



*Although Improvements Have Been Made,  
More Can Be Done to Identify Businesses by  
Their Principal Business Activity*

**July 2006**

**Reference Number: 2006-30-097**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

July 5, 2006

**MEMORANDUM FOR** COMMISSIONER, WAGE AND INVESTMENT DIVISION

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Although Improvements Have Been Made, More Can Be Done to Identify Businesses by Their Principal Business Activity (Audit # 200430023)

This report presents the results of our review of the Internal Revenue Service's (IRS) efforts to identify businesses by their principal business activity. The overall objective of this review was to evaluate the effectiveness of the corrective actions taken in response to the recommendations in a prior Treasury Inspector General for Tax Administration report.<sup>1</sup>

*Synopsis*

In the previous report, we recommended management identify business taxpayers by their principal business activity from information provided when taxpayers file Applications for Employer Identification Number<sup>2</sup> (Form SS-4). Early identification by Principal Business Activity (PBA) code would allow the Internal Revenue Service (IRS) to include these new businesses in market segment analyses to identify the need for educational or compliance assistance.

During this review, we found that the IRS has taken steps to capture the PBA codes during the processing of Forms SS-4; however, many PBA codes are still not identified during Forms SS-4 processing. Using information supplied by the IRS, the Social Security Administration now assigns appropriate PBA codes to the businesses and sends the PBA code information to the IRS.

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<sup>1</sup> *Additional Controls Are Necessary to Ensure that All Businesses are Classified by Their Principal Business Activity* (Reference Number 2001-30-117, dated August 2001).

<sup>2</sup> The Employer Identification Number is a unique nine-digit number used to identify a taxpayer's business account.



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However, limited audit testing determined only 38 percent of PBA codes were recorded on IRS records following the processing of Forms SS-4.<sup>3</sup>

Also, in the previous report, we recommended management implement processing controls to identify and correct business income tax returns with invalid PBA codes and individual income tax returns reporting business activities with invalid or missing PBA codes. Although the IRS could not take the recommended corrective actions due to the cost, the procedures for business income tax returns were improved, which should help to correct invalid PBA codes and add missing codes.

However, there are still insufficient procedures for handling both missing and invalid PBA codes on individual income tax returns reporting business activity. In a test of 562,807 individual income tax returns with an attached Profit or Loss From Business (Schedule C), we found 111,790 (20 percent) were processed without PBA codes.

If missing and invalid PBA codes are not added or corrected, the IRS may be unable to accurately profile taxpayers by their market segment for education through outreach programs, identification of nonfilers, and use in statistical reports and analyses.

### Recommendations

The Director, Customer Account Services, Wage and Investment Division, should 1) coordinate with the Social Security Administration to determine the causes for missing PBA codes on Forms SS-4 and consider developing controls and issuing instructions to address the causes identified, to ensure PBA codes are assigned when required, and 2) develop procedural instructions to identify and correct individual income tax returns reporting business activities that have missing or invalid PBA codes.

### Response

IRS management agreed with the first recommendation and determined that some North American Industry Classification System (NAICS)<sup>4</sup> codes were not transmitted between the agencies. They identified the cause of the problem, and Social Security Administration and IRS

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<sup>3</sup> We sampled 315 Form SS-4 applications that were selected at the Brookhaven, New York, IRS Campus for 1 week in August 2004. Ninety-seven of the 315 Forms SS-4 did not require a PBA code; the remaining 218 did require a code. Of the 218 Forms SS-4 requiring PBA codes, only 38 percent (82 of 218) had PBA codes entered on IRS records. The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

<sup>4</sup> According to the IRS' response to our draft report (see Appendix V), the PBA codes are now known as NAICS codes, and the IRS response uses that abbreviation in place of "PBA."



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programmers are working to correct the situation. The IRS will continue to work with the Social Security Administration to resolve this issue and develop appropriate validation controls.

