

# Nonprofits to Congress: Ditch Form 1023-EZ

05.17.18 | Linda J. Rosenthal, JD



In March and April 2018, the House of Representatives [took up and passed legislation](#), the Taxpayer First Act, H.R. 5443, to modernize certain aspects of the IRS's operations. Included in this bill is a provision for mandatory electronic filing of the information returns of exempt organizations.

During the regular period for public comment, nonprofit leaders expressed support for the electronic-filing aspect of the proposed law. They also took the opportunity to change the topic and sneak in an entirely different request: They urged Congress to eliminate the Form 1023-EZ and start over.

With a big helping of “we told you so,” major philanthropic and regulatory voices made a strong showing that the Form 1023-EZ is an experiment that has failed, and continuing its use is unwarranted and unwise.

### *The Taxpayer First Act*

In March 2018, the chair and the ranking member of the House Ways and Means Oversight Subcommittee released a [discussion draft](#) of the proposed Taxpayer First Act to “improve Internal Revenue Service (IRS) operations and our system of tax administration.” One of the many provisions is a requirement that all tax-exempt organizations file their Form 990s electronically. Under current law, only exempt organizations with assets over \$10 million must file electronically. The proposed bill includes a transition period for smaller nonprofits. Currently, about [60% of nonprofits file](#) their Form 990s electronically.

There is a [consensus in the nonprofit sector](#) in favor of “...expanding electronic-filing and providing more complete, searchable information on the nonprofit sector” so that the public can “use Form 990 data for research, fraud reduction, informed charitable giving, and other valuable purposes,” said Cinthia Schuman Ottinger who leads the [Nonprofit Data Project](#) at the [Aspen Institute](#). “From a research perspective, e-filing is a game changer,” said Jesse Lecy, a professor of nonprofit studies

at Arizona State University. “It’s opening up new frontiers.”

The subcommittee voted to approve the bill and, on April 19, 2018, the U.S. House of Representatives passed H.R. 5443, the Taxpayer First Act, by voice vote. The matter is now in the hands of the U.S. Senate.

***Form 1023-EZ Criticized***

In April 2018, Tim Delaney, President and CEO of the National Council of Nonprofits, which advocates on behalf of charitable nonprofits nationwide released a statement. While applauding the new law for the change to the mandatory electronic filing of returns, he also took the opportunity to strongly encourage an immediate departure from the usage of the Form1023-EZ:

We call on the Committee to pass legislation instructing the Internal Revenue Service to live up to its duty to enforce the law. In particular, the IRS must stop using its truncated Form 1023-EZ and its negligent screening process that have proven to be ineffective, with the IRS granting tax-exempt status to ineligible organizations and perhaps bad actors that seek to exploit improper tax-exempt status for personal gain.

This action was taken in coordination with former presidents of the National Association of State Charity Officials.

Specifically in NCN’s formal written comments about the Taxpayer First Act, the organization recommended that the bill’s sponsors include a provision “that revokes the existing Form 1023-EZ and instructs the IRS to replace it, after consultation with charitable organizations, foundations, and state charities officers, with a streamlined form that continues to collect essential information that will better protect the public from scam artists and ensure that the IRS grant tax exempt status only to eligible organizations.”

While the Taxpayer First Act was passed without these recommended changes, it will certainly not be the end of the matter on the issue of eliminating the Form 1023-EZ.

***Warnings On 1023-EZ Ignored***

NCN’s letter to the House subcommittee included a review of the history of the Form 1023-EZ and how the warnings against it went unheeded.

The decision to institute the Form 1023-EZ – effective mid-2014 – was an IRS administrative move designed, primarily, to remedy a huge processing backlog for 501(c)(3) tax exemptions. While there have been legitimate concerns that the 26-page-long Form 1023 is too cumbersome and difficult for some applicants, the simplification of the tax-exemption process was not the main reason the new format was put in place.

The IRS “ignored strong opposition and warnings expressed by its own Advisory Committee on Tax Exempt and Government Entities, the National Association of State Charity Officials,... and the National Council of Nonprofits, among others.”

Specifically, NCN had earlier “cautioned that ‘the Form 1023-EZ fails to obtain the minimum amount of information necessary to identify organizations that should not be approved or should be

monitored more closely in back-end compliance.” At that time, NASCO also warned against it, providing a list of essential information needed on the form including formal documents of the organization, compensation data, financial reporting, organizational history, and other information. These suggestions were not incorporated into the adopted Form 1023-EZ. “The IRS ignored the informed requests of these law enforcement officials tasked with protecting the public.”

*After 4 Years, 1023-EZ Failed*

NCN and NASCO presented two key arguments in support of their April 2018 recommendations to eliminate the Form 1023-EZ entirely.

First, the “abbreviated Form 1023-EZ eliminated so much information that the IRS can no longer make an informed decision about whether an applicant is eligible under existing statutory requirements.”

Second, the backlog, while shortening temporarily, has returned so that the immediate reason for implementing a short-form application process has disappeared.

“Unfortunately, the charitable community, state law enforcement, and the IRS’s own advisory group of tax accountants and attorneys accurately predicted the disaster that has been unfolding since the Form 1023-EZ went live. In our view, the most recent annual report to Congress from the Taxpayer Advocate Service (at page 26) makes the case most succinctly for revoking the Form 1023-EZ and starting over....” Those results show:

- For 2015 and 2016, 37 percent and 26 percent of approved entities in one of 20 states that post articles of incorporation online did not meet the 501(c)(3) organizational test; and
- For 2017, the erroneous approval rate jumped to 42 percent.
- The time frame for processing the (regular, 26-page) Form 1023 rose from 96 days in FY 2016 to 113 days for FY 2017.

As implemented, Form 1023-EZ created a new risk — erroneous grants of tax exemption — yet has not solved the initial problem of long processing times for the long Form 1023.

NCN added that “[b]y any measure, the problems with the express-lane approach to tax exemption continue and, indeed, are increasing. Virtually every entity that applies using the Form 1023-EZ receives tax-exempt status....” This organization, along with the former NASCO officials, pulls no punches: “...[T]he IRS’ primary obligation of preventing ineligible organizations and perhaps bad actors from receiving and exploiting tax-exempt status for personal gain is being shirked with every application processed. IRS Form 1023-EZ should be withdrawn immediately.”

*Conclusion*

These letter writers acknowledged that “some streamlining is no doubt warranted...” but the “...Form 1023-EZ is an example of what not to do.”

They asked the Subcommittee to do it right this time, by bringing together “... the parties most committed to the integrity of the charitable nonprofit community to identify appropriate and inappropriate criteria” for evaluating a request for tax exemption. Those parties, of course, include the signatories: the National Council of Nonprofits and the National Association of State Charity

Officials.

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