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FORM 1023-EZ: Recognition As a Tax-Exempt Organization Is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to Be Taxable

RESPONSIBLE OFFICIAL

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DEFINITION OF PROBLEM

In 2014, over the objections of the National Taxpayer Advocate and other stakeholders, the IRS began addressing backlogs in its inventory of applications for tax-exempt status by allowing certain organizations to use new Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.² Form 1023-EZ adopts a “checkbox approach,” requiring applicants merely to attest, rather than demonstrate, that they meet fundamental aspects of qualification as an exempt entity.

Unlike Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, Form 1023-EZ does not solicit any narrative of the organization’s activities, any financial data, any substantiating documents, or any explanatory material.³ With the adoption of Form 1023-EZ, the IRS effectively abdicated its responsibility to *determine* whether an organization is organized and operated for an exempt purpose.⁴

Experience thus far with the “streamlined” application procedures that Form 1023-EZ exemplifies has not been encouraging:

- IRS audits demonstrate that eight percent of Internal Revenue Code (IRC) § 501(c)(3) organizations do not make required changes to their organizing documents even after they attest they have done so;⁵

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 See National Taxpayer Advocate Fiscal Year (FY) 2015 Objectives Report to Congress 54-7. Among other things, organizations eligible to submit Form 1023-EZ must generally have annual gross receipts of less than \$50,000 and assets of less than \$250,000.

3 Form 1023-EZ applicants, who must file electronically, cannot submit anything with the application other than the three-page form itself, even if they want to.

4 See Patricia Cohen, *I.R.S. Shortcut to Tax-Exempt Status Is Under Fire*, N.Y. TIMES (Apr. 9, 2015) (noting “[a]n unlikely coalition of tax lawyers, state enforcement agents and even many nonprofits that favor simpler rules say that the agency — by not asking any questions about governance, conflicts of interest or function, and saying applicants don’t have to reveal any such issues — is making it too easy to commit fraud”).

5 Tax Exempt and Government Entities (TE/GE) Division Second Qtr Business Performance Review (BPR) 2015 at 2 (May 2015).

- The IRS's own analysis of a representative sample of Form 1023-EZ filers shows that the IRS approves a significant number of applications it would have rejected had the applications been subject to a slight amount of scrutiny;⁶
- TAS's analysis of a representative sample of Form 1023-EZ applicants whose applications were approved by the IRS shows that 37 percent were not, as a matter of law, IRC § 501(c)(3) organizations; and⁷
- The frequency at which IRC § 501(c)(3) organizations were referred to the Exempt Organization (EO) Examination function increased almost ninefold from FY 2014 to FY 2015.⁸

As the Tax Exempt and Government Entities division (TE/GE) acknowledges, the IRS intends to address the “perceived inadequate oversight” that stems from its new Form 1023-EZ procedures by shifting more resources to audits. This back-end, labor-intensive approach invites noncompliance, diverts tax dollars and taxpayer donations, and harms taxpayers that could have adjusted their organizing documents or the activities they pursued if the IRS had advised them of the need to do so from the outset.⁹ While audits serve a role in furthering taxpayer compliance, they are no substitute for preventive, front-end efforts to avoid compliance issues in the first place. Thus, the proposed 1023-EZ audit strategy is a misallocation of IRS resources and an unnecessary burden on compliant exempt organizations.

ANALYSIS OF PROBLEM

The Law Requires an Exempt Entity's Organizing Document to Contain Key Elements, and It Is Not Difficult to Determine Whether the Requirements Are Met

In order to be exempt from tax as an IRC § 501(c)(3) organization, an entity's organizing documents must establish that it is “organized and operated exclusively” for one of eight enumerated exempt purposes.¹⁰ Form 1023 requires applicants to submit their organizing documents; instructions for the form explain the need for and provide examples of appropriate purpose and dissolution clauses.¹¹ By inspecting organizing documents and withholding exempt status until the organization's documents meet the legal

6 TE/GE, *Form 1023-EZ First Year Report* 5; EO Response to TAS information request (Oct. 29, 2015).

7 See *Study of Taxpayers that Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra*, (describing TAS's analysis of a representative sample of 408 corporations obtaining exempt status on the basis of Form 1023-EZ located in one of 20 states that make articles of incorporation available online at no cost). Reports of increased levels of customer satisfaction with Form 1023-EZ are not surprising, given that recognition as an IRC § 501(c)(3) organization is now easily available to some organizations that do not actually qualify for that status. See Diane Freda, *Exempt Organizations: First Year Survey of Form 1023-EZ Confirms Popularity*, BNA DAILY TAX REPORT (Dec. 5, 2015).

