

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 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 has 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.

The Proposed Fix: Make it Simpler for Some

Some serious action was needed. IRS officials decided on a dramatic move: for small applicants seeking uncomplicated and noncontroversial approvals, scrap the the requirement of the 26-page monster Form 1023. Substitute a streamlined form and process.

A solution like this had been proposed, but not adopted, in 2012.

By 2014, what had been a crisis had turned into a quagmire. So the IRS decided to push ahead with the short-form alternative. The agency published drafts of a proposed 3-page, Form 1023EZ, "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, donors – it was panned from all sides.

Here’s why.

The process is turned on its head. Under the standard 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 official approval – the coveted “determination letter” – is issued.

With the Form 1023-EZ, 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; that is, 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.

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 when the Form 1023-EZ is first filed.

New Form 1023-EZ Launched in July 2014

Even the feds realized it wasn’t a great proposal. Nevertheless, with a few modifications based on public comments, the proposed Form 1023-EZ was adopted and launched on July 2, 2014, effective immediately.

According to government promises and predictions, determination letters – that is, tax exemption approvals – will 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 (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.

Regulators and other commentators and observers of the charitable sector agree with the Exempt Organizations Division that some creative and immediate modifications to the exemption application process are long overdue. But they have legitimate concerns 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.

For the startup nonprofit needing a tax exemption, this isn't a matter of policy and what will be good for the charitable sector and the general public as a whole. A newly formed organization — if it qualifies under the eligibility requirements — will like the pros of this new, simple procedure (speed and cost-savings) but will want to know about and consider the possible downsides to going his route.

In a nutshell, the possible disadvantages include:

- 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?

Stay tuned. In the next blog posts, we discuss these issues.