

Ten-Year Anniversary of the IRS Form 1023-EZ: No Celebrations in Sight

08.08.24 | Linda J. Rosenthal, JD



The July 3, 2022, headline was an attention grabber if ever there was one: [76 Fake Charities Shared a Mailbox. The I.R.S. Approved Them All.](#)

The details of this story, explained by Pulitzer-Prize-winning investigative reporter, David A. Farenthold and his team at the *New York Times*, may have shocked most readers. It certainly alarmed members of Congress enough to demand some answers. See [Letter to IRS Commissioner from Chair of House Oversight Subcommittee About IRS Processing of 501\(c\)\(3\) Exemption Applications](#) (July 20, 2022).

But it was not exactly a surprise to those in and around the nonprofit sector.

A Decade of Warnings

Ten years ago, on July 1, 2014, [against the advice of almost everyone](#), the Internal Revenue Service presented a “cure” that had the potential of becoming [almost worse than the disease](#) then plaguing the Exempt Organizations Division.

In [Part I – Introduction](#) of our 3-part series in September 2014 titled [Is The New Form 1023-EZ Too Easy?](#), we summarized the [huge problem](#) facing the already beleaguered officials of the TE/GE Division responsible for issuing or denying federal tax exemptions. For several years, “the tax agency had been deluged with a flood of new applications” for “charitable” approval under Internal Revenue Code section 501(c)(3).

“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” which had been in use for many decades. “Over the years, it had ballooned into a behemoth well beyond the comprehension of most ordinary mortals. Some serious action was needed.”

Among the proposals considered to unclog the enormous backlog of unprocessed tax-exemption applications, federal tax officials chose to go with a much-simplified application form and approval process for smaller organizations; that is, those that anticipate gross receipts of no more than \$50,000 a year. “Many experts and observers had long believed that the standard 1023 – a 26-page monster – is a bit too complex for the considerable crop of smaller organizations that regularly seek the IRS stamp of approval. A condensed version might be a good idea, these commentators agreed, but the solution that Treasury officials approved – the 3-page Form 1023-EZ with attestations only and no supporting documentation – went too far in the opposite direction.” See Part II – What the Experts Think and Part III – The Applicant’s Decision of our reporting in 2014 as the situation opened.

The Unfolding Debacle

Before long, it became clear – as the CEO of the National Council of Nonprofits (NCN) put it – that getting a federal tax exemption had become “...easier ... than getting a library card.” See, for instance, some of our real-time coverage as the exemption-application crisis further developed:

- *Has the New Form 1023-EZ Made it Easier?* (February 26, 2015) *FPLG Blog*
- *Critics’ Concerns About Form 1023-EZ: Spot On* (March 8, 2016) *FPLG Blog*
- *What’s Up These Days with the Form 1023-EZ?* (June 2, 2017) *FPLG Blog*
- *Nonprofits to Congress: Ditch Form 1023-EZ* (March 17, 2018) *FPLG Blog*

Through the past decade, there have been a few small tweaks here and there to the Form 1023-EZ. But that was far short of the louder and louder calls – “from inside the house” so to speak – to fix it.

For instance, the Taxpayer Advocate Service (TAS), “an independent organization within the IRS,” had conducted studies and undercover operations over several years to test whether fake charities could make it through the EO screening process. (The answer: Yes.)

In its annual reports to Congress, the TAS pulled no punches. See, for example, the 2017 Report with its “Most Serious Problems” list. Winning the #5 spot was this tax-exemption procedure mess: “Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase.”

The 9-page discussion by the TAS of MSP # 5 was a stinging indictment of why the Form 1023-EZ “cure” is worse than the disease. See, particularly, the final paragraphs, beginning: “As the National Taxpayer Advocate has always maintained, Form 1023-EZ does not elicit enough information from applicants to allow the IRS to determine whether they qualify for IRC § 501(c)(3) status, yet approval of a Form 1023-EZ application is virtually guaranteed.”

The critique continued: “Consequently, the IRS continues to erroneously approve Form 1023-EZ applications at an unacceptably high rate. The damage to the integrity of the tax-exempt sector caused by recognizing organizations as exempt under IRC § 501(c)(3) when they do not meet the basic requirements for that status outweighs the benefit of reduced Form 1023 cycle time.

