

Reliance Standard for Form 1023-EZ Clarification Aimed at Insiders, Attorney Says

BNA Snapshot

Development: Form 1023-EZ exempt determinations lead to possible revisions of reliance standards for grantors, contributors and donors.

What It Means: IRS could toughen rules for these individuals and organizations if they make false statements on the form.

By Diane Freda

March 20 — The IRS's effort to clarify the tax exemption reliance standards related to Form 1023-EZ is aimed at insiders, one practitioner told Bloomberg BNA.

Treasury Department official Ruth Madrigal said March 19 that the agency is looking at revising some Internal Revenue Service guidance for grantors and contributors—including donors—who deduct contributions to public charities based on Form 1023-EZ exemptions (*54 DTR G-7, 3/20/15*).

Madrigal, an attorney-adviser in the Office of Tax Policy, said some concerns have been raised about reliance on tax exemptions that have been granted based on the shorter form (Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code). It relies on attestations from the organization itself that it will be operated for charitable purposes. In addition, the IRS makes no real determination up front that the organization's activities will qualify as tax exempt, she said.

In the end, donors and contributors can lose their tax deduction if it is determined later, when the IRS does audits, that the organization didn't qualify.

Madrigal said there is a question about the current determination reliance standard, which says that tax deductions won't ordinarily be challenged unless the donor "caused or knew about the deficiencies that led to the revocation."

Ofer Lion, partner with Seyfarth Shaw LLP, is one of those who wrote to Madrigal in October 2014, specifically asking if Revenue Procedure 2014-40 effectively requires private foundations to determine whether an organization made an "incorrect attestation" on its Form 1023-EZ before it can rely on its determination letter.

Lion told Bloomberg BNA March 25 that he believes what the IRS is trying to do now is "establish that if you are an insider, you will be held to a higher level of scrutiny. That would mean that if an officer, director, founder or someone else closely involved with the organization makes a contribution, but knew or should have known that there was an issue with the exemption, it could lead to a denial of the deduction," he said.

According to Madrigal, government officials are concerned that a donor might set up an organization that is conducting activities that aren't charitable, check the box on the Form 1023-EZ that they are charitable, and then contribute and take deductions in order to fund the non-charitable activities.

Outside Donors

However, the IRS also appears anxious to set its concerns about insiders off from those of rank and file donors. Associate Chief Counsel for Tax Exempt and Government Entities Vicki Judson, who appeared on the same panel with Madrigal, said guidance on the EZ makes clear that organizations can't rely on determination letters they receive if they are based on inaccurate material information they have submitted—including incorrect attestations. But she said the question then becomes "what about other people?"

Judson said some practitioners want it to be clear that an organization that has received a tax exemption is "on the hook" with respect to attestations.

At the same time, she said the IRS doesn't want people to be worrying that they can't count on an organization being tax exempt for charitable contribution purposes when they see it as approved on IRS.gov, if they have no connection to the organization and no knowledge of anything that was misrepresented on the application.

IRS Director of Exempt Organizations Tamera Ripperda was also quick to say that there is no difference in reliance between the long and short forms. She told Bloomberg BNA March 19: "If the relier has information that leads them to believe that the application is inaccurate or anything on an application was falsely represented, then they can't rely on the letter. But if they have no knowledge of that, then they can rely on the letter, whether it was an EZ applicant or was a long form application."

Lion said the point is that individuals who are insiders will be held to a higher level of scrutiny whether the organization filed a Form 1023-EZ or a full Form 1023.

Likewise, if they aren't insiders, they will be permitted to rely on the organization's tax-exempt status, whether they filed an EZ or a full Form 1023, he said.

He added, "Internally, however, it seems clear that there are some folks at Treasury that aren't quite comfortable with giving equal deference to EZ organizations."