

## MSP #5 EXEMPT ORGANIZATIONS: 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

### RESPONSIBLE OFFICIAL

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Be Informed*
- *The Right to Finality*
- *The Right to Quality Service*

### DEFINITION OF PROBLEM

The IRS introduced Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, in July 2014.<sup>2</sup> The form was adopted in large part to reduce inventory backlogs for processing Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.<sup>3</sup> By mid-2015, the volume of Form 1023-EZ applications exceeded Form 1023 applications.<sup>4</sup> In July 2016, the Form 1023-EZ user fee was reduced from \$400 to \$275, further fueling the shift from the use of Form 1023 to Form 1023-EZ.<sup>5</sup> Virtually all Form 1023-EZ applications are approved.<sup>6</sup>

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Organizations with total assets in excess of \$250,000 and those expecting annual gross receipts to exceed \$50,000 are not eligible to use Form 1023-EZ. Rev. Proc. 2017-5, § 6.05, 2017-1 I.R.B. 230 (Jan. 3, 2017).
- 3 See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress 47 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*).
- 4 *Form 1023-EZ Update Report 2*, [https://www.irs.gov/pub/irs-tege/form\\_1023ez\\_update\\_report\\_final.pdf](https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf), referenced in *Tax Exempt and Government Entities FY 2017 Work Plan 2* (Sept. 28, 2016, as amended Mar. 8, 2017).
- 5 Rev. Proc. 2016-32, § 3, 2016-22 I.R.B. 1019 (May 31, 2016). For the third quarter of fiscal year (FY) 2017, of 65,059 Form 1023 and Form 1023-EZ applications, 41,806, or 64 percent, were submitted on Form 1023-EZ. Tax Exempt and Government Entities (TE/GE) FY 2017 Third Qtr. Business Performance Review (BPR) at 16 (Oct. 2017).
- 6 See *Form 1023-EZ Update Report 4*, [https://www.irs.gov/pub/irs-tege/form\\_1023ez\\_update\\_report\\_final.pdf](https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf), referenced in *Tax Exempt and Government Entities FY 2017 Work Plan 2* (Sept. 28, 2016, as amended Mar. 8, 2017), noting the 94 percent approval rate of Form 1023-EZ applications.

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**This year’s TAS study of a representative sample of approved Form 1023-EZ applicants from 20 states that post articles of incorporation online, similar to the studies TAS carried out in 2015 and 2016, found that 42 percent of approved organizations do not meet the organizational test. When organizations from four additional states that now post articles of incorporation online are included, the rate rises to 46 percent.**

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As the IRS is aware, it erroneously approves Form 1023-EZ applications:

- A 2015 TAS study of organizations in 20 states that post articles of incorporation online showed that 37 percent of approved entities did not meet the organizational test for qualification as an Internal Revenue Code (IRC) § 501(c)(3) organization;<sup>7</sup>
- A similar study TAS carried out in 2016 found that 26 percent of approved organizations did not meet the organizational test;<sup>8</sup> and
- The IRS’s own 2016 analysis showed that Form 1023-EZ applications failed a pre-determination review more than 25 percent of the time.<sup>9</sup>

The problem of erroneous approvals has persisted. This year’s TAS study of a representative sample of approved Form 1023-EZ applicants from 20 states that post articles of incorporation online, similar to the studies TAS carried out in 2015 and 2016, found that 42 percent of approved organizations do not meet the organizational test. When organizations from four additional states that now post articles of incorporation online are included, the rate rises to 46 percent. The organizations in this year’s sample included four churches, two limited liability corporations, and a school. These organizations are not eligible to file Form 1023-EZ.<sup>10</sup>

The time needed to process Form 1023, which was nearly a year prior to the adoption of Form 1023-EZ, decreased to 96 days in fiscal year (FY) 2016.<sup>11</sup> However, the time needed to process Form 1023 has begun to rise, and was 113 days for FY 2017. Thus, the adoption of Form 1023-EZ may have been only a short-term “solution” to the problem of long processing times for Form 1023 — a solution that comes with a high cost to the integrity of the U.S. tax exempt sector.

