



April 30, 2014

Office of Information and Regulatory Affairs
Office of Management and Budget
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RE: Proposed Internal Revenue Service Form 1023-EZ, OMB Number 1545-0056

Thank you for the opportunity to comment on the proposed Form 1023-EZ as drafted on April 23, 2014. 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 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.

Before discussing the rationale for our recommendation regarding the Form 1023-EZ, we first address a consideration that was *not* a basis for our recommendation—that the Form 1023 should deter small organizations that are more likely to be formed without the necessary funding and infrastructure in place to survive long term from applying for recognition of exemption. We do not believe that the Form 1023 should be a barrier to exemption for these organizations and we frankly suspect that the current form, with its complexity, has that effect. We hold this view while fully acknowledging that there are sometimes beneficial effects when the form does act as a barrier. But as a policy matter, 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 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.

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. While the current Form 1023 clearly

needs to be redesigned and streamlined, in the end many of the questions on the current form will still need to be asked (in some form or another) of all organizations, both large and small, although reformatting will reduce the need for smaller organizations to respond to certain questions. 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.

While there is certainly abuse in both large and small charities, some practitioners and state charity regulators we spoke with noted that some types of small charities are particularly susceptible to abuse. In their view, some small charities seemingly do little more than pay salaries to their founders and insiders. It may also be easier to embezzle from a small charity because it has few or no staff and financial controls are perhaps not as strong as they should be. Moreover, small organizations often lack sufficient reserves to withstand such losses of resources. All these considerations are relevant to the application process for small organizations. 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.’”

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.

2012 ACT Report of Recommendations. "Exempt Organizations: Form 1023- Updating It for the Future," pages 31-33, located at http://www.irs.gov/pub/irs-tege/tege_act_rpt11.pdf.

State charities regulators use the same vital information collected on Forms 1023 to ensure compliance with federal tax regulations to carry out our respective state regulatory duties to protect charitable assets from fraud and abuse, and to ensure that charitable assets are used for the purposes represented to the public. We believe that the Form 1023-EZ will increase opportunity for fraud and heighten the burden on state regulators to compensate for the reduced standards that will be required of the organization to meet federal tax exemption requirements. While we appreciate that the IRS will be committing more resources to back-end compliance examinations to address the potential for malfeasance, our concern is that the current 17% of all applicants for which the Form 1023-EZ would apply could grow exponentially if the process for obtaining tax-exempt status was significantly simplified. Both IRS and state charities regulator enforcement capabilities are already stretched thin. 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" consistent with the spirit and purpose of the Paperwork Reduction Act. NASCO is taking a leadership role in trying to create substantive efficiencies for charitable organizations in meeting state and federal regulatory requirements. We are working with the Multistate Registration and Filing Project ("MFRP, Inc.") to develop a unified multistate charities registration website that will enable tax-exempt organizations to meet state regulatory registration requirements for every

state and, at the same time, file their annual Forms 990 at one convenient, easy to use website, without duplication of data entry. Making electronic filing uniform and convenient will result in significant cost savings for charities. It will significantly decrease processing time for the IRS and state regulators, making government more efficient. It will heighten transparency by enabling effective data sharing among federal and state regulators, legislators, and the general public. 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.

Sincerely,



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