

## SECTION 1. PURPOSE

The purpose of this revenue procedure is to supersede Rev. Proc. 71-39, 1971-2 C.B. 575, to modify and supersede Rev. Proc. 75-13, 1975-1 C.B. 662, to revoke Rev. Rul. 75-75, 1975-1 C.B. 154, and to amplify Rev. Rul. 75-76, 1975-1 C.B. 154, by setting forth guidelines for public interest law firms, including procedures under which a public interest law firm may accept fees for its services. The Internal Revenue Service will issue rulings and determinations regarding exemption to new public interest law firms and test the charitable character of such organizations already holding such rulings based on the guidelines set forth in this revenue procedure. These guidelines are not inflexible and an organization will be given the opportunity to demonstrate that under the facts and circumstances of its particular program, adherence to the guidelines is not required in certain respects in order to ensure that the operations are totally charitable.

## SEC. 2. BACKGROUND

01 In Rev. Proc. 71-39, the Service announced guidelines pursuant to which it would recognize public interest law firms as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. Section 3.02 of Rev. Proc. 71-39 provides that the public interest law firm does not accept fees for its services except in accordance with procedures approved by the Service.

02 Rev. Rul. 73-74, 1975-1 C.B. 152, provides that the recognition of public interest law firms as charitable is based on their provision of legal representation for the resolution of issues of broad public importance where such representation is not ordinarily provided by private law firms because the cases are not economically feasible.

03 Rev. Rul. 75-75 holds that charging or accepting fees from clients makes the organization indistinguishable from a private law firm. The revenue ruling indicates that the expectation of fees for services might influence which cases are accepted.

04 Rev. Rul. 75-76 holds that the acceptance of fees awarded by a court or an administrative agency and paid by opposing parties does not preclude a public interest law firm that derives most of its support from grants and contributions from exemption under section 501(c)(3) of the Code. However, exemption would only be justified if it is clear that neither the expectation nor the possibility, however remote, of an award of fees is a substantial motivating factor in the selection of cases. In addition, the firm must cease to handle issues with a strong possibility of a fee award if these become economically feasible for private litigants.

05 Rev. Proc. 75-13 sets forth procedures under which a public interest law firm may accept fees for its services. Under these procedures, the organization may not receive or request fees from its clients for the provision of legal services. Attorney fees paid by opposing parties, however, are permissible if awarded by a court or administrative

agency in a case or settlement agreement.

06 The procedures of Rev. Proc. 75-13 were published to eliminate the possibility that a decision to litigate might rest on the payment the firm receives instead of the economic feasibility for the litigants and thus render a public interest law firm's practice indistinguishable from a private firm's. The Service has reconsidered these procedures and concluded that safeguards sufficient to distinguish a public interest law firm's practice from the private practice of law can be implemented without absolutely prohibiting public interest law firms from receiving client-paid fees.

07 Section 3 below sets forth general guidelines under which the Service will determine whether a public interest law firm meets the test of being exclusively charitable and thus is entitled to recognition of exemption as an organization described in section 501(c)(3) of the Code. Section 4 below sets forth approved procedures for the acceptance of court awarded attorneys' fees. Section 5 below sets forth additional procedures to apply in the case of client-paid fees to assure that the public interest law firm that accepts client-paid fees remains distinguishable from a private law firm. The procedures in Section 5 are not applicable to out-of-pocket costs incurred in litigation.

### SEC. 3. GENERAL GUIDELINES

01 The engagement of the organization in litigation can reasonably be said to be in representation of a broad public interest rather than a private interest. Litigation will be considered to be in representation of a broad public interest if it is designed to present a position on behalf of the public at large on matters of public interest. Typical of such litigation may be class actions in which the resolution of the dispute is in the public interest; suits for injunction against action by government or private interests broadly affecting the public; similar representation before administrative boards and agencies; test suits where the private interest is small; and the like.

02 The litigation activity does not normally extend to direct representation of litigants in actions between private persons where the financial interests at stake would warrant representation from private legal sources. In such cases, however, where the issue in litigation affects a broad public interest or will have an impact on the broad public interest, the organization may serve as a friend of the court.

03 The organization does not attempt to achieve its objectives through a program of disruption of the judicial system, illegal activity, or violation of applicable canons of ethics.

04 The organization files with its annual information return a description of cases litigated and the rationale for the determination that they would benefit the public generally.