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7 The study was of a representative sample of corporations that had obtained exempt status on the basis of a Form 1023-EZ and were organized in one of 20 states that make articles of incorporation available online at no cost. National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*). The “organizational test” generally requires an applicant’s organizing document to contain adequate purpose and dissolution clauses. See Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2).

8 National Taxpayer Advocate 2016 Annual Report to Congress 254 (Most Serious Problem: *Form 1023-EZ: The IRS’s Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*).

9 *Id.*

10 See Rev. Proc. 2016-5, § 3.06, 2016-30 I.R.B. 188 (Jan. 4, 2016); Rev. Proc. 2017-5, § 6.05(2), 2017 I.R.B. 230 (Jan. 3, 2017), discussed below.

11 TE/GE response to TAS information request (Aug. 31, 2017).

## ANALYSIS OF PROBLEM

### Background

In 2015, TAS studied a representative sample of corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ application was approved.<sup>12</sup> A review of the corporations' articles of incorporation revealed that 37 percent did not meet the organizational test.<sup>13</sup> Even though they had received a favorable determination from the IRS granting them tax-exempt status and making contributions to them eligible for a tax deduction by the donor, they did not qualify for IRC § 501(c)(3) status as a matter of law.<sup>14</sup> TAS conducted a similar study in 2016, using the same data collection instrument as for the 2015 study, and concluded that 26 percent of organizations in the representative sample did not meet the organizational test.<sup>15</sup> The results of the 2015 and 2016 studies are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.

At the conclusion of the 2015 study, TAS shared with Tax Exempt and Government Entities (TE/GE) the Employer Identification Numbers of taxpayers whose articles of incorporation, according to TAS, did not meet the organizational test. TE/GE did not agree with TAS's conclusions in every case, but conceded that there was an "organizational test non-compliance rate" of 17 percent.<sup>16</sup>

### The IRS Continues to Approve Form 1023-EZ Applications at an Unacceptably High Rate

In 2017, TAS again studied a representative sample of corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ application was approved.<sup>17</sup> The four

12 In all 20 states, the articles are viewable at no charge to the public, except for Texas, which charges \$1 per search. Because TAS used the IRS's account with the Texas Secretary of State to access the database, TAS did not incur this charge.

13 An applicant seeking to qualify as an organization described in IRC § 501(c)(3) must demonstrate that it meets an "organizational test" and an "operational test." Treas. Reg. § 1.501(c)(3)-1(a)(1). The "organizational test" requires an applicant's "organizing document" to establish that it is "organized and operated exclusively" for one of eight enumerated exempt purposes. IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i). Treas. Reg. § 1.501(c)(3)-1(b)(4) provides that "[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes..." and notes "an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders."

14 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*).

15 National Taxpayer Advocate 2016 Annual Report to Congress 256-57 (Most Serious Problem: *Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*).

16 *Id.* at 256.

17 This year's study considered Form 1023-EZ applications approved between July 1, 2016 and June 30, 2017. Organizations were in the following 20 states: Alaska, Colorado, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Mississippi, Missouri, New Hampshire, North Carolina, Ohio, Oregon, Rhode Island, South Dakota, and Texas. As in the previous studies, our findings are dependent upon the State posting the information accurately on the website.

states in the 2015 and 2016 studies that have adopted the *cy pres* doctrine remained the same in the 2017 study.<sup>18</sup>

TE/GE now releases to the public a data file that includes information for approved Form 1023-EZ applications beginning in mid-2014, when Form 1023-EZ was introduced.<sup>19</sup> Out of these organizations, TAS Research identified a representative, random sample of 337 organizations from the same 20 states as in the 2015 and 2016 random samples for further analysis. Like the results of the 2015 and 2016 studies, the results of the 2017 study are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.<sup>20</sup>

Out of the 337 organizations in the sample, 143 organizations, or 42 percent, do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law. Figure 1.5.1 shows the rate at which TE/GE's Exempt Organization (EO) function erroneously approved Form 1023-EZ applications over the past three years for organizations in the 20 states that were included in each TAS study. It also shows that when organizations from four additional states are included, as described below, the rate rises to 46 percent.<sup>21</sup>

In addition to selecting a valid sample of 337 organizations from the 20 states that were included in the 2015 and 2016 studies, this year we expanded the sample to include 58 representative cases from four more states that now make articles of incorporation available online at no charge.<sup>22</sup> Of the combined 395 organizations, 182, or 46 percent, did not meet the organizational test. This is due to the fact that two-thirds of organizations in the four new states (39 out of 58) failed to meet the test. One of the 58 organizations was a church and therefore not eligible to use Form 1023-EZ. Further research is needed to ascertain the reason for the higher rate of erroneous approvals for organizations from the four additional states, compared to the original 20 states.

