



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

APR 24 2000

CC:DOM:ITA:RLHodes
SPR-106666-00

MEMORANDUM FOR ROBERT E. BARR
ASSISTANT COMMISSIONER (ELECTRONIC TAX
ADMINISTRATION) OP:ETA

FROM: Lewis J. Fernandez *Lewis J. Fernandez*
Deputy Assistant Chief Counsel (Income Tax and
Accounting) CC:DOM:ITA

SUBJECT: FreeTaxPrep.com, Inc. Proposal

This responds to your request that Counsel review the electronic filing partnership proposal submitted by FreeTaxPrep.com, Inc. The proposal contains several initiatives for the promotion of FreeTaxPrep.com and for electronic tax administration in general. We asked the Associate Chief Counsel (General Legal Services) and the Assistant Chief Counsel (Disclosure Litigation) to address the legal questions raised by this proposal. General Legal Services prepared the attached memorandum. Disclosure Litigation will address issues under §7216 of the Internal Revenue Code as part of its response to your office relating to HD Vest and similar free internet return preparation applications.

Pursuant to General Legal Services's memorandum, the Service may accept FreeTaxPrep.com's proposal with the understanding that the Service may not actively market or endorse their products and services. In addition, the Service should not agree to the inclusion of commercial advertising in Government publications as it is currently prohibited by Service policy. Finally, it is questionable whether a user fee could be established in this instance.

If you have any further questions regarding this matter, or if we be of further assistance, please contact me at (202) 622-4810.

PMTA: 00366



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MEMORANDUM FOR LEWIS J. FERNANDEZ
DEPUTY ASSISTANT CHIEF COUNSEL (IT&A)

FROM:

Mark S. Kaizen
Mark S. Kaizen
Associate Chief Counsel (General Legal Services)

SUBJECT: FreeTaxPrep.com, Inc. Proposal

This responds to your request that we review the electronic filing partnership proposal submitted by FreeTaxPrep.com, Inc. The proposal contains several initiatives for the promotion of FreeTaxPrep.com and for electronic tax administration in general. You have specifically asked whether the Service may place advertising in its public mailings and Form 1040 packages, whether the Service can charge a fee for the advertising, and whether the IRS can offer a "seal of approval." For the reasons discussed below, it is our opinion that the Service may accept the proposal with the understanding that the Service may not actively market and endorse the products and services of FreeTaxPrep.com. Furthermore, it is our recommendation that the Service not agree to the inclusion of commercial advertising in Government publications as it is currently prohibited by Service policy. Finally, it is questionable whether a user fee could be established in this instance.

FreeTaxPrep.com has proposed several marketing initiatives, with the theme of "Free and Easy," to promote its products and services as well as electronic tax administration in general. In November 2000, FreeTaxPrep.com proposes to include its own promotional material, as well as offers from other commercial entities, in the Service's mailing of electronic customer numbers. A follow-up mailing would be done in January 2001. FreeTaxPrep.com also proposes a joint advertising campaign which includes the purchase of advertising in newspapers and other electronic media, placing notices on all Government employee paychecks, distribution of materials in post offices and other distributions points, and unspecified programs for libraries offering free Internet access. FreeTaxPrep.com is also seeking a "File Free and Easy" postage stamp and metered stamp, and advertising in Form 1040 packets. In terms of public relations, FreeTaxPrep.com seeks a joint press conference with the Commissioner announcing the partnership, a national press tour supported by Service and FreeTaxPrep.com executives,

video news releases, and a press event with the President doing his taxes on FreeTaxPrep.com. Finally FreeTaxPrep.com has proposed several web-based initiatives including a "Free and Easy" section on the IRS site, links to FreeTaxPrep.com from all .gov sites, Internet access in government offices for e-filing, and IRS sponsored relationship with one of the major portal sites promoting the "Free and Easy" campaign.

Ethical Considerations

The Office of Government Ethics' Standards of Ethical Conduct for Employees of the Executive Branch provides that an employee shall not use or permit the use of any authority associated with his public office to endorse any product, service, or enterprise except in furtherance of statutory authority to promote products, services, or enterprises. 5 C.F.R. § 2635.702(c)(1). Furthermore, an employee shall act impartially and not give preferential treatment to any private organization or individual. 5 C.F.R. § 2635.101(b)(8); see also Executive Order 12731 § 101(h) (Oct. 17, 1990). While these standards are expressed as applying to employees rather than the employing agency, the Service has, nevertheless, endeavored to follow them as an institution.

