

## What about Form 1023-EZ?

In July, the IRS introduced a new streamlined way to get your nonprofit status. Their purpose in doing so is to reduce their backlog of 60,000 applications (they receive 70,000 applications per year). We wish we could be excited about the new form because it is easier, but unfortunately, we don't believe it will survive, or if it survives, it will create headaches for you.

**\$50,000 Limit:** But before going into that, we'd like to note that you must be certain that you will not exceed \$50,000 in the first three years of operation. Otherwise, you cannot use the Form 1023-EZ. Most organizations are small starting out, but most of our nonprofit clients expect to grow in those first three years to be more than \$50,000. That might sound like a lot when you're small, but it's really not that much once you move forward and grow. Do you want to be one of "little faith." Unlike the long form 1023, Form 1023-EZ applicants are required to sign the form under federal penalties of perjury. Do you want to take the chance of stating that you will be under \$50,000 in the third year?

**Solid Corporate Foundation:** Next, before even considering the Form 1023-EZ, remember that you need a solid corporate foundation for your nonprofit. This means that your corporation must be set up foundationally strong, and you must have solid legal documents drafted by a lawyer. That's what we do for you, as Harvard Lawyer David Marmon has been doing for 33 years. Good lawyers easily charge \$1,000 to \$2,500 for all these documents. If you're serious about your nonprofit, and we assume you are, you won't want to be penny wise and pound foolish. Who will draft your six necessary corporate documents if you go the EZ route? By the way, there are more stringent requirements on the IRS provisions required in your Articles of Incorporation if you file the Form 1023-EZ, as compared with the long form.

**Now, a little background on the IRS:** In 2004, the IRS announced a new Form 1023 that was to reduce the four month time it took to process most applications down to no more than 30 to 60 days for almost all applications. Almost immediately, it went from four 4 to 8 months. In 2006, they made further revisions to the form, and later some more, but even today, the form is not completely correct, and at different pages on the IRS website, there is inconsistent information.

**Some more background:** In order to gain greater compliance and transparency, in 2008, the IRS revoked the status of 235,000 nonprofits that did not annually file a 990-N, a new form the IRS came out with. The problem was that they didn't notify these 235,000 nonprofits of the new requirements. Since the 235,000 nonprofits didn't know, they didn't file, and their status was revoked. Since then, like in 2004, their mistake caused the backlog to increase—this time from 8 months to at times 16 months, according to what they published on their website. We mention compliance and transparency because these have been very big issues in the past few years, and both of these are very important not only for the IRS but for nonprofits themselves.

Unfortunately, the IRS almost eliminates compliance and transparency for those applicants using the new Form 1023-EZ. We believe this new form is likely not to survive. Congress has mandated the IRS to qualify charities before granting them tax-exempt status. With the Form 1023-EZ, the IRS cannot do that. Will Congress allow this new form? Where was Congressional oversight when the IRS proposed using this new form? We don't know. We CAN say that **the IRS's own Advisory Committee on Taxation (ACT) recommended against the Form 1023-EZ.**

We quote from a letter of April 30, 2014 (abbreviated, and emphases ours) from the office of the **Attorney General of Colorado and president of the National Association of Charities (NASCO).**

“I am the current president of the **National Association of State Charity Officials (NASCO)** and write on behalf of NASCO **to reiterate state charity regulator concerns regarding an abbreviated Form 1023** tax exempt application. A survey of state charities regulators conducted prior to the 2012 report of the Internal Revenue Service's Advisory Committee on Taxation (ACT) found that **state regulators uniformly believed that collecting less information in the initial application for tax exemption** on an assumption that an organization that begins small will remain small **invites abuse and results in overall regulatory inefficiency.** The ACT [this is the IRS's own Advisory Committee] recommended **against** development of a Form 1023-EZ.

“**NASCO continues to support the ACT's recommendation against a Form 1023-EZ** and the Committee's reasoning as stated in the 2012 ACT report:

‘a. Rationale for Not Developing a Form 1023-EZ - One of our stated goals for the Form 1023 is that it be simple, and a shorter Form 1023 would

almost certainly be simpler for small organizations. But we believe that the value of this increased simplicity would be outweighed by the loss of educational value to the applying organization and the loss of effectiveness to the IRS.

‘...we believe that the Form 1023 should address the legal requirements for exemption in an effective, consistent, simple, and educational manner—nothing more, nothing less.