18 In states that have adopted the *cy pres* doctrine, a nonprofit corporation's articles need not include a specific dissolution provision because by operation of state law the organization's assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. As in the 2015 and 2016 studies, the states in the 2017 study that have adopted the *cy pres* doctrine are Massachusetts, Missouri, Ohio, and Texas. However, we reviewed dissolution clauses of all the organizations in our sample, because if the creating document contains a dissolution provision that is defective, state law or court action would not cure the defect. See Elizabeth Ardoin, *2004 EO CPE Text Organizational Test – IRC 501(c)(3) 12, Q.11*, <https://www.irs.gov/pub/irs-tege/eotopicd04.pdf>.

19 The data file is available at <https://www.irs.gov/charities-non-profits/exempt-organizations-form-1023ez-approvals>. The data is based on information provided by applicants on Forms 1023-EZ that were approved by the IRS.

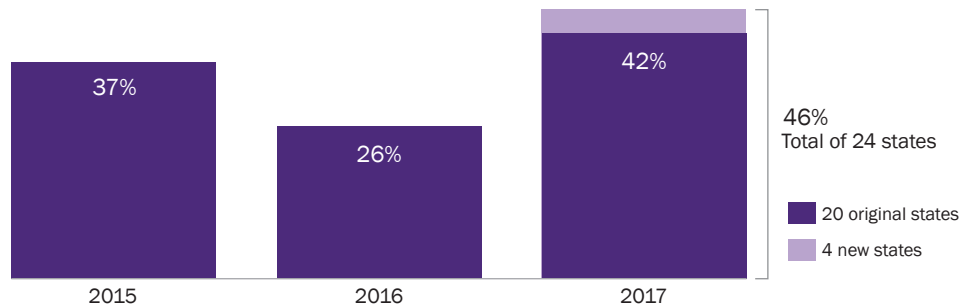
20 Study findings can be projected to the population of 20,106 organizations from the original 20 states in our study.

21 The data reflects the result of the 2015-2017 TAS studies. The Form 1023-EZ applications of organizations in the 2015 TAS study were approved between July 1, 2014 and March 27, 2015. The Form 1023-EZ applications of organizations in the 2016 study were approved between July 1, 2015 and June 30, 2016. The Form 1023-EZ applications of organizations in the 2017 study were approved between July 1, 2016 and June 30, 2017.

22 The additional four states are Arizona, Georgia, Virginia, and Vermont. None of these states have adopted the doctrine of *cy pres*. See Rev. Proc. 82-2, 1982-1 C.B. 367.

FIGURE 1.5.1

## Erroneous Approval Rate Found in Review of Form 1023-EZ Applications



Another cause for concern is the absence of some organizations' articles of incorporation on databases of states that post articles of incorporation online. Of organizations in the same 20 states as in the 2015 and 2016 studies, the initial sample size was 350. However, articles of incorporation for 13 organizations in the sample (four percent) were not found on the official site for the state in which, according to the application, the organization was formed. We excluded these organizations from our sample, resulting in a sample size of 337. Of organizations in the additional four states that made articles of incorporation available online at no cost in 2017, the initial sample size was 60. However, articles of incorporation for two of the organizations, or three percent, were not found on the official site for the state in which, according to the application, the organization was formed, and we excluded these organizations from this sample, resulting in a sample size of 58. The lack of availability of articles of incorporation raises concerns about the very existence of these entities and about the motives of the applicants who attested, under penalty of perjury, that articles of incorporation had been filed.

