

## A MODEST PROPOSAL: THE DISCOUNT AND REFUND-OR-DONATE POLICY

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Despite all of the jokes to the contrary, lawyers as a professional group are remarkably charitable. Unlike plumbers, doctors, electricians, pharmacists, and the myriad of other regulated professionals who enjoy a government-granted monopolistic right to provide services to the public, many lawyers—especially those at large firms—regard themselves as having an obligation to provide services at no cost to worthy individuals and causes. This is known as “pro bono” work, a shortening of the Latin phrase *pro bono publico*—“for the public good.”

The primary sources of this obligation are aspirational recommendations by bar associations and other professional organizations. In addition, and particularly in recent years, law schools often teach students that lawyers have a special responsibility that requires them to provide free legal services under certain circumstances.<sup>1</sup>

### Form 1023

For tax lawyers, pro bono work often takes the form of creating a new non-profit organization and, most importantly, obtaining for it recognition of charitable status from the IRS by filing Form 1023, “Application for Recognition of Exemption Under

Section 501(c)(3) of the Internal Revenue Code.” This is no small task. The IRS itself has described its Form 1023 as “extremely burdensome and difficult”<sup>2</sup> and estimates that it requires 96 hours to complete.<sup>3</sup> This estimate does not include the time that must be devoted to meeting with the individuals involved and doing the necessary corporate work.

Sometimes things go well and the pro bono work results in an enduring charity that feeds and shelters the homeless, educates the underprivileged, or engages in one of many other valuable charitable programs. But often things do not go well. Indeed, often things go very poorly.

### A not unrealistic example

Mick, a \$500-an-hour tax lawyer at a large law firm, is asked by Elvis, a colleague at the firm, to meet with his friend John, who wants to join with three other people to form a new charity. This charity will use charitable donations to help stray cats, a mission about which all four individuals are “passionate.” An animal lover himself, Mick agrees and soon has a new pro bono client, Cat Care & Kindness, a to-be-formed charity that will be founded and operated by John and his three friends, Paul, George, and Ringo.

The first meeting goes well, but Mick soon encounters difficulties. John, Paul, George, and Ringo sometimes fail to return calls, attend meetings, or send needed information. Moreover, when they do return calls or attend meetings, they tend to be late and to demonstrate that they have spent no time considering the questions Mick posed during their last conversation. Over and over again, ideas and decisions are revisited and documents are revised. Mick sometimes feels that they value his time at exactly what they are paying for it, a thought that annoys him and raises his blood pressure. But Mick conceals his displeasure and, after several months, creates the new organization, completes the Form 1023, and submits it to the IRS.

Mick spends a total of 40 hours on the project, less than half of what the IRS says the Form 1023 alone should take. He could have done it in much less time if John, Paul, George, and Ringo had been more focused.

Six months later, the IRS issues the favorable determination letter. Cat Care & Kindness is a bona fide recognized charity, ready to help poor stray cats.

Or not. By the time the IRS letter arrives, John has decided that he is more of a dog person than a cat person and has withdrawn from the project. Without a farewell, Paul has moved to California. George has decided that this was not a good way to meet girls after all and stopped participating. Ringo, still annoyed that he was manipulated by his friends into paying the \$850 Form 1023 filing fee, declares that he cannot do everything and,

accordingly, does nothing.<sup>4</sup> The organization dies before it ever lived.

The net result: Not one cat was helped. Mick's 40 hours, with a fair market value of \$20,000, were wasted. And the IRS spent thousands of taxpayer dollars in order to consider and approve a stillborn and useless organization.

Most experienced tax lawyers can relate to this fictional example. Many can provide more than one story of similar or worse real world events, all more amusing to recall than to experience.

Some can provide many more than one.

