

Washington's Underground Economy Task force



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Employee misclassification

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- Most commonly, employee misclassification occurs in the construction industry when an employer deliberately misclassifies its workers as “independent contractors,” to avoid paying workers’ compensation insurance, unemployment insurance and other state and federal taxes.
- Wage and benefit theft also occur when an employer deliberately understates the scope of work, resulting in a lower prevailed wage classification.



Employee Misclassification in Washington: Workers' Compensation

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- In the last three state fiscal years (July 2007 to May 2010) Washington State Department of Labor and Industries workers' compensation premium audits had the following results:

	Number of Audits	Dollars Identified	Workers Identified (Approx)
Unregistered Employers	1,802	\$17,578,432	22,885
Underreporting Employers	2,706	\$29,203,898	80,467
Total	4,508	\$46,782,330	103,352

Employee Misclassification in Washington: Unemployment Insurance

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- In the last 5 complete quarters (Jan 1, 2009 – March 31, 2010), Washington State Employment Security Department audits for unemployment insurance tax purposes had the following results:

Audits with New Employees Found	1,622
Total Change Audits	2,974
New Employees Identified	10,081
Taxes Found	\$2,484,096

Magnitude of the Problem

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- In 2007, an estimated \$274 million in taxes was unreported in a single year by businesses that were registered with the IRS but unregistered with Employment Security, Labor and Industries or the Washington State Department of Revenue.
- Of that amount, \$34.5 million is attributable to worker misclassification for workers' comp, and an additional \$14.8 million for unemployment insurance, or \$49.3 million in total



Magnitude of the Problem (cntd.)

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- An additional \$183 million is estimated in unreported taxes to those three agencies by firms that are also not reporting to the IRS.
- The estimate of registered but underreporting firms totaled an additional \$251 million per year, Workers' compensation underreporting represented \$84 million of this total estimate, and unemployment insurance an additional \$11 million, or \$95 million in total.

Senate Bill 5926 (2007)



- Sponsored by Sen. Kohl-Welles at the request of the Building & Construction Trades Council.
- Created Washington's Joint Legislative Task Force on the Underground Economy.
- Passed by the House and Senate unanimously.

Washington's Joint Legislative Task Force on the Underground Economy

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- Began its work in 2007
- Tasked with formulating state policy that would establish cohesion and transparency among the state agencies primarily responsible for overseeing and regulating the construction industry
- Members included:
 - Four legislative members, one from each of the Senate and House Democratic and Republican caucuses
 - Representatives from the Employment Security Department, Department of Labor & Industries, Department of Revenue
 - 4 members from both Labor and Business
 - Washington State Institute for Public Policy
- Chairs of the House and Senate Labor Committees served as co-chairs with an executive committee determining agendas.

The cost of the underground economy

- Prepared by Washington State Institute of Public Policy
- Based on the estimated size of the underground construction economy and a cumulative tax rate provided by Washington's revenue-collecting agencies, the Institute found that unpaid sales and Business & Occupation taxes and premiums associated with the underground economy were valued at \$109 million 2006, conservatively.
- This figure does not include the revenue loss to state and local governments.
- \$109 million is a large figure but does not incorporate the social cost of the underground economy.

In 2008, the Legislature provided funding for the Department of Labor and Industries to increase enforcement and educate consumers. This was a recommendation from the task force.

Suspect Fraud?

Check with the state before it's too late.

Most businesses are honest and trustworthy, but some cut corners by not registering or dodging taxes that law-abiding businesses pay. The departments of Labor and Industries, Employment Security and Revenue have teamed up to provide resources to help you determine if a business is registered and in good standing with the state.



Washington State Department of
Labor & Industries

Fraud Prevention and Compliance

- Search for Licensed Contractors, Electricians or Plumbers
- Report employer premium fraud
- Report Injured worker fraud
- Report Medical provider fraud or abuse



**Employment Security
Department**
WASHINGTON STATE

Employer unemployment tax

Report businesses that you suspect have not registered with the state.

Employment benefits

Report unemployment benefits fraud.



Department of Revenue
Washington State

Lookup a business

Search for registered businesses.

Tax and license fraud

Report business tax and license fraud.

www.suspectfraud.com

Findings and Recommendations

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The Task force submitted findings and recommendations to the Legislature in Feb. 2008

http://www.leg.wa.gov/JointCommittees/UECI/Documents/UE_FINAL_FINDINGS_RECOMMENDATIONS_021508.pdf

House Bill 3122 (2008)

Clearly defined “independent contractors” by implementing a 7-part test.

This was a recommendation of the task force.

- The individual has been and will continue to be free from control or direction over the performance of the service, both under contract and in fact.
- The service is either outside the usual course of business for which the service is performed, or outside of all the places of the enterprise for which the service is performed, or the individual is responsible, both under the contract and in fact, for the costs of the place of business.
- The individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature, or the individual has a principal place of business that is eligible for a business deduction for federal income tax purposes, other than that furnished by the employer.
- On the effective date of contract, the individual is responsible for filing, under the contract and in fact, a schedule of expenses with the IRS.
- On the effective date of the contract or within a reasonable period after the effective date, the individual has an active and valid certificate of registration and an active account with the Dept. of Revenue and valid account with any other state agencies, and has a UBI.
- On the effective date of the contract, the individual is maintaining a separate set of books or records.
- On the effective date of the contract, the individual has a valid contractor registration or electrical contractor license if the work requires the registration or license.