Moreover, because Form 1023 cycle time has now begun to rise, any such benefit may have been temporary.”

Two years later, within the TAS Annual Report to Congress for 2019, the watchdog officials included a 15-page document titled *Study of the Extent to Which the IRS Continues to Erroneously Approve Form 1023-EZ Applications*. This comprehensive review of the Form 1023-EZ experiment from its launch in 2014 included data after the program was tweaked a bit here and there in 2018.

The TAS study authors were ... harsh: “Form 1023-EZ was revised in 2018 to require applicants to provide a description (in 255 characters or less) of their mission or most significant activities. However, according to IRS procedures, the described mission or activities need only be ‘within the scope of IRC § 501(c)(3)’ to be deemed sufficient. According to the 2019 study results, the IRS made erroneous determinations more frequently after it added the description field.”

Ouch.

This 2019 Report to Congress from the Treasury Advisory Service (TAS) was – (along with the July 3, 2022, NYT article by David Farenthold) – a critical piece of evidence prompting the chair of the House Oversight Committee to write that July 20, 2022, Letter to the Commissioner of Internal Revenue demanding accountability and answers.

NCN Chimes In

The 2019 Report from the Taxpayer Advocate Service was released early in 2020 – just before everyone became understandably focused on the COVID-19 pandemic.

Nevertheless, authoritative voices continued making their concerns known: The “patient’ is demonstrably on life support; keeping it hooked up to the 1023-EZ intravenous drip is doing more harm than good.

The National Council of Nonprofits (NCN) has been at the forefront of the debate and discussion about a short-form tax-exemption application since well before the July 1, 2014, launch of the Form 1023-EZ. At that time, NCN officials had explained that the “... application process played at least two important deterrent roles: weeding out those who thought it would be a quick way to get easy money and putting applicants on notice about accountability.”

By 2018, NCN was on record urging the government to admit defeat and try something else.

And, in a major document submitted by NCN to the IRS in 2021, the nation’s largest association of 501(c)(3) organizations reiterated its no-holds-barred prescription: Toss the Form 1023-EZ out the window and start over. See *Recommendations for the 2021-2022 Priority Guidance Plan*, (May 28, 2021, 8-pp. PDF): “1. Revise significantly or abandon completely the current Form 1023-EZ and processing of the so-called ‘Streamlined Application’ for tax-exempt status (High Priority).”

These NCN Recommendations presented yet another helpful review of the history of the Form 1023-EZ beginning even before its adoption and formal launch in 2014. At that time, it was just one of several options considered by Treasury to stanch the worrisome bleeding coming from the exempt-organizations division.

Although the stated purpose in 2014 in adopting the Form 1023-EZ was “... increasing efficiencies in processing to address an ever-increasing backlog of tax-exempt applications...” it has been a failure, argued the National Council of Nonprofits. “Although the Streamlined Application clearly cuts down on the paperwork requirements on newly created charitable nonprofits (and enables the IRS to process such applications in less time), this efficiency has produced alarming results.”

For example, NCN explained: “Now, a person can use the Form 1023-EZ to secure tax-exempt status for an entity merely by claiming everything is accurate, that the applicant’s total assets do not exceed \$250,000, and its annual gross receipts will not exceed \$50,000 in either the past 3 years or projected for any of the next 3 years. The result of this bare attestation is the significant benefit of federal income tax exemption – and thereby state and local income and property tax exemptions.”

In support of its *Recommendations for the 2021-2022 Priority Guidance Plan*, NCN pointed to evidence and arguments including –

- “Numerous GAO and TAS studies and audits have subjected the Streamlined Application to significant criticism and consistently found that the IRS has erroneously approved ineligible applicants at astonishingly high rates: 37 percent (2015), 26 percent (2016), 42 percent (2017), and 46 percent (2019).”
- “Various government bodies and tax policy experts have warned that the current Form 1023-EZ provides neither sufficient guidance to the prospective organization nor adequate proof or information to the IRS as to whether an organization truly exists or is actually organized in a manner that satisfies the requirements of Internal Revenue Code Section 501(c)(3).”
- “This consistent and unacceptably high error rate, combined with the lack of subsequent entity audit or review, as initially promised by IRS commissioners, produces ‘a meaningless tax-exempt application process and a toothless monitoring regime, a combination resulting in thousands of unworthy entities enjoying charitable status,’ according to analysis by a prominent tax law professor. He went on to predict, ‘If this widespread noncompliance continues unabated, it will decimate the public’s confidence in the entire charitable sector.’”

