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Andrew Holubeck
Attn: CC:PA:01:PR (REG-132805-17)
Room 5203, Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington DC, 20044

Re: Comments on REG-132805-17, Determination of Line of Business for Purposes of
No-Additional-Cost Service and Qualified Employee Discount Fringe Benefits

Dear Mr. Holubeck,

On August 6, 2025, the Treasury Department and the Internal Revenue Service (“IRS”) (collectively, the “Treasury”) issued REG-132805-17 (the “Proposed Regulations”), addressing the determination of an employee’s line of business for purposes of the employee’s eligibility for qualified employee discount fringe benefits under section 132(c) of the Internal Revenue Code and Treas. Reg. § 1.132-4.¹ In general, a non-taxable employee discount is available to an employee only in the employer’s line of business for which the employee provides substantial services. Treasury proposes to determine an employee’s line of business by using the employer’s National American Industry Classification System (“NAICS”) four-digit industry group code instead of the outdated two-digit Enterprise Standard Industrial Classification Manual (“ESIC Manual”). Treasury also proposes updating aspects of the line-of-business aggregation rules to reflect the adoption of NAICS codes. Treasury requested comments on all aspects of the Proposed Regulations, including the use of the NAICS four-digit industry group code.

We thank Treasury for proposing to modernize Treas. Reg. § 1.132-4 by removing outdated ESIC manual references. As part of this update, we respectfully request that Treasury modify its proposal to confirm that an employer’s line of business can be determined at the enterprise level using the employer’s two-digit (or else no more than three-digit) NAICS code. Also, in recognition that the NAICS codes are updated every five years and are created for non-business interests (statisticians and economists), we ask for confirmation

¹ Unless otherwise stated, all section references are to the Internal Revenue Code of 1986 (the “Code” or the “IRC”), as amended, and the regulations promulgated thereunder.



that employers may also aggregate lines of business based on a facts-and-circumstances determination.

I. Ivins, Phillips & Barker, Chtd.

Ivins, Phillips & Barker, Chtd. (“IPB”) is a law firm specializing exclusively in the areas of tax, employee benefits, and trust and estates. As part of this practice, IPB has significant experience advising employers and employees on the tax consequences of fringe benefit programs, including qualified employee discounts. We note that, although a number of IPB clients have an interest in the subject matter of these comments, we are not writing this letter on behalf of a particular client.

II. Background

A. Section 132 and the Qualified Employee Discount

Section 132, which codified the qualified employee discount, was added to the Internal Revenue Code as part of the Deficit Reduction Act of 1984.² The purpose of section 132 was to provide certainty with respect to the tax treatment of fringe benefits.³ Prior to this legislation, employee discounts were subject to uncertain and inconsistent treatment.⁴

To remedy this uncertainty, section 132 provides that “qualified employee discounts” are excluded from an employee’s gross income.⁵ A qualified employee discount is an employee discount for “qualified property or services” that does not exceed the employer’s “gross profit percentage” with respect to that property, or 20% if the discount is with respect to services.⁶ Qualified property or services are property or services that the employer sells to customers in the ordinary course of its line of business in which the employee performs services, excluding real property or property held for investment.⁷ Section 132(c) therefore allows an employee to exclude discounted employer-provided property or services from his or her income if the employee provides substantial services to the line of business in which the property or services are ordinarily sold to customers. This section has remained largely unchanged since its enactment.⁸

B. Treas. Reg. § 1.132-4 and an Employer’s Line of Business

Under existing Treas. Reg. § 1.132-4(a)(2), an employer’s line of business is determined by reference to a two-digit ESIC Manual code.⁹ In general, an employer that sells property

² P.L. 98-369 § 531(a).

³ See H.R. Rep. No. 98-861, at 1166-72 (1984).

⁴ See, e.g., *Beckert v. Comm’r*, T.C. Summ. Op. 1978-211; *Demor, Inc. v. Comm’r*, T.C. Memo 1968-279.

⁵ IRC § 132(a)(2).

⁶ IRC § 132(c)(1).

⁷ IRC § 132(c)(4).

⁸ P.L. 99-514 § 1853(a)(2) and P.L. 115-141 § 401(a)(38) made only cursory changes to section 132(c).

⁹ Treas. Reg. § 1.132-4(a)(2)(i).



or services to customers in more than one two-digit ESIC code is considered to have more than one line of business.¹⁰ However, an employer may aggregate multiple lines of business into a single line of business if (1) it is uncommon in the industry for one line of business to be operated without the other(s), (2) it is common for a substantial number of employees other than headquarter employees to perform substantial services for more than one line of business such that it is difficult to determine which employees perform substantial services for which line of business, or (3) retail operations on the same premises would be considered one line of business if the products sold were offered for sale at a department store.¹¹

It is worth noting that the ESIC Manual was developed to classify “enterprises,” rather than “establishments.”¹² An “enterprise” is all entities which have more than 50% common ownership.¹³ The ESIC Manual uses a four-digit classification, with the first two digits representing the “Major Group.”¹⁴ The IRS previously stated that it prefers to use the two-digit code for the following reason:

The four-digit SIC structure is not practical for enterprise statistics since many enterprises encompass establishments in several industries. For instance, the Motor Vehicles and Equipment industry is made up of the establishment industries for Motor Vehicles, Motor Vehicle Parts, Truck and Bus Bodies, and Truck Trailers, since they are frequently owned by the same company.