8 TE/GE responses to TAS information request (June 11, 2015; Nov. 25, 2015).

9 TE/GE BPR First Qtr 2015 Appx. B, TE/GE Risk Register (Feb. 2015) (noting that “[p]erceived inadequate oversight of the tax-exempt sector as we undertake strategic shifts in how we conduct the up-front review of applications for tax-exempt status...” will be mitigated by “[e]xpanded compliance efforts.”).

10 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing “[a]n organization is organized exclusively for one or more exempt purposes *only* if its *articles of organization*,” among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing “[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...” (emphasis added)). In nine states, sometimes referred to as *cy pres* states, a dissolution clause is not required 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. See Rev. Proc. 82-2, 1982-1 C.B. 367; Tex. Bus. Orgs. Code Ann. § 22.304(a)(2) (2012).

11 See Part II of Form 1023; Instruction, Form 1023 at 7 (providing examples of acceptable purpose and dissolution clauses).

requirements, EO can correct noncompliance and avert noncompliance that might otherwise arise as the organization operates.

On the other hand, when EO fails to inspect articles of incorporation, it risks recognizing as IRC § 501(c)(3) organizations those that do not meet the legal requirements. For example, the IRS recognized as tax-exempt a Form 1023-EZ applicant whose articles of incorporation describe its purpose as:

My father [named individual], suffered [sic] a spinal cord injury in February 2013, which left him a quadriplegic [sic]. His physicians and physical therapists say he is capable of recovering and walking again but his insurance ((name of State] Medicaid) will not cover the expense, so we are hosting fundraisers/benefits to try to raise the money on our own to pay for his therapy out of pocket.¹²

This description raises serious doubts about whether the applicant intends, or would even be permitted by its articles, to serve a public, as opposed to a private, interest. Presumably, if EO had reviewed these articles of incorporation before conferring exempt status, it would have required additional information and insisted on changes to the articles before granting exempt status.

It appears that reviewing an applicant's case file and its articles of incorporation and then requesting amendments to the articles of incorporation takes the Tax Exempt and Government Entities Exempt Organizations function about an hour. This is a small price to pay to prevent waste, error, and abuse.

As another example, the IRS recognized as exempt a corporation whose articles are devoid of any purpose clause or description of current or planned activities (and do not allow any insight about what those activities may be), and contain the following dissolution clause: “Assets will be distributed to registrant of entity [individual taxpayer's name], if this nonprofit dissolves.”¹³ Assets that are ultimately destined for the founder's or some other individual's pocket cannot be viewed as dedicated to an exempt purpose. Had EO reviewed these articles of incorporation before it conferred exempt status, it presumably would have required their amendment.

TAS evaluated articles of incorporation of a representative sample of approved Form 1023-EZ filers incorporated in the 20 states in which the Secretary of State maintains a website that permitted TAS to view legible copies of articles of incorporation at no charge to determine whether they meet the organizational test. Such review took about three minutes on average and identified a significant portion of organizations whose applications have been erroneously approved.¹⁴ It appears that reviewing an applicant's case file and its articles of incorporation and then requesting amendments to the articles of incorporation takes EO about an hour.¹⁵ This is a small price to pay to prevent waste, error, and abuse.

¹² This is the entire text that appears as the “purposes/nature of the business” in the articles of incorporation of an organization included in a representative sample of corporations whose Form 1023-EZ application was approved. See *Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra*.

¹³ This is the actual entire dissolution clause in the articles of incorporation of an organization included in a representative sample of corporations whose Form 1023-EZ application was approved. *Id.*

¹⁴ *Id.*

¹⁵ TE/GE response to TAS information request (June 11, 2015), noting “anecdotally, employees charge approximately one hour to review a case file, check the state website, and write an additional information letter which would include the request for the Articles of Incorporation and/or amendments, as needed.”