05 The policies and programs of the organization (including compensation arrangements) are the responsibility of a board or committee representative of the public

interest, which is not controlled by employees or persons who litigate on behalf of the organization nor by any organization that is not itself an organization described in section 501(c)(3) of the Code.

06 The organization is not operated, through sharing of office space or otherwise, in a manner so as to create identification or confusion with a particular private law firm.

07 There is no arrangement to provide, directly or indirectly, a deduction for the cost of litigation that is for the private benefit of the donor.

08 The organization does not accept fees for its service except in accordance with the procedures set forth in Sections 4 and 5 below.

09 The organization must otherwise comply with the provisions of section 501(c)(3) of the Code, that is, it may not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office, no part of its net earnings may inure to the benefit of any private shareholder or individual, and no substantial part of its activities may consist of carrying on propaganda or otherwise attempting to influence legislation, (except as otherwise provided in section 501(h)).

10 A public interest law firm may accept reimbursement from clients or from opposing parties for direct out-of-pocket expenses incurred in the litigation. Courts have traditionally distinguished out-of-pocket costs such as filing fees, travel expenses, and expert witness fees from attorneys' fees. These expenses are usually nominal in comparison to the amount of attorneys' fees.

#### SEC. 4. ACCEPTANCE OF ATTORNEYS' FEES

01 The organization may accept attorneys' fees in public interest cases if such fees are paid by opposing parties and are awarded by a court or administrative agency or approved by such a body in a settlement agreement.

02 The organization may accept attorneys' fees in public interest cases if such fees are paid directly by its clients provided it adopts additional procedures as set forth in Section 5 of this revenue procedure.

03 The likelihood or probability of a fee, whether court awarded or client-paid, may not be a consideration in the organization's selection of cases. The selection of cases should be made in accordance with the procedures set forth in Section 3 of this revenue procedure.

04 Cases in which a court awarded or client-paid fee is possible may not be accepted if the organization believes the litigants have a sufficient commercial or financial interest in the outcome of the litigation to justify retention of a private law firm. The organization may, in cases of sufficient broad public interest, represent the public interest as *amicus curiae* or *intervenor* in such cases.

05 The total amount of all attorneys' fees (court awarded and received from clients) must not exceed 50 percent of the total cost of operation of the organization's legal functions. This percentage will be calculated over a five-year period, including the taxable year in which any fees are received and the four preceding taxable years (or any lesser period of existence). Costs of legal functions include: attorneys' salaries, nonprofessional salaries, overhead, and other costs directly attributable to the performance of the organization's legal functions. An organization may submit a ruling request where an exception to the above 50 percent limitation appears warranted.

06 The organization will not seek or accept attorneys' fees in any circumstances that would result in a conflict with state statutes or professional canons of ethics.

07 All attorneys' fees will be paid to the organization, rather than to individual staff attorneys. All staff attorneys and other employees will be compensated on a straight salary basis, not exceeding reasonable salary levels and not established by reference to any fees received in connection with the cases they have handled.

08 In addition to the information required by Section 3.04 of this revenue procedure, the organization will file with its annual information return a report of all attorneys' fees sought and recovered in each case.

## SEC. 5. ADDITIONAL RULES APPLICABLE TO CLIENT-PAID FEES

01 Client-paid fees may not exceed the actual cost incurred in each case, viz., the salaries, overhead, and other costs fairly allocable to the litigation in question. Costs may be charged against a retainer, with any balance remaining after the conclusion of the litigation refunded to the litigant.

02 Once having undertaken a representation, a public interest law firm may not withdraw from the case because the litigant is unable to pay the contemplated fee.

## SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 71-39 is hereby superseded. Rev. Proc. 75-13 is hereby modified and superseded. Rev. Rul. 75-75 is hereby revoked. Rev. Rul. 75-76 is hereby amplified to reflect the position taken in Section 4.05 of this revenue procedure that a public interest law firm is allowed to receive attorneys' fees in an amount not exceeding 50 percent of its expenditures attributable to its legal functions.

## SEC. 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 1987.

## DRAFTING INFORMATION

The principal author of this revenue procedure is Debra Cowen of the Exempt Organizations Technical Division. For further information regarding this revenue procedure contact Ms. Cowen on (202) 566-3586 (not a toll-free call.)