‘The primary reason we [The IRS’s own Advisory Committee] do not recommend the development of a Form 1023-EZ is because the Form 1023 serves an important educational purpose for applying organizations. Through its questions, the form forces the applying organization to think somewhat deeply about its activities, finances, and management. The form also signals to the organization that it is entering into a (probably unfamiliar) comprehensive regulatory regime, and working through the questions on the form provides the organization with a great deal of information about compliance with this regime. We agree with the many practitioners we spoke with who believe that the educational benefits of the Form 1023 are especially important for small organizations. And we do not believe that a significantly shorter Form 1023 could provide a comparable level of these benefits.’

[What does this mean for you? That those who obtain their 501c3 status with the short form will of necessity be burdened with a higher level of compliance because they were never properly qualified in the first place. The IRS knows who received their 501c3 without the scrutiny of the long form, and somehow it seems obvious they will have to make up for that in higher levels of compliance requirements, meaning more paperwork and difficulties later. If the IRS revoked 235,000 nonprofits for not filing a little 5-minute Internet postcard, can you envision being revoked because you failed to comply with items that are not required on the short form, and you didn’t know about them? Because you chose an “easier” path? Easiest is not always best.]

‘In addition, we think that it would be difficult to design a significantly shorter Form 1023-EZ that would still be effective from the IRS's perspective, i.e., that it would still provide the IRS with all the essential information it needs to make a determination on a small organization's

exempt status. It should also be noted that many small exempt organizations will be Form 990-N (e-Postcard) filers. Hence, the Form 1023 will be the only opportunity for the IRS to receive any substantive information about such organizations. Thus, it is **even more important that the Forms 1023 filed by small organizations request all the information the IRS needs because there will not be a “second chance” to obtain this information later from a (full) Form 990 or 990-EZ [again, this is the IRS’s own Advisory Committee speaking].**

‘The information an organization provides on its Form 1023 can sometimes signal to the IRS a potential for possible abuse, and the IRS can then ‘flag’ that organization for later follow-up. Our concern is that a shorter Form 1023-EZ may be less capable of providing these warning signals.

**‘State charity regulators uniformly oppose a Form 1023-EZ,** noting that such a form would make it easier for "scam" charities to obtain Section 501(c)(3) status. They also believe that there is no way at the outset to justify a rationale of exempting small charities from the Form 1023 filing burden, because all applicants, other than perhaps private foundations, begin their existence as small organizations. As one state charity regulator noted: "The application process should be the same for everyone -- no one knows how large and successful a particular organization or cause may be at its earliest beginnings, even if they pledge to 'stay small.' **[Remember what we said in the second paragraph about stating that your income will be under \$50,000 in the third year?]**

‘Another objection to a Form 1023-EZ for small organizations is the difficulty in determining an appropriate standard for what "small" should mean for this purpose. If, for example, annual gross receipts are used as the threshold requirement for using the shorter Form 1023-EZ, this could frustrate the rationale for having the shorter form. **An organization's projected gross receipts on the Form 1023 could be substantially smaller than what it actually receives in its first few years. But because its projections were small, the organization would qualify to file the shorter Form 1023-EZ, and thus avoid providing the IRS, on a (full) Form 1023, with a more comprehensive view of this now "un-small" organization. More generally, if projected annual gross receipts were used as the threshold for the Form 1023-EZ, there would be a natural inclination for organizations to understate those projections.**’

“While use of the Form 1023-EZ may result in somewhat of a short-term reduced burden in processing applications, **the long-term effect certainly will be a greatly increased burden on already overburdened state and federal regulators.**

“We submit that there are alternate and more effective ways to foster ‘accountability, transparency, and openness in Government and society.’ We believe that working together to achieve these efficiencies will ultimately alleviate burdens on charitable organizations and government more effectively than **reducing the standard for acquiring tax exempt status by enabling some organizations to obtain tax exemption with an abbreviated Form 1023-EZ.**

“In conclusion, NASCO agrees that a reconsideration of the Form 1023 is appropriate in the context of reducing the burden on charities and the government, but believes the discussion should involve input from all stakeholders with an eye towards reduced burden overall and not just in the application process.”

