are UNICAP methods specifically described in the regulations. See sections 4.01(2)(g) and 4.02(3) of the Appendix of Rev. Proc. 2002-9.

#### INTERIM PROCEDURES FOR ACCOUNTING METHOD CHANGE APPLICATIONS

Pending the issuance of further guidance, the following procedures will apply