

ISSUE

Does a nonprofit lawyer referral service qualify for exemption from federal income tax under either section 501(c)(3) or section 501(c)(6) of the Internal Revenue Code?

FACTS

The organization is a nonprofit corporation created by several bar associations in a metropolitan area to provide a lawyer referral service. The lawyer referral service aids persons who do not have an attorney by helping them to select one. Any member of the public in need of an attorney may visit or call the organization. The individual's problem is screened in order to categorize the area of law involved. From a list of attorneys maintained by the organization, an attorney specializing in the appropriate area of law is selected from within the geographic area preferred by the client. The organization arranges an appointment for the individual with the attorney. This initial appointment is for a minimum of one-half hour and the individual is asked to pay a nominal fee substantially less than the normal fee charged for a half-hour appointment. The attorney subsequently remits this fee to the organization. Any additional services performed by the attorney after the initial appointment are governed by a normal lawyer-client contractual relationship with which the organization has no connection.

Any attorney who is a member of one of the local bar associations may apply to the organization to have his or her name placed on the organization's referral list. Attorneys must apply annually to be listed. Applicants are required to show how long they have been practicing law, whether they are or have been subject to disciplinary procedures, what their areas of legal competence are, and whether they are covered by malpractice insurance. They must agree to leave open a specified number of hours each month for referral clients. If an application is approved by the organization, the attorney pays a fee and is thereupon listed on the organization's attorneys' panel. About 20 percent of the members of the local bar associations appear on the organization's list each year.

In addition to the referral fee, the organization also imposes a nominal service charge of one dollar upon all those who make use of its services. Any operating deficits are defrayed by the local bar associations.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations states that to be tax exempt, an organization must be both organized and operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term 'charitable' is used in section 501(c)(3) of the Code in its generally accepted legal sense. It includes relief of the poor and distressed or of the underprivileged, and promotion of social welfare by organizations designed to eliminate prejudice and discrimination or to defend human and civil rights secured by law.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the regulations defines a business league as an association of persons having a common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. That regulation also states that a business league's activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Rev. Rul. 71-505, 1971-2 C.B. 232, holds that a city bar association is not exempt from federal income tax under section 501(c)(3) of the Code. The association conducted a number of activities primarily directed at the promotion and protection of the practice of law. These activities were found not to be in furtherance of charitable or educational purposes. That ruling relied in part on the principle, expressed in *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279 (1945), Ct. D. 1650, 1945 C.B. 375, that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption regardless of the number or importance of statutorily exempt purposes. The same result was reached in Rev. Rul. 71-504, 1971-2 C.B. 231, which involved a city medical society carrying on substantial activities directed at promotion of the medical profession.

It is a clearly established principle of the law of charity that a purpose is not charitable unless it is directed to the public benefit. Not every purpose which is beneficial to the community, however, is deemed charitable. As a general rule, providing services of an ordinary commercial nature in a community, even though the undertaking is conducted on a nonprofit basis, is not regarded as conferring a charitable benefit on the community unless the service directly accomplishes one of the established categories of charitable purposes.

In this case, the lawyer referral service does not directly accomplish any of the established categories of charitable purposes. The program is open to all members of the community and, thus, is not operated exclusively for the relief of the poor, distressed, or underprivileged. The organization's activities are directed toward assisting individuals in obtaining preventive or remedial legal services covering the gamut of everyday legal problems and, as such, are not specifically designed to eliminate prejudice or discrimination or to defend human and civil rights secured by law. Therefore, the lawyer referral service does not confer a charitable benefit on the community.

Although the lawyer referral service provides some public benefit, a substantial purpose of the program is promotion of the legal profession. This is a noncharitable purpose, and, in accordance with section 1.501(c)(3)-1(a) of the regulations and the Better Business Bureau case, it precludes exemption under section 501(c)(3) of the Code. Thus, the organization is not exempt from federal income tax under section 501(c)(3).

Operation of the lawyer referral service in the manner described does, however, promote the common business interest of the legal profession within the metropolitan area. The principal purpose of the program is to introduce individuals to the use of the legal profession in the hope that they will enter into lawyer-client relationships on a paying basis as a result of the experience. To achieve this purpose, individuals pay only a nominal fee, substantially below the normal rates for a half-hour appointment. The program encourages people unfamiliar with lawyers to form the habit of seeking professional help, provides middle income persons an opportunity to present their legal problems to a reputable attorney for a modest fixed fee, and combats the notion that only certain persons can afford legal assistance. Thus, the organization's activities are designed to improve conditions within the legal profession as a whole as distinguished from performing particular services for individuals within the meaning of section 1.501(c)(6)-1 of the regulations. Therefore, the organization qualifies for exemption from federal income tax under section 501(c)(6) of the Code.

Rev. Rul. 61-170, 1961-2 C.B. 112, and Rev. Rul. 74-308, 1974-2 C.B. 168, which hold that organizations referring persons to nurses and to tow truck operators, respectively, are not exempt under section 501(c)(6) of the Code are distinguishable. Unlike those organizations, which serve primarily to locate customers for their members, this organization provides more than a mere business referral service that is simply a convenience and economy to members of the legal profession. Rather, in the manner described above, this organization serves to improve the image and functioning of the legal profession as a whole.

#### HOLDING

The separately incorporated nonprofit lawyer referral service

qualifies for exemption from federal income tax as a business league described in section 501(c)(6) of the Code. It does not, however, qualify for exemption as a charitable organization described in section 501(c)(3).

#### APPLICATION PROCEDURES

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1024, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(6) of the Code. See section 1.501(a)-1 of the regulations. In accordance with the instruction to Form 1024, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

#### EFFECT ON PRIOR REVENUE RULINGS

Rev. Ruls. 61-170 and 74-308 are distinguished.