#### **Amazing waste**

There are no statistics about how many charities have been formed and tax-qualified by pro bono lawyers, only to go out of existence soon thereafter without helping anyone or anything. But after the tax law was changed in 2006 to provide that tax-exempt status would be automatically revoked if three years passed without the filing of an annual tax return, more than 440,000 organizations were dropped from the IRS list of qualified tax-exempt entities.<sup>5</sup> It is generally believed that most of these organizations were small charities that ceased operations when officers and directors lost interest. They died without a bang, without a whimper, and without a final tax return.

It is not unreasonable to suppose that at least 5% of these organizations—22,000 entities—were charities that accomplished little or nothing after a pro bono lawyer provided free legal services. As a thought experiment, (1) estimate

the value of the free legal services provided to each of these 22,000 organizations, (2) estimate the costs that the IRS expended in reviewing each of the applications for recognition of charitable status, and (3) do the math. Even if the result is halved to reflect the fact that Form 1023 was previously less demanding than it is today, the amount of waste is amazing.

#### **Proposed solution—The Discount-and-Refund-or-Donate Policy**

So what is the solution? What are tax lawyers to do? Refusing to do pro bono tax work for start-up charities would be wrong. Every successful and effective charity was once a start-up.

A mechanism is needed that screens out incompetents and creates a disincentive for waste, while allowing pro bono services to be given to start-up charities that have a realistic possibility of accomplishing their goals. Fortunately, such a mechanism is not difficult to design or implement.

Specifically, law firms should adopt the following three-element “Discount-and-Refund-or-Donate Policy” (the “DRD Policy”):

- All new start-up pro bono charities will be charged hourly rates equal to 20% of normal rates. The organizing individuals will be personally responsible for payment. A \$1,000 cash retainer will be required before work begins.
- If the charity is still in existence and operating three years later, the law firm will refund all of the fees to the charity.

- If the charity is not in existence and operating three years later, however, the law firm will contribute all of the fees to the local Legal Aid Society or the American Red Cross.

If widely adopted, the DRD Policy will have the following salutary consequences:

- People who cannot come up with a relatively small amount of cash to fund their charitable “passion” will not receive free legal services. This does not reduce the common good, however, because such people are very unlikely to be successful at raising charitable dollars and operating a charity.
- Because paying even 20% of today’s high hourly legal fees is not

a trivial matter, individuals who receive pro bono legal services to start a new charity will have the same incentive that other clients have not to waste the time of their tax lawyers. This will reduce waste and make pro bono tax lawyers more willing to do pro bono work in the future.

- Pro bono tax lawyers will have more time to devote to pro bono activities that accomplish something.
- The Legal Aid Society and the American Red Cross will receive contributions from law firms.
- The number of newly formed charities will be selectively reduced, thereby alleviating some of the load on the IRS. Society

will pay little or nothing for this benefit, because most or all of the unborn charities would not have achieved much or anything of value.

### Conclusion

Anyone who agrees with the foregoing should feel free to send a copy of this article to the person who runs the pro bono program at his or her firm. If the DRD Policy becomes widespread, good charities will be helped, IRS resources will be conserved, and the stress level of tax lawyers will be reduced.

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### End Notes:

- <sup>1</sup> Some accountants similarly regard themselves as having a professional duty to do pro bono work, but this sense of obligation is less institutionalized in the accounting profession than it is in the legal profession. Especially in large accounting firms, however, it is a growing trend. Accordingly, the recommendations contained in this article are applicable to accountants as well as lawyers. *The Wall Street Journal*, Nov. 11, 2012.
- <sup>2</sup> See, e.g., study materials for “Tax Exempt Organizations: An Advanced Course” (10/18-19/12), ALI-CLE/ABA Section of Taxation, page 22.
- <sup>3</sup> See [www.pracomment.gov/Comment-on-Forms/Form-1023](http://www.pracomment.gov/Comment-on-Forms/Form-1023).
- <sup>4</sup> At one meeting, Mick was asked if his law firm, or he personally, would provide the \$850. Mick smiled as he declined, but could instantly feel his blood pressure rise significantly.
- <sup>5</sup> Exempt Org. Tax Jnl. 2012-192, Item 2 (11/19/12).