Senate Bill 6732 (2008)

The 2008 Legislature also adopted legislation that instituted real accountability and repercussions into the system

- Required an individual registering as a contractor to submit a unified business identifier number
- Required L&I to deny a contractor's registration and suspend active registration if the applicant lied or wasn't properly registered
- Instituted a penalty of up to \$10,000 against applicants who submit false information
- Prohibited a contractor from bidding on public works projects for one year under specific circumstances
- Extended the task force to December 31, 2008

The 2008 Task Force Report

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- Was presented to the Legislature in January of 2009.

http://www.leg.wa.gov/JointCommittees/UECI/documents/FinalReport_1-20-2009.pdf

Employee Misclassification in Non-Construction Industries

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- Construction was the original emphasis of the Task Force, but the practice of employee misclassification takes place in other industries as well, such as food services, trucking, and custodial services.



House Bill 1555 (2009)

The bill also extended the task force and expanded the scope to include non-construction activities.

- Increased regulation and education of contractors
- Improved consumer education
- Established benchmarks for monitoring the effectiveness of the task force's work
- Added members representing cities and counties to the task force

The benchmark subcommittee

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- House Bill 1555 required the Department of Labor & Industries, the Department of Revenue and the Employment Security Department to coordinate and report on the effectiveness of efforts to address the underground economy.
- Particular emphasis was placed on data sharing among these state agencies.

Implementation of HB 1555 (2009)

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- L&I changed its master business application (required of all new businesses in the state) so that employers must now specifically indicate if they have hired an independent contractor.
- In two months over 2,400 businesses have indicated they are using independent contractors across many industries, including 12 restaurants.

2009 Legislation

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Senate Bill 5613

- Authorized the Department of Labor and Industries to issue stop work orders for violations of certain workers' compensation provisions

Senate Bill 5904

- Applied definition of “independent contractor” used for unemployment insurance and workers compensation to the prevailing wage statutes

Senate Bill 6173

- Made changes to the requirements for making purchases for re-sale exempt from the sales tax

The task force prepared its final report and made several recommendations

http://www.leg.wa.gov/JointCommittees/UECI/documents/FinalReport_1-13-2010.pdf

2010 Legislation

- **Senate Bill 6575** would have allowed L&I to conduct contractor registration classes that unregistered contractors could have taken to reduce the cost of their penalties. The bill was vetoed by the Governor due to fiscal concerns.
- **House Bill 2789** authorized the issuance of subpoenas for the purposes of agency investigations of underground economic activity. The law went into effect on June 10, 2010.

Underground Economy Benchmark Report 2010 Report to the Legislature

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Highlights for Fiscal Year 2010 (July, 2009 – June, 2010)

- DOR, ESD and L&I uncovered a combined 1,677 unregistered businesses that were assessed nearly \$39 million in unpaid taxes, premiums, penalties and interest.
- DOR, ESD and L&I exchanged over 100,000 tips and leads through electronic data matches, up from about 25,000 in FY2009.
- L&I collected \$126.6 million from delinquent employer premiums.
- DOR issued over 220,000 reseller permits.
- ESD found 11,613 unreported or misclassified workers as a result of their audit efforts.
- L&I suspended 750 contractor registrations for failure to pay workers' compensation premiums.
- DOR, ESD, and L&I collaborated to create a marketing campaign to discourage consumers from using non-compliant businesses. Radio ads began running in October, 2010.
- L&I provided education and training to over 1,100 construction contractors and provided information on independent contractor reporting requirements to over 17,000 new businesses.

Unresolved Issues

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- Education and outreach
- Contractor registration & identification requirements
- Disclosure requirements of prior business names and/or bankruptcy



Summary of Legislation Associated with Underground Economy & Worker Misclassification

2007: **SB 5926** - Creating a joint legislative task force to review the underground economy in the construction industry.

2008: **2SSB 6732** - Implementing the recommendations of the joint legislative task force on the underground economy in the construction industry and extending the task force to December 31, 2008.

2008: **ESHB 3122** - Consolidating, aligning, and clarifying exception tests for determination of independent contractor status under unemployment compensation and workers' compensation laws.

2009: **SHB 1555** - Addressing the recommendations of the joint legislative task force on the underground economy in the construction industry.

2009: **SSB 5904** - Defining independent contractor for purposes of prevailing wage.

2009: **SSB 5613** - Authorizing the department of labor and industries to issue stop work orders for violations of certain workers' compensation provisions.

2010: **SB 6575** (Vetoed) - Concerning the recommendations of the joint legislative task force on the underground economy.

2010: **SHB 2789** - Authorizing issuance of subpoenas for purposes of agency investigations of underground economic activity.