

April 6, 2018

*Via Email*

[irsreform@mail.house.gov](mailto:irsreform@mail.house.gov)

Chairman Lynn Jenkins  
Ranking Member John Lewis  
House Ways and Means Oversight Subcommittee  
United States House of Representatives  
United States Congress  
Washington D.C.

Dear Chairman Jenkins and Ranking Member Lewis

Re: Discussion Draft: The Taxpayer First Act, H.R. No. \_\_\_\_ (March 26, 2018)

I am writing on behalf of nine other former presidents<sup>1</sup> of the National Association of State Charity Officials (NASCO). I held the office of president of NASCO during the years 2007-2008 and remain very active in its programs, committees, activities and initiatives. NASCO is an association made up of state Attorneys General and Secretaries of State, and other agencies having state oversight of charitable organizations, and their fundraising and governance practices. These include nonprofit corporations of many kinds, and charitable trusts.

We are writing to strongly suggest that the Taxpayer First Act include provisions that require the Internal Revenue Service (IRS) to revisit the use of the abbreviated Form 1023EZ, which currently allows certain organizations to qualify for tax exempt status under section 501(c)(3) for charitable, educational and religious purposes. We join with the comments submitted separately by the National Council of Nonprofits<sup>2</sup>

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<sup>1</sup> Former NASCO presidents Terry M. Knowles (NH) Chris Cash and Alissa Hecht Gardenswartz (Colo.), Karin Kunstler Goldman (NY), Elizabeth Grant (OR), Belinda Johns (Calif.), Janet Kleinfelter (TN), Mark Pacella (PA), Therese Harris (IL) and others have authorized me to communicate that they join with me, and I am virtually certain that many others would too, time permitting. I am a Senior Deputy Attorney General, with the Tax & Charities Division of the Hawaii Attorney General's office.

<sup>2</sup> The National Council of Nonprofits is an advocate for an effective, robust, ethical and transparent charitable sector and the Council and NASCO frequently collaborate together in our work to promote

which has stood firmly with NASCO on this issue to protect the public trust in the nonprofit sector. I share many of the National Council of Nonprofits' concerns about the Form 1023EZ. I and other former NASCO presidents believe that the IRS should resume using the much more robust Form 1023, although we understand, and in fact support efforts to simplify the prior form, yet make an effective tool for qualifying and educating newly formed charitable organizations.

NASCO is on record in opposition to the use of form 1023EZ and that opposition remains so today. Attached are copies of former NASCO president Alissa Hecht Gardenswartz's April 30 and May 23, 2014 letters that explain in considerable depth, why a longer Form 1023 served important governmental and societal purposes and should not be truncated to the point that it becomes ineffective in performing a gate keeping and educational function for newly formed organizations. The Form 1023 is often the first exposure a newly formed organization has to the myriad of financial, operational, fundraising and investment issues faced by a newly established nonprofit organization. As stated in the 2012 Report of the Tax Advisory Committee (ACT):

Form 1023 serves an important educational purpose for applying organizations . . . and 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 scheme, and working through the questions on the form provides the organization with a great deal of information about compliance with this regime.

The concerns of NASCO, the National Council of Nonprofits and the ACT are echoed by those of the Taxpayer Advocate Service. The Taxpayer Advocate Service recently found that exempt status was erroneously granted to up to 42 percent of applicants using the 1023EZ<sup>3</sup>. I, and my colleagues strongly agree with the Taxpayer Advocate Service's statement that Form 1023EZ's "new procedures do not require applicants to submit their articles of incorporation or bylaws to ensure they are properly organized and have adopted the appropriate charitable purpose clause as well as protections against misuse of funds."

Aside from the fact that Form 1023EZ has allowed simply "unqualified" organizations to qualify for tax exempt status, I am concerned that it has been an invitation to possibly "sham" charities to apply for and obtain tax exempt status and use that special tax status as a tool to convince donors to contribute money given the apparent IRS "stamp of approval." In at least one egregious example, a for-profit entity applied for and was granted tax exempt status using Form 1023EZ<sup>4</sup>. There may be others like this example.

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public confidence in the nonprofit sector. Because the Council represents the regulated sector, NASCO listens carefully to the Council's suggestions on a wide range of issues.

<sup>3</sup> <https://taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress/MSP-1023-EZ>

<sup>4</sup> See [https://www5.sos.state.oh.us/ords/f?p=100:7:::NO:7:P7\\_CHARTER\\_NUM:4019295](https://www5.sos.state.oh.us/ords/f?p=100:7:::NO:7:P7_CHARTER_NUM:4019295)

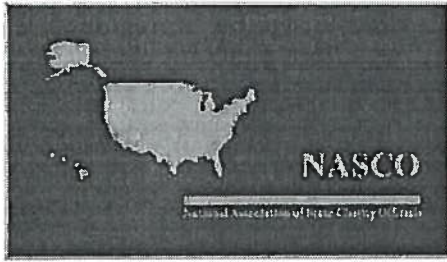
In Hawaii, nonprofit organizations may use “form” articles of incorporation to simplify the incorporation process, but those “form” articles do not satisfy the section 501(c)(3)’s requirement that a charity’s organizational documents limit their activities to one or more exempt purposes, and require that the assets be distributed to other qualifying tax exempt charities. As a result we have seen several Hawaii nonprofit organizations that obtained tax exempt status using Form 1023EZ, representing their organizational documents met stringent IRS requirements, when in fact they did not. I am sure other states that provide “form” articles of incorporation have experienced similar situations. When such organizations’ articles of incorporation do not confine the organizations activities to charitable purposes, it invites abuse and makes it very difficult for state charity regulators to protect and safeguard what should be charitable assets.