The ESIC Manual has not been updated since 1974.

III. Proposed Changes and Comments

The Proposed Regulations would amend Treas. Reg. § 1.132-4 to use a four-digit NAICS code rather than the two-digit ESIC Manual code. The Proposed Regulations also change the aggregation rules. While we generally support the goal of these proposals, a few changes would improve the clarity and administrability of these rules for employers, consistent with the statutory intent of providing certainty to employers and employee recipients of discounted property or services.

¹⁰ *Id.*

¹¹ Treas. Reg. § 1.132-4(a)(3).

¹² Announcement 86-6, 1986-4 I.R.B. 52.

¹³ *Id.*

¹⁴ *Id.*



A. Treasury Proposed Replacement ESIC with NAICS

1. Treasury Proposed Change

The Proposed Regulations would classify lines of business by four-digit NAICS codes, rather than two-digit ESIC Manual codes. While the NAICS and ESIC Manual codes have similar purposes, they are different in important ways. The NAICS codes classify establishments (a single physical business location) rather than enterprises (one or more entities).¹⁵ The first two digits of an NAICS code represent a sector, the third digit represents the subsector, and the fourth digit represents the industry group. Treasury states that the three-digit “subsector” level roughly corresponds to the ESIC Manual “Major Group.”¹⁶ Treasury notes that NAICS codes are updated more frequently than ESIC Manual codes and are generally more granular.

2. Comments

We agree that the NAICS codes offer a more accurate and up-to-date classification of the current U.S. economy than the ESIC codes, which are no longer being updated. The following, however, may cause confusion or instability in the discounts employers may offer their employees:

- Use of NAICS codes at an establishment, rather than enterprise level;
- Use of four-digit, rather than two- or three-digit, NAICS codes;
- Design of NAICS codes for non-business interests.

We request that Treasury incorporate certain changes, outlined below, to improve clarity and certainty in providing discounts to employees.

a. NAICS Codes Should Be Applied at the Enterprise Level

Treasury should clarify that an employer’s line of business can be determined using NAICS codes identified at the enterprise level and not the establishment level, given that NAICS codes typically are used at an establishment level. The Proposed Regulations suggest an establishment-level determination should apply by noting that an employee generally performs services at an establishment and, therefore, an establishment-level determination is the most accurate determination of the employer’s line of business to which an employee renders services.

¹⁵ 90 Fed. Reg. 37284, 37826 (Aug. 6, 2025).

¹⁶ *Id.* at 37826.



An establishment-level determination does not account for integrated business operations that have long been common in modern business enterprises. Businesses may have multiple establishments performing discrete tasks as part of an integrated enterprise. For example:

- A technology company may have three establishments, one designing software (NAICS: 5132), another designing hardware (NAICS: 5415), and a third designing a streaming service (NAICS: 5162), to be sold separately or as part of an integrated product, while other companies only design software or hardware.
- Car manufacturers (NAICS: 3361) were commonly prohibited from owning car dealerships (NAICS: 4411) but, due to legal changes, manufacturer-owned dealerships are becoming more common.
- Electric vehicle companies are increasingly bundling software design (NAICS: 5132) and motor vehicle manufacturing (NAICS: 3361) within the same enterprise, though not necessarily the same establishment.

As a matter of tax policy—particularly when Congress has not stated otherwise—an employee designing EV software should not be denied a discount because they work in San Francisco, not Dearborn.

An enterprise determination should provide sufficient flexibility for modern businesses to determine the main product or service rendered to customers is. That way, employees of a subsidiary that contracts to provide intergroup research and development (NAICS: 5417) need not be denied tax-free treatment on employee discounts.

This determination also would be more administratively feasible given that consolidated groups typically report a single NAICS code on a corporate income tax return. Not only can it be cost-prohibitive for advisors to evaluate every establishment of a large business operation, but it also raises questions with respect to employees who may not be tied to a particular physical establishment (e.g., remote workers or territory-based sales employees).

**b. Line of Business Should Be Determined by the
Establishment's Two-Digit (or at Most Three-Digit)
NAICS Code**

We also recommend that Treasury use the two-digit (or at most three-digit) NAICS code rather than the four-digit code. As Treasury has noted in this proposal, the three-digit NAICS code is arguably equivalent to the existing two-digit ESIC Manual code. The two-digit ESIC Manual code was relatively straightforward and is familiar to tax practitioners; there is no reason not to maintain the same broad categorization through the three-digit NAICS code. Using a two- or three-digit code also would simplify the line-of-business analysis by avoiding the need to rely on the aggregation rules, which may be uncertain in their application.