For Years, the Form 1023 Application Process Was Plagued by Delay

In the decade prior to the introduction of Form 1023-EZ, the National Taxpayer Advocate voiced concerns about delays in processing applications submitted on Form 1023.¹⁶ By 2012, the volume of EO's open inventory was 36,034 cases, applications requiring little or no development were taking four months to close, and applications requiring assignment to a reviewer were taking nine months just to be assigned.¹⁷ By 2013, the application inventory backlog stood at about 66,000 cases, and applications requiring review took a year and a half to be assigned.¹⁸

The National Taxpayer Advocate has, since 2011, recommended that the IRS develop a Form 1023-EZ for use by small organizations.¹⁹ Little did she know that the IRS, after initially dismissing the suggestion outright, would ultimately take that idea and run with it to the point of absurdity.

The Tax Exempt and Government Entities Exempt Organizations function approved Form 1023-EZ applications much less frequently — 77 percent of the time, compared to 95 percent of the time — when it requested documents or basic information from the applicants, rather than relying on the attestations contained in the form.

EO Implemented Streamlined Procedures That Addressed the Form 1023 Inventory Backlog But at the Price of Actual Oversight

In October and November of 2013, as part of a three-week pilot project, EO adopted “streamlined procedures” to address its existing inventory backlog of applications submitted on the 12-page Form 1023 that needed further development. These procedures allowed some applicants to provide “assurance of meeting the organizational and operational tests through representational attestations” rather than by submitting substantiating documents.²⁰ EO expanded the project in January of 2014 and now uses streamlined procedures to evaluate *all* Form 1023 applications.²¹ For example, if the applicant is a corporation and does not submit its articles of incorporation as required, the agent reviewing the application may retrieve the articles from official online State records, and if the corporation is legally formed and appears to otherwise qualify for favorable determination under IRC § 501(c)(3), the agent simply asks the organization for confirmation.²² On the other hand, if the articles of incorporation do not meet the organizational test, but the applicant appears to otherwise qualify for favorable determination and no other organizing document issues need to be addressed, the agent merely asks the applicant to attest that the articles have been amended to correct the deficiency (but the organization is not required to submit amended articles).²³

16 See, e.g., National Taxpayer Advocate 2004 Annual Report to Congress 193 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*); National Taxpayer Advocate 2011 Annual Report to Congress 437 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*).

17 National Taxpayer Advocate 2012 Annual Report to Congress 192, 196, 205.

18 National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*).

19 National Taxpayer Advocate 2011 Annual Report to Congress 437, 444, 562.

20 See *Proposal to Apply the Concepts from the Streamlined Application Process Pilot to Existing Inventory*, attached to TEGE-07-0215-0005, *Reissued Streamlined Processing Guidelines for All Cases* (Feb. 27, 2015).

21 *Id.*

22 TEGE-07-0315-0006, *Streamlined Processing Guidelines for All Cases* (Mar. 12, 2015). More than 20 states currently make corporations' articles of incorporation viewable online free of charge. TE/GE Third Qtr BPR 2015 at 5 (Aug. 2015).

23 TEGE-07-0315-0006, *Streamlined Processing Guidelines for All Cases* (Mar. 12, 2015).

TE/GE has begun to audit some filers that obtained exempt status using streamlined procedures.²⁴ As of March 27, 2015, TE/GE had started 284 audits and closed 51.²⁵ Of the closed audits of IRC § 501(c)(3) organizations, eight percent failed to meet the organizational test at the time the examination commenced, even though they had already interacted with TE/GE after they had filed Form 1023 — *i.e.*, assuming that TE/GE followed its own procedures, after reviewing the Form 1023, it notified the organizations of the deficiencies in their organizing documents and the organizations attested that those deficiencies had been corrected.²⁶ For the amount of time it took to correspond with and audit these organizations, EO could have required a copy of the amended articles after its initial review in the application phase, making certain, while it had the organizations' attention and leverage over them, that they met the organizational test. Instead, the IRS substituted an exchange of correspondence (and issued a favorable determination letter) for actual oversight of organizations it knew were not compliant.