In the IRS Restructuring and Reform Act of 1998 (RRA), Pub. L. 105-206, 112 Stat. 685 (July 22, 1998), Congress declared that it should be the goal of the Service to have at least 80 percent of all returns filed electronically by the year 2007. RRA § 2001(a)(2). To achieve that goal, Congress has directed the Service to cooperate with and encourage the private sector by encouraging competition to increase electronic filing. RRA § 2001(a)(3). Finally, the Service is authorized to promote the benefits of and encourage the use of electronic tax administration programs, as they become available, through the use of mass communications and other means. I.R.C. § 6011(f)(1), as amended by RRA § 2001(c). While the Service has statutory authority to promote electronic tax administration, it does not have statutory authority to promote the products and services of specific companies. Consequently, the Service cannot appear to endorse the products and services of one or more companies to the exclusion of other similarly situated companies.

The Service may include FreeTaxPrep.com stuffers in its mailings of ECN packets and Form 1040 packets, provided it includes an appropriate disclaimer.¹ The Service may

¹For example, the ETA Partners Page on the Service's Digital Daily web site contains the following disclaimer: "[t]he Internal Revenue Service has entered into partnership agreements with these companies to foster electronic filing. As a convenience to taxpayers, the Internal Revenue Service has provided links to these companies' web sites, and the companies have provided the aforementioned descriptions of their products and services. The Internal Revenue Service and the United States Government do not endorse or warrant these companies or their products or services. The decision to use or

also participate in press events with FreeTaxPrep.com. However, the Service officials involved can not extoll the virtues of FreeTaxPrep.com. The Service officials will be limited to discussing the benefits of the electronic filing program in general, stopping short of any endorsement of FreeTaxPrep.com or the Service's other partners. The Service may provide a link from ETA's Partners Page on the Service's Digital Daily web site to FreeTaxPrep.com, accompanied by the disclaimer already posted on the Partners Page. The Service, however, has no control over the creation of links between other Government web sites, or the provision of Internet access on Government employee work stations for the purpose of electronic filing.²

While the Service should not appear to endorse the products and services of a particular company to the exclusion of other similarly situated companies, the Service does not have to enter into identical agreements with all of its partners, nor does the Service have to provide identical levels of support to each of its partners. Under the statutory authority to promote electronic filing, the Service has the latitude to enter into different agreements based on the proposal of the prospective partner and the expected benefits to electronic tax administration. However, the Service may be subject to criticism by Congress and the public that it has gone too far in promoting the products of one partner if, for example, it only included a stuffer for one of its partners in a mailing. The potential for such criticism should be taken into account in evaluating the proposal of a prospective partner.

To ameliorate criticism of the Service for its interactions with its electronic filing partners, the Service may wish to explore alternative means of entering into electronic filing partnerships. Recently, the Service has entered into Memorandums of Agreement with various companies to promote electronic filing. Because the agreements do not involve the expenditure of appropriated funds, they are not subject to the Federal Acquisition Regulation. As an alternative, the Service may wish to consider promulgating a regulation or issuing a Revenue Procedure detailing the minimum standards for acceptance as an electronic filing partner, and the responsibilities of the prospective partner and the Service with respect to the electronic filing program. See e.g. Rev. Proc. 98-50 (Sept. 21, 1998) (Form 1040 IRS *e-file* program). The regulation or revenue procedure may be written in

not to use any of these products and services will not result in any special treatment from the Internal Revenue Service."

²The Standards of Ethical Conduct states that Executive Branch employees shall only use Government property for authorized purposes, and shall use official time in an honest effort to perform official duties. 5 C.F.R. §§ 2635.704(a), 2635.705(a). Because the preparation and filing of individual income tax returns is a personal activity, it is questionable whether the preparation of an employee's income tax return would be an authorized use of official time and resources.

such a way to retain the flexibility of the current solicitation and encourage continued innovation and creativity. Furthermore, by publishing a regulation or revenue procedure outlining the standards of acceptance and responsibilities of each of the parties to an electronic filing partnership, the public will become more aware of and involved in the electronic filing program, decreasing the likelihood for criticism.

