

What's Up These Days with the Form 1023-EZ?

06.02.17 | Linda J. Rosenthal, JD



The Internal Revenue Service used to have a huge problem: it generally took 18 months to two years to process even a fairly straightforward 501(c)(3) tax-exemption application.

That's when a big change was proposed: the introduction of the Form 1023-EZ for the many new, smaller, organizations.

We posted about that rollout in July 2014, and about the early reaction and results [here](#), [here](#), and [here](#). Tim Delaney, the President and CEO of the National Council of Nonprofits summed it up fairly well: "It's easier to get tax-exempt status under Form 1023-EZ than it is [to get a library card](#)."

It did, however, clear up the backup.

So, How is the Form 1023-EZ Doing These Days?

The Taxpayer Advocate Service "is an [independent organization within the IRS](#)." Its job is "to ensure that every taxpayer is treated fairly and ...[knows and understands its] ...rights."

Each year, the TAS issues a report to Congress that "[analyzes the most serious problems](#) facing taxpayers, recommends tax law changes to Congress, and presents original research studies into issues affecting taxpayers."

Report on 2015

About a year ago, in "[Critics' Concerns About Form 1023-EZ: Spot On](#)," we told you about the parts of the [2015 Annual Report to Congress](#), that relate to exempt organizations. It was brutal.

The "highlights" section on the cover had this observation: "*Recognition as a Tax-Exempt Organization is Now Virtually Automatic for Most Applicants.*" It went downhill from there.

”

The rebuke about the tax-exemption application process is one of 9 selected areas of concern. It is a ‘stinging indictment of the IRS’s “absurd” handling of applications for tax exemption, especially the recently introduced 1023-EZ “short form” designed for use by small new charities.

Specifically, the full 2015 TAS discussion on the Form 1023-EZ applications problem are summarized as:

- The Form 1023-EZ “invites noncompliance, diverts tax dollars and taxpayer donations, and harms organizations later determined to be taxable.
- The approval rate for 1023-EZ applications is 95%, but when the agency does a pre-determination review on a sampling basis, the approval rate is just 77% when documents or basic information are reviewed, “rather than relying only on the attestations contained in the form.”
- In the same pre-determination samplings, almost 20% of applicants, “despite their attestations to the[contrary, did not qualify for exempt status as a matter of law.” These results are consistent with the Taxpayer Advocate Service’s own representative sample of 1023-EZ applications: “37% of the organizations ... did not satisfy the legal requirements for exempt status.”

The National Taxpayer Advocate recommended revisions to the Form 1023-EZ; in particular, to –

”

require applicants to submit their organizing documents, unless they are corporations in states that make articles of incorporation publicly available online at no cost. Form 1023-EZ should also require applicants to submit a description of their actual or planned activities and financial information such as past and projected revenues and expenses. The IRS should make a determination only after reviewing the application and these supporting materials, and when there is a deficiency in an applicant’s organizing documents, the IRS should require the applicant to submit a certified copy of reformed articles before it confers exempt status.

Report on 2016

Did the situation improve in 2016? The Taxpayer Advocate Service just issued its most recent report. Here’s how the relevant section of the 2016 Annual

Report to Congress begins:

”

Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant ... § 501(c)(3) Status to Unqualified Organizations.

Ouch!

The problem continues to be that the streamlined application requires applicants only to “attest that they meet the requirements for qualification as” 501(c)(3) organizations.

Since – now – “most applications” for 501(c)(3) status are “submitted on Form 1023-EZ” and, also, “the IRS approves 94 percent of Form 1023-EZ applications,” too many organizations that are either unqualified or are not eligible to use the Form 1023-EZ process, manage to slip through and get approved.

”

The IRS erroneously approves Form 1023-EZ applications at an unacceptably high rate. The IRS agreed to revise Form 1023-EZ to require a narrative statement of applicants' activities, but additional information is needed. Analysis Treasury regulations generally require IRC § 501(c)(3) organizations to pass an “organizational test” by including acceptable purpose and dissolution clauses in their organizing documents. According to the IRS's pre-determination reviews of a portion of Form 1023-EZ applicants, 25 percent do not qualify for exempt status because they do not meet this organizational test.

Next, the Report commented on the comparative results of representative sampling:

”

A 2015 TAS study of a representative sample of approved Form 1023-EZ applicants in 20 states that make articles of incorporation viewable online at no cost showed that 37 percent do not meet the organizational test. A similar 2016 TAS study showed that 26 percent of approved organizations do not meet the organizational test. In the 2016 TAS study, four percent of the approved organizations consisted of two limited liability companies; two churches; seven schools, colleges, or universities or supporting organizations; and one private operating foundation. Such organizations are never eligible to file Form 1023-EZ.

What are the current recommendations?

What are the current recommendations? The National Taxpayer Advocate recommends that the IRS require Form 1023-EZ applicants to submit their organizing documents, unless they are already available online at no cost, and summary financial information; and make a determination only after considering narrative statements and this additional information.

New Form 990-EZ

There's more news about the "EZ" 501(c)(3) process: The IRS has [recently released](#) an "updated [Form 990-EZ, Short Form Return of Organization Exempt From Income Tax](#), that will help tax-exempt organizations avoid common mistakes when filing their annual return."

”

This new form "includes 29 'help' icons describing key information needed to complete many of the fields within the form. The icons also provide links to additional helpful information available on IRS.gov. These "pop-up" boxes share information to help small and mid-size exempt organizations avoid common mistakes when filling out the form and filing their return.

This change was made in part to encourage online filing which produces fewer errors than paper-filed returns.

Conclusion

We'll monitor and report on any new developments related to this alternate format available to many – though not all – 501(c)(3)s.