An example of an inadequate purpose clause we encountered in this year's study was one organization's statement, in its entirety: "Establishment and operation of a farmer's market." The IRS has opined that a farmer's market whose primary purpose and activity was the conduct of a regular business of a kind ordinarily carried on for profit did not qualify for exempt status under IRC § 501(c)(3).<sup>23</sup> A different organization in the sample has no purpose clause at all, and its entire dissolution clause provides: "No assets will be acquired during the course of business. Plan to apply for exemption status with the IRS." Yet another organization's dissolution clause provides: "The assets of this non-profit will be distributed evenly amongst the families of the team [team name]. The team will have authority to donate said assets to another non-profit organization within the [named city] Metro area." Still another organization, on the date it filed its Form 1023-EZ as well as on the date it was given a favorable determination ruling, had been involuntarily dissolved by the state in which it was incorporated. It was still in that status on December 1, 2017, when we last consulted the state website. None of these organizations are described in IRC § 501(c)(3). All of them are holding themselves out as having IRC § 501(c)(3) status, supported by determination letters from the IRS.

23 See Non Docketed Service Advice Review 19990219, 1999 WL 33949267 (July 30, 2017). See also the IRS letter ruling denying IRC § 501(c)(3) status to an organization operated for the purpose of facilitating sales for the benefit of vendors at its farmers' market, reported at 2017 TNT 227-22 (Nov. 28, 2017). An organizing document that expressly empowers the organization to engage in activities which are not in furtherance of one or more exempt purposes (other than as an insubstantial part of its activities) does not meet the organizational test. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(b).

Some organizations in our sample would not likely qualify for exempt status even if they met the organizational test.<sup>24</sup> For example, one organization's website solicits donations for research about a specific illness that affects the organizer's child.<sup>25</sup> The only indication that contributions could be used other than for the benefit of the organizer's child is the statement that other named, well-known IRC § 501(c)(3) organizations "will benefit from all proceeds raised." Thus, serious questions of inurement are presented by this organization's website.

Evidently interested in learning more about its use of Form 1023-EZ, TE/GE plans to engage an independent consultant, MITRE, to "conduct an independent assessment of the efficacy of Form 1023-EZ."<sup>26</sup> The focus of the MITRE study is "measuring and evaluating EO's current pre- and post-determination sampling practices and to identify applications in need of closer inspection prior to making a determination."<sup>27</sup> TE/GE intends to measure the efficacy of Form 1023-EZ sampling practices primarily by comparing Form 1023-EZ determinations and subsequent compliance by Form 1023-EZ filers with corresponding data for Form 1023 filers.<sup>28</sup> Investigating how to improve procedures for reviewing *every* application for IRC § 501(c)(3) status — before conferring that status — does not appear to be the primary purpose of the project.

### The Adoption of Form 1023-EZ Alleviated Form 1023 Processing Backlogs, But the Improvement May Be Temporary

Prior to the introduction of Form 1023-EZ, the increased number of applications for exempt status and the decrease in the number of EO employees who handle them was a recurring theme in the National Taxpayer Advocate's Annual Reports to Congress.<sup>29</sup> By the first half of FY 2014, average cycle time (the number of days that elapse between the date the application was received and the date it was closed) for all approved applications was 315 days.<sup>30</sup> TE/GE's announced goal was to process all applications

24 As noted above, to qualify for IRC § 501(c)(3) status, an organization must also satisfy the "operational test" which is met if: the organization engages primarily in activities which accomplish one or more of the eight exempt purposes specified in IRC § 501(c)(3); no more than an insubstantial part of its activities is not in furtherance of an exempt purpose; and it is operated to further public rather than private interests. See Treas. Reg. § 1.501(c)(3)-1(c)(1), (d)(1)(ii). We did not attempt to develop a conclusion about whether organizations in our sample met the operational test. However, an EO Determinations employee reviewing a Form 1023-EZ application would consult relevant information such as the organization's website in making a determination as to exempt status. See Internal Revenue Manual 7.20.9.4.6, *Pre-determination Review and Tax Examiner Referral Cases (Specialist)* (June 27, 2016).

25 The organization's articles of incorporation do not contain any purpose clause and thus the organization does not meet the requirements for IRC § 501(c)(3) status on that basis alone.

