

January 11, 2021

Internal Revenue Service  
ATTN: Kinna Brewington  
Room 6526  
1111 Constitution Avenue NW  
Washington, DC 20224

**RE: Public Comments on Exempt Organization IRS Forms**  
85 FR 71992, [Doc. No. 2020-25012](#), published November 12, 2020

Dear Ms. Brewington:

On behalf of the National Council of Nonprofits, we submit the following comments in response to the invitation for public comment on proposed and continuing information collections regarding IRS forms and schedules completed by exempt organizations. The National Council of Nonprofits is the nation's largest network of nonprofits, with more than 25,000 organizational members. Our membership reflects the wide spectrum of charitable nonprofit missions, from advocacy to zoos and everything in between. In formulating these comments, we have relied on extensive communications and feedback from within this network and multiple organizations representing subsector groups across the nonprofit sector.

In this set of comments, we will address three topics: **(1)** the need to extend this review process for an additional 90 days; **(2)** the need to revise Form 990 to better reflect the manner in which charitable organizations earn revenues from governments; and **(3)** the need to eliminate Form 1023-EZ and restore integrity to the process for determining tax-exempt status under Internal Revenue Code Section 501(c)(3).

## **1. IRS Regulatory Review of Exempt Organization Forms**

On November 12, 2020, the IRS published the above-referenced request for comments on more than four dozen forms and related schedules used by exempt organizations to report financial and other matters. The IRS stated the review is "part of its continuing effort to reduce paperwork and respondent burden," and invited "the general public and other Federal agencies to take this opportunity to comment on proposed and continuing information collections, as required by the Paperwork Reduction Act of 1995 (PRA)." This review process is of enormous interest to charitable organizations both because of the paperwork burdens that the informational tax returns impose and because charitable organizations are committed to transparency and public awareness.

Our concern about the timing of this regulatory review is that there has not been sufficient time for the regulated community to consider adequately and thoroughly the many forms at issue. The 60-day public comment period was announced during a very intense time when the public's attention was riveted on: the rising deaths and illnesses caused and exacerbated by the uncontrolled pandemic; whether, and if so how, Congress would pass COVID-relief legislation;

turmoil caused by multiple legal challenges to the presidential election counts; the national holidays at the end of a tumultuous year; and a deadly and destructive insurrection at the U.S. Capitol from which many in the country are reeling. This 60-day review period overlapped with what turned out to be one of the most distressing and distracting times in our nation's history, when the attention of the country and nonprofits focused on urgent, existential threats. Believing that the IRS views public comments seriously, and that it wants and needs meaningful input, we believe both the Service and the public would benefit from an extension of time for nonprofits to submit comments.

**We recommend** that the IRS reopen the regulatory review of exempt organization forms and extend the period of public comment for an additional 90 days.

## **2. Form 990 Reporting of Revenues Earned from Government Grants and Contracts**

The IRS Form 990 as currently written invites misleading and inaccurate reporting of nonprofit revenues earned from governments and must be reformed. Governments hire charitable nonprofits to provide vital services and pay the nonprofits for those services pursuant to written agreements. The current Form 990 provides that government **grants** are reported at Part VIII, Line 1e – “Government grants (contributions).” Revenues earned pursuant to government **contracts** are reported under Line 2 – “(Program Service Revenue),” a category that can include Medicare and Medicaid reimbursements and payments for many other services. As discussed below, this reporting regime leads to greater confusion and creates a false narrative harmful to governments, nonprofits, and the public.

The technical, legal distinctions between grants and contracts may make sense to accountants who deal with the differences on a daily basis. But the distinction is neither self-evident nor logical to nonprofits or government employees operating in the real world. At the federal level, government grants are governed by the [OMB Uniform Guidance](#); contracts are controlled by the [Federal Acquisition Regulations \(FAR\)](#). However, at the state and local levels, governments refer to the written agreements with terms that employees often use interchangeably – “grants” and “contracts” – even if the technical definitions in those jurisdictions mean something different. Indeed, in at least one state, the written agreement for nonprofit services performed on behalf of the government is called a “grants contracts.” There is no clarity or consistency when similar terms mean different things not only in different jurisdictions but also among government employees within one jurisdiction.