The IRS Approved Virtually All Form 1023-EZ Applications, Despite Its Own Analysis Showing Form 1023-EZ Provides Insufficient Information

In the first year after introduction, EO approved 95 percent of applications submitted on Form 1023-EZ.²⁷ When it introduced Form 1023-EZ, TE/GE committed to review a sample of Form 1023-EZ applications in greater detail before making a determination.²⁸ As of June 26, 2015, EO had selected 1,191 organizations for pre-determination review, and had closed 965 of these 1,191 cases.²⁹ EO agents requested additional information from these applicants, such as “the organizing document with language required to meet the organizational test” and “a detailed description of past, present, and future activities; revenues and expenses.”³⁰ As Figure 1.3.1 shows, EO approved Form 1023-EZ applications much less frequently — 77 percent of the time, compared to 95 percent of the time — when it requested documents or basic information from the applicants, rather than relying on the attestations contained in the form.

24 In 2014, TE/GE began a post-determination audit program of organizations (both Form 1023 filers and those that filed Form 1024, *Application for Recognition of Exemption Under Section 501(a)*) that received exempt status from April - September 2014 under the streamlined procedures. Correspondence audits of a statistical sample of these organizations began in October 2014, with the plan of starting 1,400 new audits and closing 1,200 in FY 2015. See *Post-Determination Compliance (PDC) Examinations*, TE/GE BPR Second Qtr 2015 at 2 (May 2015).

25 TE/GE Second Qtr BPR 2015 at 2 (May 2015).

26 TE/GE's third quarter BPR reports that as of June 26, 2015, TE/GE had closed 204 audits, but does not report how many organizations failed to meet the organizational test at the time the audit commenced. TE/GE Third Qtr BPR 2015 at 7 (Aug. 2015). TE/GE requests any necessary amendments to organizing documents during the audit process. TE/GE response to TAS information request (June 11, 2015).

27 TE/GE Third Qtr BPR 2015 at 4 (Aug. 2015) (reporting that in the year since it introduced Form 1023-EZ, EO received 43,157 Form 1023-EZ applications). It closed 42,089, of which it approved 39,907, an approval rate of 95 percent.

28 See Rev. Proc. 2014-40, § 5.03, 2014-30 I.R.B. 229 (providing that “the Service will select a statistically valid random sample of Forms 1023-EZ for pre-determination reviews”); Rev. Proc. 2015-5, § 5.03, 2015-1 I.R.B. 186 (providing the same). Interim guidance to employees describes as the goals of the review to: “Identify applicants that do not qualify for exemption; Identify applicants that are not eligible to file Form 1023-EZ (those that should have completed the full Form 1023); Gauge the effectiveness of Form 1023-EZ (*i.e.*, identify situations in which a streamlined application was not appropriate such as where the activities should have been addressed in full development); Learn about the population of organizations applying for exemption using Form 1023-EZ; Enhance public trust by reinforcing that submission of Form 1023-EZ does not guarantee tax exemption will be recognized.” TEGE-07-0714-0017, *Interim Guidance on Processing Form 1023-EZ* (July 1, 2014).

29 TE/GE, *Form 1023-EZ First Year Report* 5-6, EO Response to TAS information request (Oct. 29, 2015).

30 *Id.*

FIGURE 1.3.1³¹

Form 1023-EZ Approval Rates



EO rejected 152 applications included in the pre-determination review sample because the organization was ineligible to apply using Form 1023-EZ (even though Form 1023-EZ applicants attest they have completed an Eligibility Worksheet included in the instructions to the form and are eligible to use the form), or because the organization did not respond to the request for additional information.³² It is possible that these applicants would qualify as IRC § 501(c)(3) organizations. However, as of March 27, 2015, EO had also identified 181 cases in which a review of the organization's articles of incorporation revealed that the applicant did not initially meet the organizational test, despite their attestations to the contrary.³³ Even assuming that no further such organizations were identified by the time TE/GE made its determinations in all 965 cases it had closed by June 26, 2015, the 181 organizations that did not initially meet the organizational test represent a rate of noncompliance of almost 20 percent.³⁴