However, the IRS disagreed with our second recommendation. Further, they stated that they disagreed with one of the basic premises of our report, that early identification by NAICS codes would allow the IRS to include new businesses in market segment analyses to identify the need for educational or compliance assistance, stating that, “while we acknowledge there is the potential to use this information as you describe, we do not currently use the NAICS codes for this purpose since we do not communicate directly to the small business taxpayer; instead, we find it more effective for us to provide education through leveraged liaison and outreach activities with practitioner organizations and small business and industry associations.” IRS management considered our recommendation but determined that implementation would require additional return processing steps, which would increase the costs and extend the time required to process applicable individual income tax returns reporting business activities. This, combined with the fact that the IRS does not use the NAICS codes to identify and contact small business taxpayers regarding their possible needs, led to the conclusion that it is not in the interest of tax administration to implement the recommendation. Management’s complete response to the draft report is included as Appendix V.

### *Office of Audit Comment*

We are not advocating that the IRS communicate directly with the small business taxpayer, and we do not disagree with the IRS’ use of outreach activities. However, we believe these outreach activities can be more useful if focused on taxpayer segments with specific, identified needs. For example, we are now completing a review that identified a significant number of commercial fishermen who could have paid less tax by taking advantage of a relatively new provision allowing them to average their income from fishing; however, these taxpayers apparently were unaware of this provision. We identified these taxpayers by NAICS code. Therefore, we believe the IRS should reconsider taking some steps to improve the accuracy of the NAICS codes.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-8500.



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## *Background*

Principal Business Activity (PBA) codes are used to classify businesses by type of activity. These codes were originally based on the Standard Industrial Classification index and were used exclusively through 1998 by the Internal Revenue Service (IRS). As of 1999, the four-digit Standard Industrial Classification-based number was changed to a six-digit number based on the North American Industry Classification System (NAICS), which was developed through a cooperative effort among the Governments of the United States, Canada, and Mexico. This System was designed with more than 1,000 codes, approximately 400 of which the IRS has adopted for its use.

In a prior report,<sup>1</sup> we found the IRS successfully adopted the new NAICS codes; however, the IRS had not taken advantage of the opportunity to immediately identify taxpayers' PBA codes when the taxpayers were first established on the IRS Business Master File (BMF).<sup>2</sup> Also, processing controls were not sufficient to ensure valid PBA codes were identified for all business-related tax returns filed on both the BMF and the Individual Master File.<sup>3</sup>

This review was performed at the IRS Brookhaven, New York, Campus<sup>4</sup> during the period March 2005 through March 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>1</sup> *Additional Controls Are Necessary to Ensure that All Businesses Are Classified by Their Principal Business Activity* (Reference Number 2001-30-117, dated August 2001).

<sup>2</sup> The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

<sup>3</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>4</sup> The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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## *Results of Review*

### ***More Can Be Done to Identify Businesses by Their Principal Business Activity When Business Accounts Are Established***

We previously reported:

The IRS cannot identify taxpayers by industry or market segment until the taxpayers provide valid PBA codes with the filing of a U.S. Individual Income Tax Return (Form 1040) containing a Schedule C or F,<sup>5</sup> a U.S. Return of Partnership Income (Form 1065), or one of the various U.S. Corporation Income Tax Returns (Form 1120 series). Therefore, newly established businesses cannot be placed in industries or market segments based on their PBA codes, nor can they be targeted for pre-filing outreach or compliance activities until they file tax returns with valid PBA codes. With approximately 2 million Employer Identification Numbers (EIN)<sup>6</sup> issued annually, this problem affects a great many newly established businesses.

Although the PBA information was available, the IRS had not yet taken the opportunity to use it. When taxpayers file an Application for Employer Identification Number (Form SS-4), their accounts are established on the IRS Master File.<sup>7</sup> Although the principal business activity is described on the Form SS-4, taxpayers are not required to enter PBA codes, nor does the IRS use the taxpayer's description of the business to identify the code for entry to the Master File at that time.

We recommended management identify business taxpayers by their principal business activity from information provided when taxpayers file Forms SS-4 requesting an EIN and their entities are established on the BMF. Early identification by PBA code would allow the IRS to include these new businesses in market segment analyses to identify the need for educational or compliance assistance.

In their response to the previous report, IRS management agreed that efforts could be made to identify the PBA codes at the time of processing Forms SS-4. Management also stated they would need additional resources to perform the validity and correction process. The IRS planned to perform a cost/benefit analysis to make certain the benefits would justify the cost to perform this work and, ultimately, whether such funding was available.

