

Nonprofits By the Numbers: The Impacts of IRS Automatic Revocation and Form 1023-EZ

 wagenmakerlaw.com/blog/nonprofits-numbers-impacts-irs-automatic-revocation-and-form-1023-ez

How has the number of tax-exempt nonprofit organizations changed over the past decade? According to IRS data released this year, significant shifts have occurred for Section 501(c)(3) and Section 501(c)(4) organizations, in large part due to new “auto-revocation” consequences for not filing required Form 990s and the introduction of IRS Form 1023-EZ. Author Michael Wyland’s excellent *Nonprofit Quarterly* article provides substantial data analysis,^[1] from which further observations can be made on nonprofit trends.

As set forth in Mr. Wyland’s article, in 2017, 1,682,000 tax-exempt organizations were registered with the IRS. This number included about 1,286,000 Section 501(c)(3) organizations and about 82,000 Section 501(c)(4) organizations. These substantial numbers would be even higher if not for the Pension Protection Act of 2006 (“PPA”). The PPA’s “closet-cleaning” measures provide for the automatic revocation of the tax-exempt status of organizations that fail to file their annual Form 990 with the IRS for three consecutive years. The effects of automatic revocation were, unsurprisingly, most profound when the measure first took effect in 2010 and 2011, but they continue to be significant. However, since 2014, the IRS Form 1023-EZ application for 501(c)(3) tax exemption has been off-setting the effect of automatic revocation, and the interplay between the two has produced interesting trends over the past several years. Nonprofit leaders should be aware of these two relatively new and powerful measures, which have had, and will continue to have, significant impacts on shape and size of the nonprofit sector.

The PPA and 501(c)(3) Organizations

Under the PPA, the initial round of cuts was the deepest. The first round of automatic revocations in 2010 and 2011 took away the tax-exempt status of over 450,000 tax-exempt organizations, some 275,000 of which were 501(c)(3) organizations. At least 30,000 of these 501(c)(3) organizations regained their tax-exempt status, so the initial results of the IRS measure included the successful “cleaning” of about 245,000 tax-exempt 501(c)(3) organizations, reducing the number of 501(c)(3) organizations by almost 20 percent.

From the year following that initial round of revocations until 2017, the IRS automatically revoked an average of around 28,000 501(c)(3) organizations annually, of which about 20 percent were reinstated. This means that the automatic revocations from 2012 to 2017 reduced the number of 501(c)(3) organizations by over 20,000 each year.

The PPA’s Impact on 501(c)(4) Organizations

The data regarding Section 501(c)(4) organizations from 2010 to 2017 are more enigmatic. The advent of automatic revocation brought the number of 501(c)(4) organizations from about 140,000 to about 100,000 by 2011. After that first wave of revocations, less than 5,000 Section 501(c)(4) organizations automatically lost their tax-exempt status each year until 2016. In 2016, the number spiked to over 10,000, and in 2017 it rose to over 45,000 (even more than the first wave of “closet-cleaning”). As a result, except for a noticeable uptick in 2014, the total number of 501(c)(4) tax-exempt organizations has declined each year since the first automatic revocations in 2010 and 2011, and the number of 501(c)(4) organizations in 2017 was only about 58% of what it was in 2010.

The Counter-Impact of 1023-EZ

Over and against the above reductions stemming from the 2006 Act, Mr. Wyland’s article also highlights the increases to the exempt organization’s pool through the introduction of the 1023-EZ in 2014. Before the 1023-EZ application was introduced in 2014, there were approximately 40,000-50,000 successful applications for new 501(c)(3) organizations each year from 2010 to 2013. With the introduction of the 1023-EZ, this number increased to 80,000-90,000 annually from 2014 to 2017. (For our This boost was more than enough to restore the pre-2010 overall growth rate of the number of 501(c)(3) organizations, and by 2017 there were as many 501(c)(3) organizations with tax-exempt status as there had been before the start of the automatic revocations in 2010. By 2017 the number of 501(c)(3) organizations had regained its pre-2011 level of over 1,280,000.

Conclusion

The data in Mr. Wyland’s article underscores the countervailing impacts of the PPA and 1023-EZ. While the PPA has significantly trimmed the number of organizations on the IRS register of exempt entities, the introduction of the 1023-EZ has more than restored the number of 501(c)(3) organizations to pre-2011 levels. No comparable streamlined application exists for 501(c)(4) organizations, so it remains to be seen whether the steady downward trend for these social welfare organizations will continue.

[1] Mr. Wyland’s article, “How Many Nonprofits Are There? What the IRS’s Nonprofit Automatic Revocation and 1023-EZ Processes Left Behind,” appeared in the summer 2018 issue of the *Nonprofit Quarterly*. The underlying IRS data can be found on the IRS website under “Tax Exempt Organization Search Bulk Data Downloads” at <https://www.irs.gov/charities-non-profits/tax-exempt-organization-search-bulk-data-downloads> and in The Internal Revenue Service Data Book for fiscal years 2007-2017, available at <https://www.irs.gov/statistics/soi-tax-stats-prior-year-irs-data-books> (FY 2007-2016) and <https://www.irs.gov/statistics/soi-tax-stats-irs-data-book> (FY 2017).



Wagenmaker & Oberly

Trusted Advisors to Nonprofits

wagenmakerlaw.com