31 TE/GE, *Form 1023-EZ First Year Report* 5, EO Response to TAS information request (Oct. 29, 2015).

32 *Id.* at 5-6, EO Response to TAS information request (Oct. 29, 2015) (reporting that 68 applications were rejected because the applicant was not eligible to apply using Form 1023-EZ and 84 applications were rejected because the organization did not respond to a request for additional information). Because TE/GE adopted the practice of making follow-up calls to nonresponsive organizations, the rate of nonresponse has declined from 12 percent of all applications (in the first six months of Form 1023-EZ processing) to six percent (in the second six months of Form 1023-EZ processing), which has presumably resulted in an increase in the approval rate.

33 TE/GE response to TAS information request (June 11, 2015). In those cases, EO requested the organizations to amend their organizational documents and accepted an attestation, under penalties of perjury, that the document had been amended to include the required provisions.

34 Moreover, EO's initial review of the description of the organization's activities identified 40 organizations that did not meet the operational test. To the extent these 40 organizations were not already counted among those that failed the organizational test, the rate of noncompliance was greater than 20 percent. In these cases, EO requested clarification in an additional information letter, or, as happened in four cases, if the description indicated the applicant could qualify under a different subsection of the Code, such as IRC § 501(c)(4), EO asked the organization to reapply on Form 1024. In one case, the description indicated the applicant did not qualify for recognition of exemption, and EO advised the applicant it would propose an adverse determination. TE/GE response to TAS information request (June 11, 2015). Ultimately, 21 of the 40 applications were approved. Fifteen applications were rejected (eight because the organization did not respond to the request for information, six were not eligible to use Form 1023-EZ, and one had an invalid EIN. Four organizations appeared to not qualify as IRC § 501(c)(3) organizations and withdrew their applications (three of these four were encouraged to reapply by submitting Form 1024). TE/GE response to TAS information request (Oct. 27, 2015).

Figure 1.3.2 summarizes the rate at which EO's own analyses showed that organizations did not meet the organizational test, as demonstrated by the two separate review or audit programs:

- EO's post-determination audits of organizations whose Form 1023 was approved using streamlined procedures; and
- EO's pre-determination review of a representative sample of organizations that submitted Form 1023-EZ.

FIGURE 1.3.2³⁵

Rate at Which Applicants for Exempt Status Did Not Meet Organizational Test for Qualification as an IRC § 501(c)(3) Organization



TAS Analysis of Approved Organizations Shows Many Did Not Meet the Requirements for Exempt Status, Often for Reasons They Could Have Easily Corrected Had EO Reviewed Their Documents

From July through September 2015, TAS reviewed a representative sample of 408 organizations whose Form 1023-EZ applications were approved.³⁶ The analysis showed that 149, or 37 percent, of the organizations in the sample did not satisfy the organizational test. Of these 149 organizations, 22 appeared to have an adequate purpose clause, but lacked a sufficient dissolution clause (where one was required), a condition the organizations could have easily corrected had they been advised to do so. For some organizations, an exempt purpose could be inferred even though the articles did not have an adequate purpose clause. These organizations might very well have been able to craft an accurate, tax-compliant purpose clause had they been advised of the need to do so, and correcting that deficiency might have averted future noncompliance as they commenced or continued their operations.

The numbers show that the IRS is actually undermining compliance by failing to take simple prophylactic measures, such as requesting and reviewing an applicant's organizing documents, before conferring exempt status.

³⁵ TE/GE Second Qtr BPR 2015 at 2 (May 2015); TE/GE response to TAS information request (June 11, 2015).

³⁶ See *Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra* (describing TAS's analysis of a representative sample of 408 corporations obtaining exempt status on the basis of Form 1023-EZ located in one of 20 states that make articles of incorporation available online at no cost).