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<sup>5</sup> The Schedules are Profit or Loss From Business (Schedule C) and Profit or Loss From Farming (Schedule F).

<sup>6</sup> A unique nine-digit number used to identify a taxpayer's business account.

<sup>7</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.





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Changes made since our prior audit include:

- **Revisions to Form SS-4** - During the previous audit, Form SS-4, revised in April 2000, instructed taxpayers to enter, “the exact type of business being operated (for example, advertising agency, farm, food or beverage establishment, labor union, real estate agency, steam laundry, rental of coin-operated vending machine, or investment club).” The current Form SS-4, revised in December 2001, asks taxpayers to check 1 of 12 boxes which best describes the principal activity of the applicant’s business. Although the boxes that business taxpayers are asked to check are limited to only 12 categories, the instructions continue to ask the applicants to describe their principal line of business in more detail.
- **Adoption of New Procedures for Assigning PBA codes** - The IRS now transcribes and electronically transmits the information from Forms SS-4 to the Social Security Administration, which then assigns an appropriate PBA code to the business and sends the PBA code information to the IRS within approximately 2 months. The six-digit codes are then added to the Master File records for the business entities.

**More needs to be done to ensure PBA codes are assigned**

In a judgmental sample of Forms SS-4 that consisted of Internet, fax, and mail-in applications submitted to the IRS during 1 week in August 2004, only 38 percent of PBA codes were recorded on the BMF after the processing of Forms SS-4 and before the filing of tax returns by businesses that applied for EINs.<sup>8</sup>

Although the 38 percent represents a significant improvement from our previous audit, many businesses are still not assigned PBA codes during Form SS-4 processing. Instead, PBA codes are not assigned until the businesses file their first tax returns.

The IRS studied alternative methodologies for assigning PBA codes during Form SS-4 processing and decided not to adopt our recommendations, primarily due to cost factors. While actions have been taken to include taxpayers as stakeholders in providing information on the Form SS-4 concerning their principal business activity and the Social Security Administration as a stakeholder in assigning PBA codes, sufficient controls and procedures have not been established to ensure PBA codes are assigned to taxpayers.

Consequently, the IRS will not receive the full benefit of more accurate and complete profiling of taxpayers by their market segment for education of taxpayers through outreach programs, identification of nonfilers, and use in statistical reports.

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<sup>8</sup> We sampled 315 Form SS-4 applications that were selected at the IRS Brookhaven Campus. Ninety-seven of the 315 Forms SS-4 did not require a PBA code; the remaining 218 did require a code. Of the 218 Forms SS-4 requiring PBA codes, only 38 percent (82 of 218) had PBA codes recorded on the BMF.





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## **Recommendation**

**Recommendation 1:** The Director, Customer Account Services, Wage and Investment Division, should coordinate with the Social Security Administration to determine the causes for missing PBA codes on Forms SS-4 and consider developing controls and issuing instructions to address the causes identified, to ensure PBA codes are assigned.

**Management's Response:** IRS management agreed with this recommendation and determined that some NAICS<sup>9</sup> codes were not transmitted between agencies. They identified the cause of the problem, and Social Security Administration and IRS programmers are working to correct the situation. The IRS will continue to work with the Social Security Administration to resolve this issue and develop appropriate validation controls.

## ***Procedures Were Developed to Correct Invalid Principal Business Activity Codes and Add Missing Codes for Business Income Tax Returns but Not for Individual Income Tax Returns***

In our prior report, we recommended management implement processing controls to identify business income tax returns with invalid PBA codes and individual income tax returns with invalid or missing PBA codes, for research and correction during processing.

In response to that report, management stated they would need additional resources to perform the validity and correction process. A cost/benefit analysis would be performed to make certain the benefits would justify the cost to perform this work and, ultimately, whether such funding was available. In its analysis, the IRS would consider any impact that might delay the processing of returns, thus adversely affecting customer service.

### **PBA code processing - business income tax returns**

Although the IRS could not take the recommended corrective actions due to the cost, procedures were improved to correct invalid PBA codes and add missing codes for business tax returns.