26 TE/GE FY 2017 Third Qtr. BPR 5 (Oct. 2017).

27 TE/GE response to TAS fact check request (Dec. 8, 2017).

28 TE/GE explains, "The scope of the work will include quantifying the accuracy and precision of current 1023-EZ sampling practices, comparing the 1023-EZ data with the 1023 data to look for variances or other anomalies. MITRE will review our pre-determination sampling methodology and compare determination results, subsequent Form 990 filings, and audit results for entities using the 1023-EZ against those of organizations that submitted full 1023 filings before the EZ was created. MITRE will also stratify the 1023-EZ population to determine whether the sampling strategy can be made more efficient. It will also investigate models for identifying entities that are potentially non-compliant."

29 National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*); National Taxpayer Advocate 2004 Annual Report to Congress 193, 203 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*).

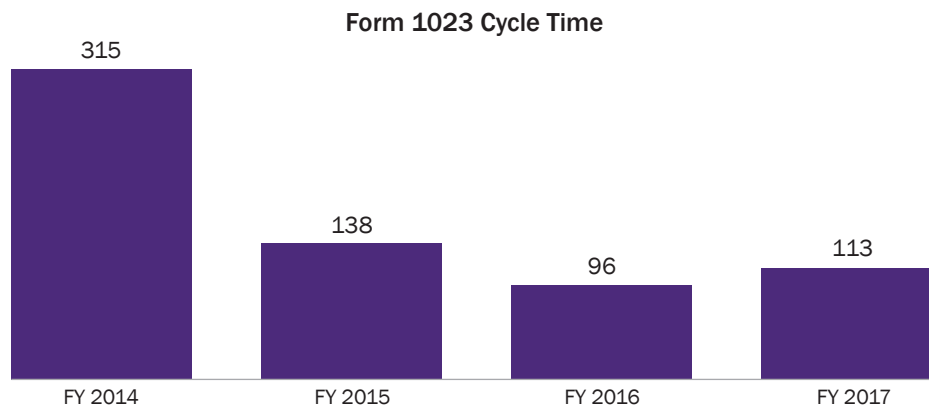
30 National Taxpayer Advocate 2015 Objectives Report to Congress 47-48 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*). Virtually all applications were for exempt status under IRC § 501(c)(3) rather than under another subsection such as (c)(4).



within six months.<sup>31</sup> By the end of FY 2015, Form 1023 cycle time had been reduced to 138 days. At the beginning of FY 2016, TE/GE realigned more than 20 percent of the EO Determinations specialists who evaluated Form 1023 applications to the EO Examination function.<sup>32</sup> By the end of FY 2016, Form 1023 cycle time was 96 days but for FY 2017 increased to 113 days.<sup>33</sup>

Figure 1.5.2 shows the average cycle time for Form 1023 applications in recent years.

**FIGURE 1.5.2**



Cycle time for Form 1023-EZ has always hovered at around 14 days.<sup>34</sup> This cycle time is achievable because it takes only a little more than 30 minutes of direct time on average to evaluate a Form 1023-EZ application.<sup>35</sup> Thirty minutes or so may be sufficient to ascertain whether an applicant checked the appropriate boxes on Form 1023-EZ, signed the form, and paid the user fee, but it is difficult to

31 Jeff Carlson, *IRS Making Progress in Improving 501(c)(3) Application Process, Says Koskinen*, CCH News (Apr. 8, 2014), reporting on Commissioner Koskinen's testimony before the House Appropriations Committee Subcommittee on Financial Services and General Government on the FY 2015 IRS budget at <http://tst-news.cchgroup.com.php56-7.ord1-1.websitetestlink.com/2014/04/08/irs-making-progress-in-improving-501c3-application-process-says-koskinen/>.

32 TE/GE response to TAS information request (Aug. 31, 2017), noting that in FY 2015, there were 134 full-time equivalent EO Determinations specialists, who evaluate applications submitted on Form 1023; Form 1024, *Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120*; Form 8940, *Request for Miscellaneous Determination*; and Form 1028, *Application for Recognition of Exemption*; and other letter applications (other than Form 1023-EZ). In FY 2016, TE/GE realigned 31 one full-time equivalent EO Determinations specialists to EO Exam. As of the third quarter of FY 2017, there were 75 full-time Determinations specialists evaluating these applications.