End of the Colorado Attorney General’s letter:

**Will your state attorney general ask you if you used the short form, perhaps asking you to provide a copy of your IRS application? If so, will you be required to give your state the same information the IRS has failed to ask you on the short form? Even possibly not allowing your nonprofit to operate in your state until you satisfy their requirements and regulations that show you truly qualify for tax-exempt status. The states can rely on the IRS scrutiny for those that use the long form and receive 501c3 status. They CANNOT rely on a 501c3 status that is based on minimal information provided for the short form. As you look to the future with your nonprofit, wouldn’t you prefer to settle all these questions now, instead of your state coming back later with problems for you in the future?**

We don’t believe the Form 1023-EZ will survive, and those who file it will find themselves without “true” 501c3 status. The IRS will have to correct its mistake with bureaucratic problems for those applicants, perhaps going back to them to file a complete Form 1023, or putting them in abeyance until a solution can be found for the problems stated above. The Form 1023-EZ is not a viable solution to the IRS backlog. We believe it simply cannot work and will not survive.

Remember not long ago the IRS had a big problem with political action committees and were found to be in the wrong. They admitted this. Any

bureaucracy is difficult to handle. We have had cases where a few weeks after obtaining 501c3 status, the status was revoked for not filing the three previous years, and these nonprofits weren't even in existence during those years. The IRS recognized the computer glitch, said they were aware of the problem, and were trying to fix it. Six months later, the same was still happening. For our clients found in this dilemma, it could not be easily fixed. They were being required to apply to reinstate their application only weeks after they had received their status. This is the kind of bureaucratic headache we believe those who use the Form 1023-EZ could be looking forward to. Our recommendation is to go the long Form 1023 route, even though more difficult in the short run.

**The IRS is already overburdened. In our 33 years of working with the IRS, we have found IRS agents to be some of the most dedicated people in government. They are hard-working and very conscientious. We have tremendous respect for them. These comments in no way reflect upon them.** Congress has now mandated that the IRS will be the agency to insure that all Americans are in compliance with Obamacare and assessing penalties for failure to obtain health insurance—another burden for an already overburdened agency. So we can readily understand the IRS's desire to make things simpler for themselves. But the Form 1023-EZ is abdicating the responsibility Congress has mandated to “qualify” a charity before granting tax-exempt status. It may very well “blow up” or at least be radically changed. Do you want to be caught in the consequences? The IRS readily admits that the long Form 1023 can still be used and must be used for churches, schools, organizations projecting more than \$50,000 in any of the first three years of operations, as well as private operating foundations.

Consider this scenario: You use the Form 1023-EZ and project that your third year projected income will be less than \$50,000 (unlike the long form 1023, you must sign the EZ form under penalties of perjury). In your third year, you exceed that. You will have to file a Form 990-series form at that time. It would seem you have just increased your chances that you will be audited (the IRS does not disclose what are the criteria for an audit). Why? Because it never had an opportunity to qualify you when you filed your application for 501c3 status using the EZ form. If you misjudge your third year income on a long form 1023 application, there is no problem when you file a 990-series form for your third year because the IRS has already qualified you. But with the EZ form, they haven't truly qualified you, and therefore it seems to us that your chances for an audit are increased should future years' income be over \$50,000. Could the IRS consider your financial projections fraudulent?

**State Regulators (often the Attorney General):** Now, the states can no longer depend on the IRS qualifying your nonprofit unless you use the long form. For those who use the EZ form, they will have to qualify you, and that could be difficult. This was a major objection of the states to the new EZ form. The long form 1023 gives you a green light with your state through the regulations and requirements of nonprofit status. You're free! But for those who don't use the long form 1023, the states have no choice but to qualify you since the IRS didn't do that. Somebody has to do it. The IRS is a one-time process, but with you state, it could drag on for years since you are local to your state and because they are only beginning to be set up to do the qualification.

These states tell you they rely on the IRS to do the qualification (from our page: <http://501c3go.com/about-501c3/state-tax-exempt-status/>):

“For the following states, you are automatically tax-exempt when you receive your IRS 501(c)(3) status: Alaska, Colorado, Connecticut, Hawaii, Idaho, Illinois, Kansas, Louisiana, Michigan, Mississippi, Missouri, Nebraska, New Mexico, North Dakota, Oklahoma, Oregon, South Carolina, Virginia, West Virginia, Wisconsin.” What will they do now?

“For the following states, you are tax-exempt upon notifying the state that you have IRS 501(c)(3) status (requirements differ as to what must accompany the notification, whether just the IRS Determination Letter, Articles, Bylaws, etc.): Alabama, Arizona, Arkansas, Delaware, Florida, Georgia, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Texas, Utah, Vermont, Washington D.C.” What will they do now?

Now that the IRS is not qualifying your nonprofit if you use the EZ form, the states' attorneys general will have to qualify you. We think it will be a lot easier to go through the IRS process than to untangle the state regulations while you're trying to get up and running with your nonprofit (especially as the states develop new requirements to qualify you).

