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Draft Version of Simplified Exemption Application Criticized.

Draft Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," does not ask for enough information and therefore could hinder the IRS's ability to ferret out applications filed under false pretenses, according to Arthur Rieman and Jessica Shofler of The Law Firm for Non-Profits P.C.

April 30, 2014

Office of Information and Regulatory Affairs,
Office of Management and Budget
ATTN: Desk Officer for Treasury
New Executive Office Building, Room 10235
Washington, DC 20503

Treasury PRA Clearance Officer
1750 Pennsylvania Ave. NW., Ste 8140
Washington, DC 20220

Re: Comment on Draft Form 1023-EZ (OMB Number 1545-0056)

To Whom It May Concern:

This letter is written as a comment to the draft Form 1023-EZ (Rev. 5-2014). The Law Firm for Non-Profits, P.C. has been assisting exempt organizations for more than twenty years and has prepared and submitted hundreds of Forms 1023. We have concerns about the use of the Form 1023-EZ as drafted, which are set forth below along with our recommendations:

Concerns:

- From our experience, a great many people desire to and do establish 501(c)(3) organizations under false pretenses (e.g., to obtain contributions or avoid taxation). This is borne out by the fact that the Service denies a large number of exemptions for organizations of all sizes on the basis of private inurement.
- Exemption based on a properly completed Form 1023-EZ will be all-but-automatic. That is, there will be NO SCRUTINY of the applicant other than to ensure that all boxes and blank lines on the application form are properly completed.
- The narrative portions of Form 1023 enable Exempt Organization Specialists the opportunity to ferret out exemption applications filed under false pretenses. Form 1023-EZ eliminates these narrative portions, eviscerating the Service's ability to identify such exemption applications and thus deny exemption to those applicants.
- Rather than requiring applicants to describe their exempt activity, Form 1023-EZ would automatically recognize as exempt any organization whose founder ticks nine boxes "attesting"

that he or she complies with certain legal requirements. Signing under penalty of perjury will not stop people from using the Form 1023-EZ under false pretenses. Requiring an applicant to set forth a narrative of the organization's intentions instead of simply checking boxes increases the likelihood that (1) an applicant understands he or she will be held responsible for the information set forth in the application, and (2) that Exempt Organization Specialists will identify and deny exemption to applicants that file under false pretenses.

- Form 1023-EZ converts the privilege that is exemption under § 501(c)(3) to something akin to applying for a library card. With its adoption of Form 1023-EZ, the IRS will no longer have the ability to ensure that organizations that claim the privilege of exemption under section 501(c)(3) actually meet that statute's requirements.
- An applicant for exemption may use Form 1023-EZ if it attests that its annual revenue during its first three years of operation is not expected to exceed \$200,000. The applicant is not required to provide a projected budget with the application. This will lead to abuse in the application process. As there will be no substantive scrutiny of an applicant's Form 1023-EZ, those filing under false pretenses will certainly claim that their annual expected revenue will not exceed \$200,000 in order to avoid the review by an Exempt Organization Specialist that would take place if the applicant instead filed a Form 1023.
- The Service estimates that 17% of Applicants for exemption under § 501(c)(3) of the Internal Revenue Code will use Form 1023-EZ. The lack of scrutiny afforded organizations that use Form 1023-EZ will incentivize applicants to underestimate their projected revenue in order to use Form 1023-EZ instead of Form 1023. This will result in a far greater percentage of such applicants using Form 1023-EZ, perhaps as much as 50%.
- The Service vastly overestimates the time it takes to complete Form 1023 and the time it will take to complete Form 1023-EZ, at 101 hours and 14 hours, respectively. Based on our experience, it takes a nonprofessional an average of about 20 hours to complete Form 1023. It will take under an hour for the average person to complete Form 1023-EZ.
- Form 1023-EZ was developed by the IRS in consultation with Lean Six Sigma consultants. Lean Six Sigma is a methodology used by businesses to manage and improve business processes. Its stated goal is to identify and remove *nonessential and non-value added* steps in a process. Adoption of Form 1023-EZ by the Service would suggest that review of an applicant's proposed activities does not add value to the review process.
- By automatically recognizing as exempt any organization that submits a properly completed Form 1023-EZ, the Service will shift the burden of enforcement almost entirely to the investigation and audit function. This will be a costly mistake. It takes much greater resources to ferret out and stop an organization that is violating the law than it does to review an exemption application and deny exemption.
- Further, Form 1023-EZ will unleash an unprecedented number of exemption applications — and will in effect encourage individuals to establish unnecessary exempt organizations. In turn this will substantially increase the number of 501(c)(3) organizations. Without a concomitant increase in the exempt organization investigation and audit staff, the Service will not have the resources to effectively monitor and audit 501(c)(3) organizations. In turn, this will lead to increased abuse of exempt organization law, including private inurement and noncharitable activity, by organizations established under false pretenses.

Recommendations:

- 1. It may be appropriate for small organizations to submit an abbreviated version of the Form 1023, but the proposed Form 1023-EZ does not include information sufficient for Exempt Organization Specialists to make the exemption determination. The Form 1023-EZ should include information about an applicant's proposed budget and activities.

2. Where eligibility to file Form 1023-EZ is based on projected annual gross receipts and assets, the projection requirement should be far lower. The Form 1023-EZ is only appropriate for organizations that are similar to those filing the Form 990N-ePostcard. In addition, there must be substantive penalties imposed on organizations that clearly under-project their revenue.

3. It should be made more apparent that the Form 1023-EZ is being filed under penalty of perjury. Filers must be reminded that a fraudulent claim to meeting the Form 1023-EZ's eligibility requirements is a crime punishable by time in prison.

Thank you in advance for your consideration of this firm's concerns and recommendations.

- Very truly yours,
- Arthur Rieman, Esq.
- Jessica Shofler, Esq.
- The Law Firm for Non-Profits, P.C.
- Studio City, CA

cc:

Rep. Darryl Issa

Rep. Brad Sherman

Rep. Xavier Becerra

Tax Analyst