As an example, some restaurant companies provide off-site catering services (NAICS: 7223) that operate out of separate facilities than company restaurants (NAICS: 7225), though such a feature may not be “common” enough across the industry to treat as aggregated. Some establishments of the same employer may not provide catering, while others do. Using the two- or three-digit code (72 or 722) would simplify the analysis while arriving at what is a reasonable policy result: catering employees should be entitled to discounts at employer restaurants and restaurant employees should be entitled to catering discounts.

Using a four-digit, establishment-level code is unnecessarily punitive to employees who are working to create a single product in an integrated company but who happen to work on separate parts of that product. For example, an integrated car company may have separate factories (and separate entities) that produce car parts (NAICS: 3363) and car bodies (NAICS: 3362) that are assembled into functional cars at a third plant (NAICS: 3361). Use of a two- or three-digit code (33 or 336) would clarify the applicability of a discount for vehicles without the added uncertainty of applying aggregation rules.

B. Aggregation Rules

1. Proposed Change

The Proposed Regulations amend the aggregation rules of Treas. Reg. § 1.132-4(a)(3) to make modifications that incorporate the proposed change to NAICS codes. The Proposed Regulations also update a reference to “department store[s]” with “general merchandise store[s], including warehouse clubs and super centers” to reflect the pervasiveness of such establishments in the modern retail economy and to provide “equal treatment for employees working for other types of employers that similarly sell a variety of kinds of merchandise on their business premises, but the variety is more narrowly tailored to cater to a specific segment of the retail market.”¹⁷

2. Comment

We generally agree with the changes made in the Proposed Regulations to reflect the adoption of NAICS codes and the ubiquity of warehouse clubs and supercenters in the modern retail economy. We request that Treasury consider adding an additional aggregation rule that permits aggregating lines of business under a facts and circumstances test.

a. Treasury Should Add a Facts and Circumstances Test for Determining Line of Business

We believe that Treasury should permit the determination of a line of business under a facts and circumstances test. A facts and circumstances analysis would ease administrability in

¹⁷ 90 Fed. Reg. at 37827.



the face of evolving business structures and the relatively more-frequent NAICS code updates.

The NAICS, which is updated every five years, may not always accurately reflect current business practices. Single lines of business could become divided into two or more NAICS codes if statisticians and researchers become more interested in a particular aspect of that business. In quickly expanding industries, this could require employers to reconsider and redesign employee discounts every few years to align with tax rules. Furthermore, NAICS codes may not reflect actual business practices as businesses expand or become integrated in innovative ways. For example, a single enterprise may operate supercenters (NAICS: 4552) and supermarkets (NAICS: 4451) as it seeks to provide goods and services to consumers in different residential districts. The current rules would effectively prohibit employees from supercenters to receive discounts at supermarkets, and vice versa, despite operating in substantially similar industries and providing substantially similar products.

To ameliorate these issues, in which companies are caught unaware by NAICS updates or are arbitrarily split between NAICS codes that represent substantially similar industries, we suggest a facts and circumstances aggregation test as Treas. Reg. § 1.132-4(a)(3)(iv):

(iv) If under the facts and circumstances the employer's separate lines of business are reasonably characterized as a single line of business. The factors to be considered include whether the lines of business are operated as an integrated economic unit, whether the lines of business provide similar products or services in related industries, whether the lines of business share branding and marketing such that the operation of one is associated with the operation of the other, whether the lines of business compete for the same kinds of employees in the labor market, whether products or services from one line of business may be integrated or bundled with those from the other, and whether the lines of business were historically treated as the same line of business by the employer or the NAICS.

This rule could provide aggregation for employers that become two or more lines of business because of a change in NAICS codes or who have substantially similar operations but who would be deemed to have two or more lines of business because of the NAICS numbering systems. In addition, if the final regulations maintain the use of the four-digit NAICS code, we suggest that Treasury add a presumption that lines of business sharing a three-digit NAICS code can be aggregated unless doing so would be unreasonable under the facts and circumstances.



IV. Conclusion

We support Treasury's efforts to modernize the line of business rules for purposes of employee discounts, and we appreciate the opportunity to provide suggestions that may improve the Proposed Regulations. We believe that the modifications identified above would minimize disruption to current employer programs and ease administrability by allowing discounts enterprise wide, rather than requiring a costly and burdensome establishment-by-establishment determination that has no specific basis in the language of the Code. It would also be beneficial to employers and employees alike that NAICS determinations not be the only avenue for identifying a single "line of business"; employers should be permitted to establish reasonable tax-favorable employee discount programs based on the relevant facts and circumstances applicable to their own workforce.

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Thank you for the opportunity to share our comments. We welcome an opportunity to discuss these issues further if you have any questions.

Respectfully submitted,

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Harrison B. Richards

Ivins, Phillips & Barker, Chtd.