Procedures regarding PBA codes were added to the Internal Revenue Manual covering the processing of business returns. When codes are missing or invalid, tax examiners are now instructed to use the information on the returns and the list of PBA codes to determine what the code should be. If they are unable to make a determination, a generic code is used.

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<sup>9</sup> According to the IRS' response to our draft report (see Appendix V), the PBA codes are now known as NAICS codes, and the IRS response uses that abbreviation in place of "PBA."



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**PBA code processing - individual income tax returns**

In the prior audit, we reported the IRS did not have sufficient controls for handling both missing and invalid PBA codes on individual income tax returns and there were no Internal Revenue Manual instructions to identify and correct the PBA codes. Specifically, we reported that:

Approximately 2 million individual income tax returns containing Schedules C or F were processed with missing codes. This represented 9.6 percent of all tax returns filed with these Schedules. Just over 780,000 individual income tax returns with Schedules C or F were processed with invalid codes. This represented 3.7 percent of all tax returns filed with these Schedules.

Although Internal Revenue Manual instructions were developed to address and correct invalid PBA codes on business income tax returns, management has not addressed missing and invalid PBA codes on individual income tax returns reporting business activities. The procedural changes adopted for processing business returns should also be adopted for processing individual income tax returns. This should help ensure missing PBA codes are added and invalid codes are corrected on individual income tax returns reporting business activity.

Filing instructions for tax returns with attached an Schedule C and/or Schedule F require PBA codes. Our audit test showed that approximately 20 percent of individual income tax returns with an attached Schedule C did not have PBA codes. Using a computer application, we identified 562,807 returns filed with a Schedule C for Tax Year 2003 and found 111,790 were processed without PBA codes.

If these missing and invalid PBA codes are not added or corrected, the IRS may be unable to accurately profile taxpayers by their market segment for education through outreach programs and use in statistical reports and analyses.

**Recommendation**

**Recommendation 2:** The Director, Customer Account Services, Wage and Investment Division, should develop procedural instructions to identify and correct individual income tax returns reporting business activities that have missing or invalid PBA codes.

**Management's Response:** IRS management disagreed with this recommendation. Further, they stated that they disagreed with one of the basic premises of our report, that early identification by NAICS codes would allow the IRS to include new businesses in market segment analyses to identify the need for educational or compliance assistance, stating that, "while we acknowledge there is the potential to use this information as you describe, we do not currently use the NAICS codes for this purpose since we do not communicate directly to the small business taxpayer; instead, we find it more effective for us to provide education through leveraged liaison and outreach activities with practitioner organizations and small business and industry associations." IRS



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management stated they considered our recommendation but determined implementing it would require additional return processing steps, which would increase the costs and extend the time required to process applicable individual income tax returns reporting business activities. This, combined with the fact that the IRS does not use the NAICS codes to identify and contact small business taxpayers regarding their possible needs, led to the conclusion that it is not in the interest of tax administration to implement the recommendation.

**Office of Audit Comment:** We are not advocating that the IRS communicate directly with the small business taxpayer, and we do not disagree with the IRS' use of outreach activities. However, we believe these outreach activities can be more useful if focused on taxpayer segments with specific, identified needs. For example, we are now completing a review that identified a significant number of commercial fishermen who could have paid less tax by taking advantage of a relatively new provision allowing them to average their income from fishing; however, these taxpayers apparently were unaware of this provision. We identified these taxpayers by NAICS code. Therefore, we believe the IRS should reconsider taking some steps to improve the accuracy of the NAICS codes.



