

# Is the New Form 1023EZ Too Easy? Part I - Introduction

09.10.14 | Linda J. Rosenthal, JD



Unless your organization is fairly new, you may not be aware that the IRS Exempt Organizations Division has been grappling with a huge problem.

No. Not the one about the lost emails and Congressional subpoenas and social welfare organizations' political activities.

This one's about the absurdly long time it's been taking for the beleaguered agency to approve Section 501(c)(3) tax exemptions. For several years, the Internal Revenue Service has been deluged with a flood of new applications. At the same time, the budget had been slashed. More work and fewer people to do it: The approval process sputtered and stalled to the point where a 12- to 18-month timeframe was not uncommon along with a backlog of over 60,000 applications.

Combine this quagmire with the complexity of the Form 1023, Application for Recognition of Exemption. Over the years, it had ballooned into a behemoth well beyond the comprehension of most ordinary mortals.

Some serious action was needed.

## ***The Proposed Fix: Make it Simpler for Some***

IRS officials decided on a dramatic move for small applicants seeking uncomplicated and noncontroversial approvals. First, toss out the requirement of dealing with a 26-page monster form. Second, create a streamlined form and process.

In 2012, a solution like this had been proposed, but not adopted.

By 2014, what had been an unfortunate backlog had turned into a crisis. So the IRS decided to push ahead with the short-form alternative. The agency published drafts of a proposed 3-page, Form 1023-EZ, “Streamlined Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code,” and requested public comments.

The public were not impressed.

Criticism of this proposed fix poured in from almost every quarter: nonprofit organizations, lawyers and accountants, state regulators, academics and commentators, consultants serving this sector, board members, and donors. It was panned from all directions.

### ***Concerns Raised***

Here’s why.

Under the existing Form 1023, applicants submit certified copies of organizing documents, and describe in detail proposed purposes, operations, and activities. It’s a front-end, comprehensive review by the IRS before the agency issues the official approval; that is, the coveted “determination letter.”

With the Form 1023-EZ, the entire process is turned on its head. The applicant does not submit the documents. It merely attests, under penalty of perjury, that it will meet the requirements for exemption under Section 501(c)(3) of the Internal Revenue Code; namely, that it will be “organized exclusively for charitable purposes,” and will eventually adopt and file acceptable governing documents.

The applicant also affirms — in conclusory terms only, and with little detail — that it will be operated “exclusively for charitable purposes,” and that it will not violate any of the rules like the absolute prohibition on political activities or the ban on excessive lobbying.

The plan is that, after about a year or so, the IRS will evaluate the newly minted organization to verify that it is actually qualified for this valuable tax-exempt status, and that it is operating in the manner represented in the Form 1023-EZ.

In a small sample of cases, the IRS will do a more in-depth review at the time the Form 1023-EZ is first filed.

### ***Launch in July 2014***

Even the feds realized it wasn’t a great proposal. Nevertheless, with a few modifications based on public comments, on July 2, 2014 – effective immediately – they launched the brand-new Form 1023-EZ .

According to government promises and predictions, determination letters — that is, tax exemption approvals — would be flying out of the Cincinnati field office (that is the hub of the exempt organizations operations) in as few as 2 to 4 weeks, and at half the cost (i.e., the user fee) for the standard Form 1023.

### ***Mixed Bag of Good and Bad News***

The new Form 1023-EZ is a mixed bag of good news and bad news for the affected constituencies.

For the startup nonprofits needing a tax exemption, this new procedure is expected to be quite popular.

For commentators and observers of the charitable sector – who generally agree with the Exempt Organizations Division that some creative and immediate modifications to the exemption application process are long overdue – they have legitimate worries. The key concern is that the introduction of the Form 1023-EZ will open the door to quick and easy tax exemptions for unscrupulous groups and people intent on making use of the system for their own benefit or to scam the public.

These experts also worry that the simplicity of the new procedure and the lack of front-end involvement and oversight by regulators may be a “trap for the unwary.” They fear that innocent and good-faith actors will, inadvertently run afoul of the law and eventually face serious consequences, sanctions, and penalties.

### ***Summary of Possible Disadvantages***

Critics pinpoint many open questions and as well as foreseeable downsides to the proposed change. For example:

- Will an upfront, expedited approval based on mere attestations by the organization and its key people be firm enough for grantmakers and other donors to safely rely on it and give money?
- Will the person completing and signing the Form 1023-EZ – under penalty of perjury – realistically face any liability for attestations and other information that later turns out to be inaccurate or incomplete?
- Will the quick application and approval with little or no involvement by IRS determinations specialists mean that a new organization skips and doesn't have the benefit of an in-depth planning phase?

### ***Conclusion***

Stay tuned.

In the next few blog posts, we'll discuss some of these issues.

— Linda J. Rosenthal, J.D., FPLG Information & Research Director