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The IRS Intends to Audit Its Way Out of the Potential Noncompliance It Helped Create

TE/GE will begin correspondence audits of Form 1023-EZ filers in FY 2016, selecting cases through a statistical sample of organizations that have operated for a complete tax year after receiving a determination letter.³⁷ However, TE/GE, rather than sampling from all organizations that received exempt status on the basis of Form 1023-EZ, will only sample from approved Form 1023-EZ filers that filed a 990-series return.³⁸ E-Postcard submitters are required to submit the e-Postcard annually, and will lose their exempt status if they fail to do so, but only if the failure persists for three consecutive years.³⁹ To the extent organizations required to submit an e-Postcard do not do so every year, TE/GE will have an incomplete sample of approved Form 1023-EZ filers. It remains to be seen whether, if the post-determination audits of Form 1023-EZ filers show high levels of noncompliance, TE/GE will adjust its procedures by strengthening its initial review process.

We also note that from FY 2014 to FY 2015, the frequency with which EO Determinations employees referred IRC § 501(c)(3) organizations to TE/GE's EO Examination function increased almost ninefold.⁴⁰ In view of the fact that this surge in referrals coincided with the introduction of Form 1023-EZ, TE/GE might gain further insight into compliance levels of Form 1023-EZ filers by analyzing these referrals in greater detail.

To its credit, TE/GE is implementing a broader compliance risk framework, expected to unfold over several years, that entails defining and measuring compliance for the exempt organization population. It plans to divide the population into meaningful market segments, grouped by common traits, behavior, and interactions with the IRS. It will then (1) select a random sample for each market segment, both to establish an initial baseline compliance rate and to develop a market segment-specific compliance risk model; (2) assign different treatment types to each organization based on its risk score; and (3) re-evaluate the model and treatments based on the results.⁴¹ The National Taxpayer Advocate has long advocated for more research into the behavior, needs, and preferences of exempt organizations.⁴² This work is very important, as the National Taxpayer Advocate noted in 2007 and 2009, and it is not mutually exclusive with the pre-determination oversight we recommend. In fact, the approaches work hand in hand.

37 TE/GE response to TAS information request (June 11, 2015).

38 TE/GE, *Form 1023-EZ First Year Report* 9, EO Response to TAS information request (Oct. 29, 2015).

39 IRC § 6033(j).

40 In FY 2014, EO Exam received 19 referrals from EO Determinations employees for all IRC § 501(c)(3) organizations, without distinction between Form 1023 and Form 1023-EZ filers. For FY 2015, EO Exam received 184 such referrals, an almost nine-fold increase. TE/GE responses to TAS information request (June 11, 2015; Nov. 25, 2015).

41 TE/GE response to TAS information request (June 11, 2015).

42 See, e.g., National Taxpayer Advocate 2007 Annual Report to Congress 197, 209 (recommending that the IRS conduct an exempt organization Taxpayer Assistance Blueprint (TAB) to study exempt organizations' service needs and preferences (by size and type of organization) and develop a plan to improve service to these organizations, followed by further research of the tax exempt sector, and that it "[d]edicate a group of employees, from both outreach and compliance functions, entirely to small EOs. Such entities have very different needs from mid-sized and large EOs and require a different approach."). See also National Taxpayer Advocate 2009 Annual Report to Congress 287, 299 (reiterating the recommendation that the IRS design and implement an exempt organization TAB in order to formulate a targeted outreach plan based on research).

CONCLUSION

By adopting Form 1023-EZ to address inventory backlogs, the IRS relinquished its power to effectively determine whether applicants qualify as IRC § 501(c)(3) organizations. The IRS's own analysis shows a significant discrepancy between the rate at which Form 1023-EZ filers obtain exempt status and the rate of approval when the IRS subjects their applications to a slight amount of scrutiny. TAS's review of Form 1023-EZ filers that obtained exempt status confirms there is a significant level of erroneous approvals. Rather than auditing its way out of the noncompliance it helped create, the IRS should reconsider its decision to use Form 1023-EZ in its present form.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise Form 1023-EZ to require applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents.
2. Revise Form 1023-EZ to require applicants to provide a description of their actual or planned activities and submit summary financial information such as past and projected revenues and expenses.
3. Make a determination only after reviewing the Form 1023-EZ application, the applicant's organizing documents, its description of actual or planned activities, and its financial information.
4. Where there is a deficiency in an organizing document, require an applicant to submit a copy of an amendment to its organizing document that corrects the deficiency and has been approved by the state, even where the documents are available online at no cost, before conferring exempt status.