

Should My Nonprofit Use the 1023-EZ Form?: The Pro's and Con's

Not long ago the IRS released a new Application for Exemption (1023-EZ) to help with backlog. Shorter, and filled out online, it allows certain organizations to get determination letters quicker. Typically those bringing in a small amount of revenue.

But in the time leading up to, and shortly after, finalizing the form you'd thought the IRS was banning Nutella (which would, in fact, justify a mutiny.) Accountants, lawyers, and state legislators were in arms. Things have died down, but it's not hard to find vocal critics every now and again.

What's the big deal? And is this something you should get in on?

"Squint" Organizations

The best way I can give context to the uproar is by anecdote. Every now and again I encounter what I call "squint" organization's. We sit down to coffee. And as they explain their mission/purpose I find myself squinting. Trying my best to grasp the concept. As they passionately explain they're raising funds so grandma can finally afford that motorhome. Or selling microwaves to fund the development of penguin shelters.

The longer 1023 form isn't a fail-safe, believe me. But those working with nonprofits know it helps weed "squint" organization's out. Organization's go through the application and find exempt orgs must operate for the benefit of the general public. Whoops, there goes grandma's motorhome. Or its activities must substantially relate to its charitable mission. So much for the microwave funded penguin homes.

But What About You?

Regardless of how anyone feels, the form is here. So for those tinkering with the idea of using the 1023-EZ form, here are a few things to think about.

Pro's

- **The process is much MUCH faster.** Applicants report the standard application process takes anywhere from 6 months to 1 and 1/2 years. And the amount of time can be important for organizations with grants pending receipt of a determination letter.
- **Filling out the application is quicker.** Because the application is shorter, and filled out online, it's much quicker to fill out. It's also far less intensive resource wise.
- **The application fee is cheaper.** The fee for applying is also much cheaper than the standard application is. There are a few caveats here, and the fee is non-refundable.
- **The barrier of entry is lower.** It's debatable whether this is good or bad. Most critics think this is a problem for ill-prepared or lower quality organizations. But it's easier for an organization to get exemption.

Con's

- **Audit more likely.** The IRS all-powerful have said the looser front end will create more capacity to enforce on the back end. In other words, audits. And lots of em'. To it might be safe to assume those who go the way of the 1023-EZ might be more susceptible to an audit.
- **Foundation grants harder to get.** Foundations have a responsibility to ensure funds go to qualifying organizations for permitted use. I've heard funders express concern with self-declaring under the 1023-EZ because some organizations may not actually "qualify". Without testing the model, organizations may find foundations asking more questions or shying away from orgs that file this way altogether.
- **Education opportunities lost.** The determination process can create opportunities for review and advice. Albeit long, the standard application explains legal requirements organizations

should be familiar with. There's also a review of organizational docs and ability to make clarifications. These opportunities are lost with the 1023-EZ form. Leaving some organizations in the dark until an audit.

- **There are still kinks.** Like anything new, there are still kinks with the form. So it can be confusing. For example, a presenter pointed out the way, "Do you lobby?" is asked it might lead organizations to believe that's a bad thing. But, the standard form makes it clear a certain amount of lobbying is ok.

- **Getting it wrong.** What if the organization doesn't qualify for an exemption? Especially a concern for novel organization's. All that time and expense, only to have the organization start over again? And it could be responsible for back taxes; not only on the federal but the state and local level.

Summary...

There are a few more pro's and con's. If I'm being honest, right now the con's still seem to be winning. The process is just so new and confusing. There's also inconsistencies. For example, the 1023-EZ checklist says you can't use the form if funds will be set aside or come with conditions. Well, every organization has funds come with conditions. So how does that work? What happens if an organization doesn't guess its gross income correctly and makes more than it anticipated? Does it lose exemption until it applies using the standard form? Or is just the belief enough? Not to mention, is lowering the barrier to the ability to fog up a piece of glass the way we want to go with those entrusted with public funds?

I guess we'll see. In the meanwhile, I can't fault organization's who go in this direction. But caution, all the uncertainty means they should spend more time and money on the front end to make sure ducks are in a row. Who knows how many organizations will get popped. But for those who do the effects may be devastating.