Dear Applicant:

This is in response to the ruling request contained in your letter dated April 29, 1996. You request a ruling that the lawyer referral service which you operate is not an unrelated trade or business within the meaning of section 513 of the Internal Revenue Code.

[...]

[...]

[...]
You are exempt from federal income tax as an organization described in section 501(c)(6) of the Internal Revenue Code. You are a bar association whose membership is open to any person who is a member in good standing of the Bar of the State of M and who either resides, works, or maintains an office for the practice of law in N County. Your activities are normally conducted through committees which deal with various areas of the law, the administration of justice, and with other matters of concern to the legal profession. You conduct educational programs for lawyers and law office personnel, and you also have programs which provide pro bono and low fee attorneys to represent battered women, children, and minority members of the community.

You operate a lawyer referral service ("LRS") as part of your activities. The LRS assists the public in obtaining competent, experienced legal assistance in matters specific to the attorney's area of expertise and the client's needs. It also provides other services, as described below.

An individual seeking assistance from the LRS is given the names of one or more attorneys who participate in the service and who are experienced in the appropriate area of law. A participating attorney agrees to provide a one-half hour consultation with a referred client for a maximum fee of $25. The lawyer retains the consultation fee. Any services performed by the lawyer after the initial appointment are subject to the fee arrangement agreed to by the lawyer and the client.

The LRS also assists the public in obtaining non-legal assistance where appropriate. The LRS frequently receives calls wherein it is determined that the individual needs the assistance of a social service or government agency rather than that of a lawyer. In such cases, the caller is provided the name and telephone number of the appropriate agency. For illustration, you cite a consumer credit counseling service and a battered women's shelter.

Sometimes the LRS receives calls from individuals who are unable to pay for a lawyer's services. If appropriate, such callers are given information that will help them in obtaining a lawyer from the N County Legal Aid Society or the N County Public Defender's Office. Calls are also received from social workers on behalf of individuals who need legal assistance but who are unable to pay the fee of a private attorney. If legal assistance is appropriate and if the services of Legal Aid are unavailable, then LRS tries to find attorneys who will undertake the representation for a reduced or no fee. Finally, the LRS provides to low and moderate income persons the names of attorneys who are willing to represent them for a greatly
reduced fee at closings for low and moderate income housing.

7 The LRS regularly receives calls involving complaints against lawyers. These callers are referred to the District Fee Arbitration Committee or the District Ethics Committee. These Committees were created by, and operate under, court rules promulgated by the highest court of the State of H. When the LRS receives complaints about lawyers to whom referrals have been made, it attempts to resolve the attorney-client dispute.

8 LRS publicizes its services through the distribution of cards describing itself to about 121 agencies and organizations, which includes court staffs, hospitals, social services agencies, and libraries. You also advertise the LRS in the yellow pages and at local movie theaters. The LRS also becomes known through its volunteer speakers, who appear before various community groups, including schools, civic organizations, and social service agencies.

9 Court rules for the State of M provides that a summons issued to an individual defendant in a matter before either of two specified courts must advise the defendant that if he or she is unable to obtain an attorney, then the defendant may call a specific county bar association LRS to obtain the name of a lawyer.

10 Your LRS is open to any lawyer who is a member in good standing with you and who is licensed to practice law in M; who has a minimum of one year of legal practice experience; and who is actively engaged in the practice of law. In order to participate in the LRS a lawyer must provide evidence of certain minimum amounts of malpractice insurance and must agree to notify the LRS if he or she is convicted of a crime, disciplined by the District Ethics Committee, is no longer a member in good standing of the M Bar, or is no longer insured. About 200 of your members participate in the LRS.

11 Participating attorneys must also agree to release to the LRS any information on file with the District Ethics Committee or of any public or private censure. An attorney may be removed or suspended from participating in the LRS if criminal charges involving theft, embezzlement, or fraudulent appropriation of property are instituted against the lawyer; if the lawyer violates the Rules of Professional Conduct; if the lawyer is suspended, disbarred, or resigns from the practice of law; if the lawyer fails to obtain or maintain the required malpractice insurance; if the lawyer falsifies the information provided to the LRS; or if the lawyer fails to pay the annual registration fee or otherwise comply with the LRS Rules.
and Procedures.

12 In order to participate, an attorney pays an annual enrollment fee of $100. Participating attorneys also pay 15% of each fee in excess of $750 that results from a referral. The attorney agrees to keep the LRS advised of the status of any cases resulting from a referral and to provide the LRS with access to the attorney’s records on referred matters.

13 Your LRS also provides lawyer referrals for the public in two contiguous counties, O and P. The respective bar associations of these counties are too small to bear the [11] cost of operating their own referral services. Neither the O or P County bar associations nor the referred clients pay for these referral services. About 35 attorneys from both counties participate; they pay a $125 annual enrollment fee.

14 For 1994, you report gross and net operating income of $117,721 and $70,006, respectively (mainly because of an unusual recovery in one case) from operation of the LRS. For 1995, your gross operating income was $57,413, but you incurred an operating loss of $2,942.