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## Appendix I

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to evaluate the effectiveness of the corrective actions taken in response to the recommendations in a prior Treasury Inspector General for Tax Administration (TIGTA) report.<sup>1</sup> To accomplish this objective, we:

- I. Determined whether corrective measures were taken by the Internal Revenue Service (IRS). We reviewed management's response to the original report to identify which findings required corrective actions and how the corrective actions were to be implemented. We also determined what corrective actions had been implemented.
- II. Evaluated the adequacy and effectiveness of corrective actions taken.
  - A. Determined whether processing instructions involving the Application for Employer Identification Number (Form SS-4) were adequate and/or updated to ensure Principal Business Activity (PBA) codes were established when business entities were created by Form SS-4 filings. We reviewed a judgmental sample<sup>2</sup> of 315 Forms SS-4 processed at the IRS Brookhaven, New York, Campus<sup>3</sup> and researched IRS records to determine whether PBA codes were assigned to the businesses. For 1 week in August 2004, 198 Employer Identification Number (EIN)<sup>4</sup> applications selected were initiated through the Internet, 103 EIN applications selected were Forms SS-4 faxed to the Brookhaven Campus, 6 EIN applications selected were submitted with correspondence, and 8 EIN applications selected were received in the mail. We also evaluated the cost/benefit analysis performed regarding establishing PBA codes at the time of Form SS-4 filing.
  - B. Determined whether processing instructions for resolving missing or invalid PBA codes on business and individual income tax returns were adequate and/or updated. Using a computer application, we extracted from the TIGTA Data Center Warehouse,<sup>5</sup> as of July 20, 2005, 562,807 Tax Year 2003 individual income tax

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<sup>1</sup> *Additional Controls Are Necessary to Ensure that All Businesses are Classified by Their Principal Business Activity* (Reference Number 2001-30-117, dated August 2001).

<sup>2</sup> A judgmental sample was selected because the Forms SS-4 are available for a limited time only. The IRS processed approximately 3.5 million Forms SS-4 during 2004, but the Forms are generally available only when they were being processed.

<sup>3</sup> The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

<sup>4</sup> A unique nine-digit number used to identify a taxpayer's business account.

<sup>5</sup> The Warehouse is a centralized data storage facility that TIGTA auditors use to obtain IRS data.



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returns, with an attached Profit or Loss From Business (Schedule C). We analyzed the file and determined the number and percentage of returns processed without PBA codes.

- III. Determined, where substantive corrective actions had not been taken, if there were corrective actions that could be taken to improve the processing of PBA codes. We also interviewed program analysts to determine whether there were less costly corrective actions that could be taken.



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## **Appendix II**

### *Major Contributors to This Report*

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)

Kyle R. Andersen, Director

Robert K. Irish, Audit Manager

Paul R. Baker, Lead Auditor

Stephen A. Wybaillie, Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI  
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM  
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Management Controls OS:CFO:AR:M  
Audit Liaison: Senior Operations Advisor, Wage and Investment Division SE:W:S





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## Appendix IV

### *Outcome Measure*

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

**Type and Value of Outcome Measure:**

- Reliability of Information – Actual; 111,790 taxpayer accounts affected (see page 4).

**Methodology Used to Measure the Reported Benefit:**

Our audit test showed that approximately 20 percent of individual income tax returns with an attached Profit or Loss From Business (Schedule C) did not have Principal Business Activity codes. Using a computer application, we identified 562,807 returns filed with a Schedule C for Tax Year 2003 and found 111,790 were processed without Principal Business Activity codes.



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**Appendix V**

*Management's Response to the Draft Report*



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

June 15, 2006

RECEIVED  
JUN 16 2006

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard J. Morgante *Richard J. Morgante*  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Although Improvements Have Been Made,  
More Can Be Done to Identify Businesses by Their Principal  
Business Activity (Audit # 200430023)

I reviewed the subject draft report and appreciate your acknowledgement of the steps we have taken to improve the process of identifying Principal Business Activity (PBA) codes. The PBA codes are now known as North American Industry Classification System (NAICS) codes, the acronym used for the remainder of this response. Our improvement initiatives focused on several key areas:

- We improved the Form SS-4, Application for Employer Identification Number (EIN), to allow taxpayers to choose from 12 NAICS business activities and to describe their business activity. Prior versions of Form SS-4 only required the taxpayer to describe their business activity. This improvement enables taxpayers to easily pick the business activity related to their business purpose.
- We now transcribe and electronically transmit the information from Forms SS-4 to the Social Security Administration (SSA). The SSA uses an auto-coding tool developed by the United States Bureau of Census (Census) to assign NAICS codes. Our transcription instructions require that Lines 14 and 15 of Form SS-4 be input. Line 14 is the NAICS category checkboxes, and line 15 is a more detailed description of business activity. We believe this procedural change also significantly improves the percentage of EIN applications that can be assigned NAICS codes by SSA.