Form 990, Part VIII, line-items 1e and 2 expect nonprofits to divine and apply yet another set of categories for revenues earned via government written agreements, without relying on how the government that issued the written agreement labeled it. This quite clearly breeds confusion and generates unwelcome angst (e.g. “In reporting revenues, do I discard what the state or city called the agreement or reject the IRS instructions – and what are the consequences for either?”). It also invites inconsistent reporting.

Confusion about where to report revenues earned via written agreements with governments can take inordinate time because of the inconsistent use of the terms government grants versus

government contracts. When people innocently report the data on the wrong line, it deprives the public of knowing the underlying facts.

Further, Form 990, Part VIII line-items 1e and 2 create and perpetuate damaging narratives about governments just “giving” money to nonprofits and nonprofit dependence on government funding. These narratives undermine public support for nonprofits and prevent a full understanding of how their governments operate. In reality, many of the government programs that affect the lives of residents are performed by charitable nonprofits pursuant to government grants. The declaration of the payments as “contributions” on line-item 1e trivializes the payments for the performance of essential services as mere gifts, as if they were voluntary and discretionary by government officials, or to use the outdated term, “alms.” The IRS must alter Form 990, Part VIII to delete “(contributions)” to remove this inaccurate and harmful qualifier.

We agree with the views expressed by the Aspen Institute and others (Comments to the Internal Revenue Service Taxpayer First Act Office, July 3, 2020) that Form 990 Part VIII “now lacks sufficient clarity with respect to the reporting of government revenue, confusing users of the form, and likely resulting in inaccurate reporting.” As an interim step, we adopt Recommendations 2a and 2b of those comments to help clarify through changes to Form 990 instructions on which lines nonprofits should report their revenues.

**We recommend** that the IRS commit to a more thorough analysis of Form 990, Part VIII, with the goal of eliciting stakeholder input on how nonprofits can best report revenues earned pursuant to written agreements with governments at all level. The networks of the National Council of Nonprofits will certainly participate in such a review that promotes clarity, administrative ease, and public support.

### **3. IRS Form 1023-EZ Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code**

In 2014, the IRS radically streamlined its application and approval process for certain organizations seeking tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. Generally, organizations with total assets up to \$250,000 and those expecting annual gross receipts up to \$50,000 are eligible to use Form 1023-EZ to apply for recognition of exempt status. However, the Taxpayer Advocate has consistently found that virtually every entity that applies using the Form 1023-EZ receives tax-exempt status regardless of eligibility. The Taxpayer Advocate performed extensive reviews and found erroneous approvals at rates of 37 percent, 26 percent, and 42 percent during 2015, 2016, and 2017, respectively. In its most recent report, the **Taxpayer Advocate found**: “The IRS approves Form 1023-EZ applications submitted by organizations that do not qualify for IRC § 501(c)(3) status at a rate that is unacceptable and is higher now than when the form was introduced.” The erroneous approval rate was found to be 46 percent.

The recommendations for improvements by the Taxpayer Advocate address specific problems with the IRS processing of the form but do not get to the root cause of the problem. Quite frankly,

the form fails to provide adequate information to ensure that only eligible organizations attain tax-exempt status and the privilege of receiving tax-deductible donations.

**We recommend** that the IRS withdraw the Form 1023-EZ and engage stakeholders – charitable regulators, nonprofit infrastructure organizations, funders, and tax-law practitioners – to develop a workable replacement that will respect the IRS’ primary obligation of preventing ineligible organizations and perhaps bad actors from receiving and exploiting tax-exempt status for personal gain. Learn more about the challenges of and the broad opposition to [IRS Form 1023-EZ](#).

We thank the IRS for conducting this regulatory review process and stand ready to assist in convening stakeholders and promoting greater transparency.

Sincerely,



David L. Thompson  
Vice President of Public Policy