We recommend that this is a suitable time to require the IRS to re-examine use of the truncated IRS Form 1023EZ. The IRS should give full consideration to the suggestions made by the National Council of Nonprofits, and in the 2012 Final Report of the Act. Based on the foregoing, we again recommend that the Taxpayer First Act include provisions which require the IRS to revisit the use of the abbreviated Form 1023EZ to ensure that it performs an effective gate keeping and educational function that it once did.

Thank you for listening to our concerns.

Respectfully submitted,  
  
Hugh R. Jones  
NASCO President 2007-2008

Attachments (2)



May 23, 2014

**Via Electronic Mail**

Ms. Sunita Lough  
Commissioner, Tax Exempt and Government Entities Division  
Ms. Tamera Ripperda  
Director, Exempt Organizations  
United States Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

**RE: Proposed Internal Revenue Service Form 1023-EZ, OMB Number 1545-0056**

Dear Sunita and Tammy:

I am writing to follow up on our May 6 conversation addressing NASCO's concerns about the IRS's implementation of the 1023-EZ. As we mentioned during the call and in our April 30 comments to the OMB and Treasury, NASCO does not oppose the idea of a more streamlined "core form" 1023. We are concerned, however, that the most recent draft of the 1023-EZ fails to obtain the minimum amount of information necessary to identify organizations that should not be approved or should be monitored closely in back-end compliance. Accordingly, we strongly recommend that the following information be requested in the 1023-EZ:

- Provision of articles and by-laws as well as Part III of the current 1023 that requires organizations to state where their purpose is in

- organizing documents and greater specifics (beyond mere attestation) on provisions for distribution of assets upon dissolution.
- Detailed information regarding compensation and other financial arrangements with officers, directors, and key employees of the organization. Information provided here could be a source for red flags (for example, the organization will be all volunteer, the executive director's salary will be 70% of total revenue, organization will receive goods/services from an organization associated with an officer or director, etc.) – the vast majority of questions in the current Part V should be required.
  - Some financial reporting should be required – at minimum revenues and expenses.
  - Part VI is also a source for potential concerns and serves a valuable educational purpose for the many well-meaning organizations that do not realize they cannot form a tax-exempt charity to raise funds for a single individual.
  - Organizational history, i.e., whether the organization is a successor organization or has submitted an application more than 27 months after formation.
  - Part VIII (specific activities) could be somewhat limited as proposed in the current 1023-EZ, but should also include questions on fundraising activities and contracts, whether the organization is affiliated with a governmental entity, and planned activities with other organizations (joint ventures, loans, etc.).

Other items that could be included on a 1023 application that would be helpful to state regulators and the IRS alike would be questions regarding relationships to previously revoked (c)(3)s, criminal backgrounds of officers and directors, and/or affiliations of the applicant charity with other charities that have been subject to legal action. Even if bad actors are inclined to not answer these questions truthfully, the sheer fact that the questions are asked may deter some people from using tax-exempt status for nefarious purposes, and untruthful responses could provide a basis for state enforcement actions for fraud or impermissible private benefit.

NASCO very much appreciates the opportunity to provide the IRS with feedback regarding its rollout of the 1023-EZ, and we hope that you seriously

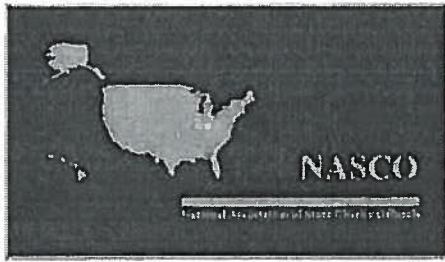
consider our suggested modifications to the current form. We look forward to continuing to work with you as you implement these changes.

Sincerely,



Alissa Hecht Gardenswartz  
NASCO President (2013-2014)  
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Alissa.gardenswartz@state.co.us

cc: Ruth Madrigal, Attorney Advisor  
Office of Tax Policy, U.S. Dept. of the Treasury (via email)



April 30, 2014

Office of Information and Regulatory Affairs  
Office of Management and Budget  
Attention: Desk Officer for Treasury  
New Executive Office Building, Room 10235  
Washington, DC 20503  
Via email at [OIRA\\_Submission@OMB.EOP.gov](mailto:OIRA_Submission@OMB.EOP.gov)

Treasury PRA Clearance Officer  
1750 Pennsylvania Avenue NW, Suite 8140  
Washington, DC 20220  
Via email at [PRA@treasury.gov](mailto:PRA@treasury.gov)

**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](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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