A basic premise in your report is that, "Early identification by NAICS codes would allow the IRS to include these new businesses in market segment analyses to identify the need for educational or compliance assistance." While we acknowledge there is the potential to use this information as you describe, we do not currently use the NAICS



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codes for this purpose since we do not communicate directly to the small business taxpayer; instead, we find it more effective for us to provide education through leveraged liaison and outreach activities with practitioner organizations and small business and industry associations.

Below are two significant factors that are also improving the NAICS assignment process:

1. Communication between IRS, SSA, and Census regarding assignment of NAICS codes, including the following two communication streams.
  - Customer Account Services has regular contact with SSA and Census regarding the quality of data IRS provides to SSA. The SSA's ability to use the auto-coding tool developed by Census to assign NAICS codes is dependent upon the quality of IRS data.
  - The IRS, SSA, and Census hold quarterly meetings to share information on the NAICS process, discuss problems or trends, provide news of any systems changes, and brainstorm ways to improve the process. We recently shared with SSA and Census a draft revised Form SS-4, which included adding six new NAICS checkboxes to the form. Both agencies strongly disagreed with this change, because the current checkboxes and written business descriptions provide all the information they require.

We have improved our communication with our partners and believe our current level of interaction with them is highly effective and results in an improved product.

2. Expansion of Internet EIN service. The original Internet Employer Identification Number (I-EIN) program rolled out on April 21, 2003, allowing our customers to input their SS-4 applications through the Internet. This program has automated part of the applications input on the Internet where lines 14 and 15 of the Form SS-4 are mandatory fields. These mandatory fields ensure that the NAICS codes can be assigned. Use of this new service has increased dramatically as illustrated in the table below. We anticipate continued improvement in the entry rate and quality of NAICS codes.

I-EIN Usage Compared to Total EIN Closures*
FY03 6.5%
FY04 34%
FY05 45%
FY06 50% through May 22



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\*The total used to compute the percentage comparison includes all EIN closures (phones, paper and automated).

We agree with your Outcome Measure as shown in Appendix IV. We note, however, that correcting or adding the NAICS codes would have no material impact on tax administration. The described condition does not warrant any actions that would require additional resources to perform validity and/or correction checks.

Our responses to your recommendation are detailed in the attachment. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact David L. Medeck, Director, Customer Account Services, at (404) 338-8910.

Attachment



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Attachment

**RECOMMENDATION 1**

The Director, Customer Account Services, Wage and Investment Division, should coordinate with SSA to determine the causes for missing NAICS codes for Forms SS-4 and consider developing controls and issuing instructions to address the causes identified to ensure that NAICS codes are assigned.

**CORRECTIVE ACTION**

We agree with this recommendation. We have determined that some NAICS codes were not transmitted between agencies. We have identified the cause of the problem and SSA and IRS programmers are working to correct the situation. We will continue to work with SSA to resolve this issue and develop appropriate validation controls.

**IMPLEMENTATION DATE**

October 15, 2006

**RESPONSIBLE OFFICIAL**

Director, W&I CAS, Accounts Management

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 2**

The Director, Customer Account Services, Wage and Investment Division, should develop procedural instructions to identify and correct individual income tax returns reporting business activities that have missing or invalid NAICS codes.

**CORRECTIVE ACTION**

We do not agree with your recommendation to identify and correct individual income tax returns reporting business activities that have missing or invalid NAICS codes. We considered this recommendation, but have decided not to implement it, because it will require additional staff resources to perform validity checks, conduct research, and as necessary, initiate corrective actions. The additional return processing steps required by this recommendation will increase costs and extend the time required to process applicable individual income tax returns reporting business activities. The increased costs and processing time associated with this recommendation, combined with the fact that we do not use the NAICS codes to identify and contact small business taxpayers regarding their possible needs, have led us to the conclusion that it is not in the interest of tax administration to implement this recommendation.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A



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**CORRECTIVE ACTION MONITORING PLAN**  
N/A