15 Section 501(c)(6) of the Internal Revenue Code provides for the exemption from federal income tax of nonprofit business leagues, chambers of commerce, and boards of trade, no part of the net earnings of which inures [12] to the benefit of any private shareholder or individual.

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

17 Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax [13] under section 501(c) of the Code.

18 Section 512(a)(1) of the Code defines the term "unrelated business taxable income" to mean the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which
are directly connected with the carrying on of such trade or
business, both computed with the modifications provided in subsection
(b).

19 Section 513(a) of the Code provides that the term
"unrelated trade or business" means, in the case of any organization
subject to the tax imposed by section 511, any trade or business the
conduct of which is not substantially related to the exercise or
performance by such organization of its charitable, educational, or
[*14] other purpose or function constituting the basis for its exemption.

20 Section 1.513-1(d)(2) of the regulations provides that a
trade or business is "related" to exempt purposes only where the
conduct of the business activities has a causal relationship to the
achievement of exempt purposes (other than through the production of
income). Further, it is "substantially related", for purposes of
section 513 of the Code, only if the causal relationship is a
substantial one. For this relationship to exist, the production or
the performance of the service from which the gross income is derived
must contribute importantly to the accomplishment of exempt purposes.
Whether the activities productive of gross income contribute
importantly to such purposes depends, in each case, upon the facts
and circumstances involved.

[*15]

21 Section 1.513-1(b) of the regulations states that, "The
primary objective of the unrelated business income tax was to
eliminate a source of unfair competition by placing the unrelated
business activities of certain exempt organizations upon the same tax
basis as the non-exempt business endeavors with which they compete."

lawyer referral service which arranges at the request of any member
of the public an initial half-hour appointment for a nominal charge
with a lawyer whose name is on an approved list maintained by the
organization. An attorney specializing in the appropriate area of law
is selected from within the geographic area preferred by the client.
Any further contact between the lawyer and the client is arranged
without the involvement of the organization. The organization has
been created by several bar associations in a metropolitan [*16] area.

23 HELD, the lawyer referral service is not exempt under
section 501(c)(3) of the Code, but is tax exempt as a business league
under section 501(c)(6).
The rationale for exemption under section 501(c)(6) is as follows:

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 [*17] 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 [*18] 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.

In Kentucky Bar Foundation v. Commissioner, 78 T.C. 921 (1982), the Tax Court held that the operation of a lawyer referral service by the Kentucky Bar Association, an integrated bar, was a charitable activity within the meaning of Code section 501(c)(3). The referral service was similar [*19] in operation to the one described in Rev. Rul. 80-287.

With respect to your own ruling request, the LRS promotes the common business interests of members of the legal profession in N County by facilitating the utilization of legal services by members of the general public. In addition, the LRS benefits the local community through the referrals it makes concerning the non-legal services available from public and governmental social service agencies.
27 Your operation of the LRS assists the court system by helping to ensure that all persons have adequate legal representation as contemplated by the Court Rules of the State of M. The LRS also has a continuing interest in the lawyer's relation with the referred client and that interest [*20] continues until the referred matter is concluded. The lawyer is required to report to the LRS on the status of the referred matter. The client will typically turn to the LRS for assistance if there is difficulty in the relationship with the lawyer. Further, the LRS's ability to monitor the percentage amounts that participating lawyers charge referred clients ensures compliance with the Rules of Professional Conduct as far as fees are concerned.

28 One cited rule from the Rules of Professional Conduct for attorneys in the State of M prohibits an attorney from participating in organizations that promote the use of the attorney's services, except in limited circumstances, one of which is a referral service that is operated, sponsored, or approved by a bar association. In fact, lawyer referral services for the public are operated only by bar associations in M. Thus, the LRS that you operate does not compete with [*21] taxable businesses, an important consideration in determining whether an activity should be considered an unrelated trade or business. See section 1.513-1(b) of the regulations.

29 The effect of the activities engaged in by the LRS, as outlined above, is to enhance the reputation of the legal profession in N County and thereby encourage the general public to utilize its services. This promotes the common business interests of the attorneys in N County. Accordingly, the activities of the LRS are directly in furtherance of your exempt purposes within the meaning of Code section 501(c)(6) and section 1.501(c)(6)-1 of the regulations. See the holding in Rev. Rul. 80-287, discussed above. Therefore, the LRS should not be considered an unrelated trade or business within the meaning of section 513(a). It follows that the annual enrollment fee and the 15% fee in excess of $750 paid by participating lawyers [*22] on referred matters should not be subject to the tax imposed by section 511.

30 Based on the foregoing, we rule that the LRS as described above is not an unrelated trade or business within the meaning of section 513 of the Code. Accordingly, all amounts received by the LRS (assuming it continues to operate in essentially the same manner as at present) will not be treated as unrelated business taxable income within the meaning of section 512.

31 This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be
reported to your Key District Director.

32 We are sending a copy of this ruling to your Key District Director for exempt organization matters. Because this letter could help resolve any questions about your tax status, you should keep it with your permanent records.

33 If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

34 This ruling is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

35 Thank you for your cooperation.

Sincerely,

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 5