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CLIENT ALERT:

IS THE NEW FORM 1023-EZ RIGHT FOR YOU?

Recently, the Internal Revenue Service (the “IRS”) released a shorter, simpler application for small organizations applying for exemption from federal income taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”). While the short length and quick processing time of the Form 1023-EZ are appealing on the surface, there are some significant disadvantages to consider before applying for tax exemption using the new Form 1023-EZ.

Who can use the Form 1023-EZ application?

In general, the new form may be used by organizations (1) that expect to collect less than \$50,000 in gross receipts (the total amount of money received without subtracting any costs or expenses) in the next three years, and (2) that do not have total assets in excess of \$250,000. Certain types of organizations are automatically disqualified from using the Form 1023-EZ, including limited liability companies, successors to for-profit entities, churches, schools, hospitals, and medical research organizations.

Disadvantages to the Form 1023-EZ

On its face, the new form is appealing – the Form 1023-EZ is only 3 pages compared to the Form 1023’s 26 pages and the wait time for a determination from the IRS is weeks instead of months. However, there are significant drawbacks to using the new form.

First, when an organization uses the standard Form 1023, the IRS reviews the activities of the organization described in the Form 1023 and makes a determination regarding whether the organization qualifies for tax exemption under Section 501(c)(3). In contrast, an organization using the Form 1023-EZ is asked to assert that it qualifies for tax exemption, and the IRS relies on that assertion in granting tax exempt status. As a result, an organization that has used the Form 1023-EZ which conducts, or will conduct, activities that raise questions under the 501(c)(3) rules and regulations may encounter future problems with the IRS since the IRS did not review the organization’s plans during the tax exemption application process. Unlike other organizations, the organization using the Form 1023-EZ will not be able to respond to such questions by asserting that the IRS reviewed and was satisfied by the organization’s 501(c)(3)

compliance. In addition, grant-makers, funders, and other parties who rely upon the IRS determination letter as evidence that an organization is tax exempt may be less likely to rely upon a determination letter issued by the IRS for an organization that used the Form 1023-EZ.

Moreover, an organization that uses the new Form 1023-EZ may be more likely to be subject to an IRS audit. To ensure that organizations are compliant with the requirements of 501(c)(3), the IRS has stated that it intends to audit a sample of organizations approved for tax exemption through the Form 1023-EZ process in the near future.

Even if an organization may qualify to use the new form, organizations should carefully consider the risks associated with using the Form 1023-EZ.

For any questions about Form 1023-EZ or Form 1023 and other 501(c)(3) tax exemption issues, please contact attorney Elka Sachs (esachs@kb-law.com) or attorney Judith Kim (jkim@kb-law.com) at Krokidas & Bluestein LLP.