**State Solicitation Regulations:** Now, the 40 states that have solicitation regulations can't depend on whether or not you have been truly qualified by the IRS if you went the EZ route. Now, they will have to qualify you, and as mentioned above, that could be difficult. So when you go to apply at your state to solicit, they can ask, “By the way, did you use the EZ to get your status?” Before,

if you were religious, they would let you go through without registering because, again, the IRS qualified you. Now, we don't think they'll be able to do that. All EZ applicants will have to be qualified by their respective state, even religious nonprofits. Our guess is they will have blanket regulations for those applying for solicitation, with a waiver for those that filed the long form.

If you wish to file the Form 1023-EZ, against our judgment and counsel, we can do that for you. That would be far better than trying to do it on your own.

**Addendum:** the name EZ conveys that the form will be easy. The fact that it can be done online makes it sound even easier (no paper forms will be accepted). But how easy is it?

First, how long do they say it will take?

“The time needed to complete and file this form will vary depending on the individual circumstances. The estimated average time is:

Recordkeeping	10 hr., 02 min.
Learning about the law or the form	2 hr., 30 min.
Preparing the form	5 hr., 33 min.
Copying, assembling, and sending the form to the IRS	48 min.

TOTAL: 18 hr., 53 min.”

We can assure you that if you have us prepare your Form 1023 EZ, it will be far, far less time-consuming than the above figure.

Is it really easy? Do you feel you can easily grasp the following, which is a part of the instructions?

**Line 1a.** Check this box if you either:

Normally receive 33<sup>1</sup>/<sub>3</sub>% or more of your total support from governmental agencies, contributions from the general public, and contributions or grants from other public charities (the “33<sup>1</sup>/<sub>3</sub>% public support test”); or

Satisfy the following three-part “facts and circumstances test”: (1) you normally receive 10% or more of your total support from governmental agencies, contributions from the general public, and contributions or grants from other public charities (the “10% public support requirement”); (2) you are organized and operated to attract new and additional public or governmental support on a continuous basis (the attraction of public support requirement); and (3) you have other characteristics of a publicly supported organization (see other factors below).

**Facts and circumstances test: other factors.** The following factors are taken into account in determining whether an organization that meets the 10% public support requirement and the attraction of public support requirement



qualifies as publicly supported: (i) the percentage of financial support the organization receives from the general public, governmental units, or public charities (the higher the percentage, the lower the burden of meeting the other factors); (ii) whether the organization receives support from a representative number of persons; and (iii) all other facts and circumstances, including the public nature of the organization's governing body, the extent to which its facilities or programs are publicly available, the extent to which its dues encourage membership, and whether its activities are likely to appeal to persons having a broad common interest or purpose. For additional information about the facts and circumstances test, see Publication 557, and Regulations section 1.170A-9(f)(3).

The following definitions apply for purposes of both the 33% public support test and the 10% public support requirement.

**Normally.** Whether an organization "normally" receives the required level of public support generally is measured using a five-year computation period that includes the current tax year and four prior tax years. For a newly formed organization, the test is whether the organization can reasonably be expected to meet the requirements of the 33% public support test or the 10% public support plus facts and circumstances test during its first five taxable years as a section 501(c)(3) organization. The basic consideration is whether its organizational structure, current or proposed programs or activities, and actual or intended method of operation can reasonably be expected to attract the type of broadly based support from the general public, public charities, and governmental units that is necessary to meet the public support requirements described above. For more information about the public support requirements, see Publication 557.

**Total support.** "Total support" includes contributions, membership fees, net income from unrelated business activities, and gross investment income, but does not include income from activities directly related to your exempt function.

**Public support.** "Public support" does not include contributions from any individual, corporation, or trust that exceed 2% of the organization's total support during the five-year computation period. In applying the 2% limit, all contributions made by a donor and by any persons in a special relationship to the donor (for example, family members of the donor and entities controlled by the donor) are considered made by one person.

**Note.** You do not meet either of these public support tests if you receive almost all of your support from gross receipts from related activities and an insignificant amount of your support from governmental units and contributions made directly or indirectly by the general public.

EZ? Easy? Don't you think you need some professional help?

Here are two more links: [An Express Lane to More Trouble for the IRS \(The Hill\).pdf](#)  
[National Council of Nonprofits Comments About IRS Proposed Form 1023-EZ.pdf](#)