33 TE/GE response to TAS information request (Oct. 20, 2017). The response also noted that EO Determinations "has no plans to reassign any FTEs [full-time equivalent employees] to other areas of EO or other TE/GE functions. However, EO Determinations does anticipate a reduction of case working revenue agents within the Determinations' function due to attrition (retirements, competitive selections for other positions, etc.)." The response also notes that the EO Rulings and Agreements function "plans to solicit 20 Grade 11 revenue agents from EO Examinations to assist with processing EO Determinations cases for a NTE [not to exceed] one year period."

34 TE/GE response to TAS information request (Oct. 20, 2017). The number of full-time equivalent employees who process Form 1023-EZ applications has been stable, at approximately 29. TE/GE responses to TAS information request (Aug. 31, 2017 and Oct. 20, 2017).

35 TE/GE FY 2017 Third Qtr. BPR, at 16 (Oct. 2017), reporting that determination hours per case for Form 1023-EZ applications averaged 36 minutes in FY 2017. In contrast, it took 2.6 hours on average to evaluate a Form 1023 application in FY 2017. When a Form 1023-EZ application is selected for review as part of TE/GE's pre-determination process, the review takes an average of 2.6 hours. TE/GE response to TAS fact check request (Dec. 8, 2017), noting that this estimate includes only time directly attributable to the case by the Revenue Agent. As of June 30, 2017, audits of Form 1023-EZ filers were taking on average 14.6 hours. TE/GE FY 2017 Third Qtr. BPR, at 30 (Oct. 2017) (describing audits of cases assigned project code 8004).

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By the end of FY 2015, Form 1023 cycle time, which had been 315 days in the first half of 2014, had been reduced to 138 days and by the end of FY 2016, cycle time was 96 days; the FY 2017 cycle time for Form 1023 increased to 113 days.

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understand how an actual determination as to exempt status can be made in that amount of time. The National Taxpayer Advocate has always maintained that Form 1023-EZ should solicit additional information sufficient to allow the IRS to make a reasoned determination and at the same time drive compliant behavior when organizations are forming.<sup>36</sup>

In response to the National Taxpayer Advocate's September 26, 2016 Taxpayer Advocate Directive (TAD), the IRS agreed to revise Form 1023-EZ to require applicants to submit a brief narrative statement of their actual or planned activities.<sup>37</sup> This welcomed change may reduce the rate at which TE/GE erroneously approves Form 1023-EZ applications. The Deputy Commissioner for Services and Enforcement rescinded that portion of the TAD in which the National Taxpayer Advocate ordered the IRS to also require submission of organizing documents (unless the documents are already retrievable from a state online database) and summary financial information such as past and projected revenues and expenses.

## CONCLUSION

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. 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.

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<sup>36</sup> See, e.g., National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 35, 64 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*) referencing the desirability of requiring from applicants seeking IRC § 501(c)(3) status: (1) the articles of incorporation (2) the bylaws (3) a narrative statement and (4) attestations of core requirements such as having a conflicts of interest policy — all of which drive better practices and behavior at the outset of the entity's existence.

<sup>37</sup> Memorandum from the Deputy Commissioner for Services and Enforcement to the National Taxpayer Advocate (Oct. 25, 2016) sustaining in part National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016). See also T.D. 9819, 82 Fed. Reg. 29730-01 (June 30, 2017), final Treasury regulations that permit the IRS to adopt Form 1023-EZ and note in the preamble that the regulations are sufficiently flexible to allow revision of Form 1023-EZ to require filers to submit information regarding their proposed activities.



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Require Form 1023-EZ applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents.
2. Require Form 1023-EZ applicants to submit summary financial information such as past and projected revenues and expenses.
3. Revise Form 1023-EZ to include a question about whether the organization has a conflicts of interest policy.
4. Accept electronically Form 1023-EZ supporting documents, such as articles of incorporation.
5. Make a determination about qualification as an IRC § 501(c)(3) organization only after reviewing a Form 1023-EZ applicant's narrative statement of actual or planned activities, organizing documents, and any other supporting documents.
6. Make the primary purpose of the contract with MITRE to investigate how to improve procedures for reviewing every application for IRC § 501(c)(3) status, before conferring that status.