IRS "Seal of Approval"

As discussed above, the Service may not endorse the products and services of a company or enterprise to the exclusion of other similarly situated companies and enterprises. Providing an IRS "Seal of Approval" to FreeTaxPrep.com would constitute a prohibited endorsement. However, FreeTaxPrep.com may state in its own marketing material that it is a Service electronic filing partner. Furthermore, the Assistant Commissioner (Electronic Tax Administration) may authorize FreeTaxPrep.com to use the IRS *e-file* logo in its marketing material.

Placement of Advertisements in Service Publications

FreeTaxPrep.com has also proposed the placement of advertising in the Service's publications. Although there is no statutory prohibition against the sale of commercial advertising to promote electronic filing, Federal policy has traditionally opposed commercial advertising in Government publications and programs. Government Printing and Binding Regulations § 13; GAO, *Principles of Federal Appropriations Law* (2d Ed. 1992) 4-186. The Service has adopted the Federal policy against commercial advertising. See IRM 1278 § 872.1(1). Pursuant to the Service policy, commercial advertising is not a proper or authorized Government function, and no Government publication or other Government printed matter prepared or produced with appropriated or nonappropriated funds shall contain any advertisement or insertion by or for any private individual, firm or corporation, or contain material which implies in any manner that the Government endorses or favors any specific commercial product, commodity, or service.³ IRM 1278 § 872.1.

³The current IRM provisions regarding commercial advertising in Government publications are based on Government Printing and Binding Regulations, § 13. However, these regulations are not binding on Executive Branch agencies. See Memorandum for Emily C. Hewitt, General Counsel, General Services Administration from Richard L. Shiffrin, Deputy Assistant Attorney General, Office of Legal Counsel, Department of Justice, *Re: Use of Appropriated Funds to Purchase Employee Business Cards*, p. 2 (Aug. 11, 1997).

As stated in the Service policy, the traditional reasons against involvement in commercial advertising include the fact that such advertisements are unfair to those who do not so advertise in that, whether intentionally or not, they are frequently made to appear to have the sanction of the Government. Furthermore, the publication of such advertisements is unjust to the public in that the advertisers profit at the expense of the Government, as the publications are circulated free of charge under Government frank. Advertising in Government publications is also unfair to the publishers of other periodicals in that they generally cannot meet such competition, owing to the great advantage possessed by a Government publication. Another reason for objecting is that advertisers are apt to use Government periodicals for the purpose of currying favor with the officers issuing the publications or the special class among whom the publications are circulated. IRM 1278 § 872.1(2).

The prohibition against commercial advertising is a matter of policy, not a matter of law. In order to meet the ambitious Congressional mandate to achieve an 80 percent level of electronic filing by 2007, the Service may wish to reconsider the policy against commercial advertising in light of the expected benefits of promoting electronic tax administration. The Service may conclude that the inclusion of commercial advertising outweighs any appearance that the Service is endorsing the products and services of any particular partner, including FreeTaxPrep.com. In 67 Comp. Gen. 90 (1987), the Comptroller General found that there was no statutory prohibition against the use of commercial advertising in programs broadcast over the United States Information Agency's Voice of America. However, the Comptroller General advised against the adoption of a policy permitting the broadcast of commercial advertising in the absence of specific statutory authority. The Comptroller General recommended that the USIA consult with appropriate Congressional committees to obtain authority to broadcast commercial advertising. In the absence of specific statutory authority to sell commercial advertising, we would recommend following the Comptroller General's advice, and consulting with the appropriate Congressional committees before acting in contravention of a well established Federal and Service policy against involvement in commercial advertising.

Should the way be cleared for advertising for FreeTaxPrep.com in Service publications, a further factor to consider is that the Service may appear to be promoting the products and services of FreeTaxPrep.com to the exclusion of the Service's other electronic filing partners. The appearance of preferential treatment or endorsement should be taken into consideration in evaluating a partnership proposal. However, as stated above, the Service may enter into different agreements with different partners based upon the expected benefits to electronic tax administration.