Treasury Inspector General

On October 3, 2022, the Treasury Inspector General for Tax Administration (TIGTA) issued Report Number 2023-10-001. Titled *More Information Is Needed to Make Informed Decisions on Streamlined Applications for Tax Exemption*, the 37-page PDF document (including appendices) offers summaries followed by detailed findings and recommendations.

TIGTA performed this audit “...to assess the efficiency of the” Form 1023-EZ as well as the “use of resources and processing times in making determinations.” Without enough information, the EO Determinations Unit “may approve tax exemption for organizations that do not meet the legal requirements, and could allow unscrupulous individuals to use the exemption for illegal activities. This could also diminish public trust in legitimate tax-exempt organizations.”

In the “What TIGTA Found” summary, the answer is clear: “Based on our assessment of internal and external stakeholder opinions, States’ reporting requirements, comparison with the information required on the long application form, our testing of the application process, and limited examination compliance efforts, we determined that the information provided on the Form 1023-EZ is insufficient to make an informed determination about tax-exempt status and does not educate applicants about eligibility requirements for tax exemption.”

TIGTA went undercover with five “nonexistent organizations”; IRS granted 501(c)(3) exempt status for four of them. “The IRS correctly identified one of our fictitious applications as potentially ineligible and sent a request for additional documentation. Our undercover testing illustrates vulnerabilities in the IRS’s tax-exempt status determination process.”

The TIGTA Report’s summary section also addressed the failure of the supposed back-up audit strategy: “The IRS relies on a Form 1023-EZ examination strategy to detect noncompliance after organizations are approved; however, less than 1 percent of tax-exempt organizations are examined each year. In addition, online guidance for the Form 1023-EZ is inaccurate. The online web page used to apply for tax-exempt status includes educational links to assist Form 1023-EZ applicants. However, one of the educational links takes the applicant to a web page containing inaccurate information for applicants using the Form 1023-EZ.”

The Treasury Inspector General made four recommendations to the IRS:

- “Revise the activities description narrative on Form 1023-EZ,
- Assess the feasibility of requiring applicants to submit their organizing documents as an attachment to Form 1023-EZ,
- Notify applicants when additional time is needed to process their Form 1023-EZ applications, and
- Update online guidance with accurate information on the application process for Form 1023-EZ filers.”

TIGTA reported that “IRS management agreed with the second and fourth recommendations” only. As for the two others, “the IRS will consider notifying applicants when their submissions need additional time to process. However, the IRS believes that requiring detailed activity descriptions is unnecessary to make determination decisions.”

In the body of the Report, there were further details and findings, bolstered by appendices reprinting the back-and-forth written exchanges between the Inspector General and IRS “management” on each of these four recommendations. At this 8-year point in the Form 1023-EZ experiment, IRS management seems to be reluctant to confront the grim prognosis offered from many quarters.

A further observation: Compared with the National Council of Nonprofits’s bold “pull the plug” advice, TIGTA’s recommendations are a bit timid, particularly since the Treasury Inspector General for Tax Administration has an official advisory role in how the IRS operates.

“The TIGTA conducts audits that advise Congress, the Secretary of the Treasury, and IRS management of high-risk issues, problems, and deficiencies related to the administration of IRS

programs and operations. TIGTA's audit recommendations aim to improve IRS systems and operations, while maintaining fair and equitable treatment of taxpayers. TIGTA's oversight is essential to the efficiency and equity of the federal tax administration system.”

Conclusion

The tenth anniversary of the launch of the brand-new and experimental Form 1023-EZ has come and gone – without apparent fanfare, without celebration.

Behind the scenes, are the loved ones “making arrangements”? Who knows.

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