User Fee Issues

You have also asked whether the Service could charge FreeTaxPrep.com for services provided in relation to the proposed marketing initiatives, including the provision of advertising space in Service publications. Any revenue received for services rendered from FreeTaxPrep.com would constitute an impermissible augmentation of the Service's appropriations. One of the basic principles of Federal appropriations law is that agencies may only spend funds appropriated by Congress and may not augment their appropriations by accepting funds from other sources. See generally GAO, *Principles of Federal Appropriations Law* at 6-103, et. seq. Consequently, absent statutory authority to receive revenue from the provision of marketing services, the Service could not charge a fee for providing the marketing services.

In the absence of specific statutory authority, the Service could charge its partners for the promotional services under the general statutory authority for the establishment of user fees found in Title V of the Independent Offices Appropriations Act of 1952 (IOAA) codified at 31 U.S.C. § 9701 (General User Fee Statute). OMB Circular A-25 prescribes the policies for establishing user fees. OMB Circular A-25, 58 Fed. Reg. 38142 (July 15, 1993). Pursuant to OMB Circular A-25, a user fee will be assessed against each identifiable recipient of a special benefit derived from Federal activities beyond those received by the general public. OMB Circular A-125 § 6. A special benefit is conferred where a Government service is performed at the request of, or for the convenience of, the recipient and is beyond the services regularly requested by other members of the same industry, class, or the general public. OMB Circular A-25 § 6(a)(1)(c). A user fee must be established by the promulgation of a regulation. OMB Circular A-25 § 7(a).

Given the number of electronic filing marketing proposals submitted by companies such as FreeTaxPrep.com, it is questionable whether the marketing services requested by FreeTaxPrep.com are beyond the services regularly requested by other members of the same industry. However, we recommend consulting with OMB regarding the establishment of a user fee in this instance.

Assuming a user fee could be established in this case, the Treasury, Postal Service, and General Government Appropriations Act, 1995, Pub. L. 103-329, Title I, § 3, September 30, 1994, as amended by Pub. L. 104-19, July 27, 1995, provides in pertinent part that the Service may "spend [up to \$119,000,000 per year in] new or increased fee receipts to supplement appropriations made available to the Internal Revenue Service appropriations accounts in fiscal years 1995 and thereafter: *Provided*, That the Secretary shall base such fees on the costs of providing specified services to persons paying such fees." Thus if the Service established a user fee, it could retain such fees provided that the fees were based on the Service's actual cost and the \$119,000,000 cap was not exceeded. Any fees

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received in excess of the \$119,000,000 cap must be deposited in the Treasury as miscellaneous receipts. 31 U.S.C. § 3302(b).

When the Government is acting in its sovereign capacity, any established user fee should be sufficient to recover the full cost to the agency of providing the service, resource, or good when the Government is acting in its sovereign capacity. OMB Circular A-25 § 6(a)(2)(a). Market prices may be charged when the Government, not acting in its sovereign capacity, is leasing or selling goods or resources, or is providing a service. OMB Circular A-25 § 6(a)(2)(b). As Service policy states that involvement in commercial advertising is not a proper or authorized function, it is questionable whether the Service is acting in its sovereign capacity. See IRM 1278 § 872.1(2). If the Service is not acting in its sovereign capacity, it may charge market rates for the advertising space. However, the Service must then deposit any revenues received in the Treasury as miscellaneous receipts because the Service may only retain the proceeds of user fees if the user fees are based on the actual cost of the service provided.

We note that the Service has statutory authority to use appropriated funds to promote electronic filing, including the expenses of promotional campaigns with its electronic filing partners. See I.R.C. § 6011(f)(1), as amended by RRA § 2001(c). Furthermore, establishing a user fee may be counterproductive to the promotion of electronic filing. Charging the Service's partners a fee may discourage private sector participation in the Service's electronic filing program. A user fee may also increase the cost of electronic filing which may, in turn, be passed on the taxpayers. Consequently, the establishment of a user fee in this instance may not be in the best interest of customer oriented tax administration.

If you have any questions regarding this matter, or if we be of further assistance, please contact Kirsten Witter of this office at (202) 283-7900.