

**Size and Cost of Construction Industry Tax Fraud:
Survey of National and State Studies**

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Corrupt construction firms, even on large commercial projects, steal work away from law-abiding employers. That is done through a practice commonly called misclassification. It can also be called “construction industry tax fraud” due to the intentional nature of the practice.

Employers commit tax fraud to avoid withholding income taxes, paying employment taxes, overtime and workers compensation premiums. Fraud comes in two forms. First is the intentional reporting of employees as independent contractors to state and federal authorities or workers’ compensation carriers and issuing an IRS 1099 Misc. form at the close of the tax year. Second, and more common, are the construction employers who operate in the underground economy - they don’t bother to report all or a sizable portion of their workers. As will be seen, many studies of the problem do not quantify the degree or cost of the underground economy, which results in underestimating the true scope of the problem.

In the construction industry, tax fraud gives irresponsible employers a 30 percent or more advantage in labor costs. And, in a competitive industry like construction, that means responsible employers who play by the rules (and their employees) lose work. Fraud in construction is more common than in other industries, because of competitiveness, mobility of employers and the workforce, the temporary nature of the work and the multiple layers of contractors and subcontractors.

Below are brief descriptions of numerous national and state studies and other research of the size and cost of tax fraud. Many are available at: StopTaxFraud.net.

National Studies

*A 1984 study by the Internal Revenue Service found that 19.8 percent of construction employers misclassified their employees.¹ The rate for all industries was 15%.² The total income, unemployment and Social Security tax loss was \$1.6 billion.³ Moreover, the IRS estimated that the loss of Social Security and unemployment taxes alone would be \$2.3 billion in 1987 and \$3.3 billion in 1992.⁴ A different estimate by the Government Accountability Office put the IRS' 1984 number in 2006 dollars for a tax loss of \$2.72 billion.⁵

*In 1994 Coopers & Lybrand estimated that the federal government would lose \$3.3 billion in revenues in 1996 due to misclassification, and from 1996 to 2004 misclassification would cost the government \$34.7 billion.⁶

*A study released in 2000 for the US Department of Labor Employment and Training Administration by Planmantics, Inc. found an unemployment tax loss of \$198 million annually due to misclassification of employees as independent contractors.⁷ Again, the construction industry was cited by sources as the most likely to offend.⁸

Unemployment tax audits in the following states found these percentages of employers with misclassified workers:⁹

California 29%, Connecticut 42%, Maryland 19.9%, Minnesota 13.4%, Nebraska 10%, New Jersey 9.15 %, Wisconsin 23% and Washington 10.3%.

*Many studies do not include the extent of unreported pay in the underground economy.¹⁰ A Bear Stearns 2005 report estimated that the United States is losing \$35 billion a year due to the number of jobs that are now "off the books."¹¹

¹Described in *Tax Administration: Issues in Classifying Workers as Employees or Independent Contractors*, Statement of Natwar Gandhi, GAO/T-GGD-196-130, p. 13 (June 20, 1996).

² *Ibid.*, p 1.

³ *Ibid.* pp. 4-5.

⁴ *Ibid.*

⁵ *Employment Arrangements: Improved Outreach could Help Ensure Proper Worker Classification*, GAO-06-565, p. 2 (July 2006).

⁶ *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers*, by Coopers & Lybrand, p. 3 (June 1994).

⁷ *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, by Planmantics, Inc., pp. iv, 69 and 93 (2000).

⁸ *Ibid.*, pp. 41-44.

⁹ *Ibid.*, pp. 57.

¹⁰ *The Social & Economic Cost of Employee Misclassification in Construction*, Construction Policy Research Center, Labor & Worklife Program, Harvard Law School & Harvard School of Public Health, by Bernhard and Herrick, p. 1 (December 2004) (Massachusetts Study), *The Social & Economic Cost of Employee Misclassification in the Maine Construction Industry*, Construction Policy Research Center, Labor & Worklife Program, Harvard Law School & Harvard School of Public Health, by Bernhard and Herrick, p. 1 (April 2005) (Maine Study), *Economic Costs of Employee Misclassification in the State of Illinois*, Dep. Of Economics, Univ. Missouri-Kansas City, by Kelsay, Sturgeon and Pinkham, p. 2 (December 2006) (Illinois Study) and *Misclassification of Employees as Independent Contractors*, Office of the Legislative Auditor, State of Minnesota, p. 15 (November 2007).

***The Government Accountability Office (GAO) issued a 2009 report on misclassification.**¹² The report begins with: “The national extent of employee misclassification is unknown; however, earlier and more recent, though not as comprehensive, studies suggest that it could be a significant problem with adverse consequences.”¹³ The GAO had several recommendations to the executive branch to improve law enforcement including increasing referrals to other state and federal agencies and the formation of an interagency group including the IRS, DOL and other state and federal agencies to identify best practices and to improve efficiency of enforcement.¹⁴ The IRS and DOL agreed with the recommendations.¹⁵

A report on the unemployment tax and workers’ compensation premium losses shifted to law-abiding employers was done by Dr. Michael P. Kelsay of the Department of Economics at the University of Missouri-Kansas City. Using conservative estimates of misclassification, Dr. Kelsay found that \$831.4 million in unemployment taxes and \$2.54 billion in workers’ compensation premium losses are shifted annually to law-abiding employers.¹⁶

Voters were surveyed in 2016 by Hart Research Associates **on contracting out of work.**¹⁷ The survey of registered voters focused on alternative work arrangement, such as temporary work, on-call work, contract workers, independent contractors and freelancers.¹⁸ Here are the key findings:

- 59% of voters (59% Democrat, 58% Republican, 61% independents) think that the increase in the number of companies that hire firms to supply them with labor is a negative trend.¹⁹
- 73% do not think saving money by not providing employee benefits is a legitimate reason to use subcontract workers instead of employees. 72% think the same if the motivation is saving money on wages or to make it easier to terminate workers.²⁰
- 70% said that the increase in use of subcontract labor is bad for workers.²¹
- 58% thought the shift toward subcontract labor was bad for the economy.²²

¹¹ *The Underground Labor Force is Rising to the Surface*, Bear Stearns Asset Management, by Justich and Ng, p. 3 (January 3, 2005).

¹² *Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention* GAO-09-717 (August 2009).

¹³ *Ibid.*

¹⁴ *Ibid.*, pp. 41-42.

¹⁵ *Ibid.*, pp. 42-43.

¹⁶ *Cost Shifting of Unemployment Insurance Premiums and Workers’ Compensation Premiums*, by Michael P. Kelsay, pp. 5-6 (September 12, 2010).

¹⁷ *Contracted Out: Findings from a National Voter Survey*, by Hart Research Associates (October 19, 2016) available at <http://www.nelp.org/content/uploads/Contracted-Out-NELP-National-Voter-Survey-Findings.pdf>.

¹⁸ *Ibid.* p. 2.

¹⁹ *Ibid.*

²⁰ *Ibid.* p. 3.

²¹ *Ibid.* p. 4.

²² *Ibid.*

- 62% of voters said that the increase in use of independent contractors is a bad change.²³
- 78% of voters believe that being an employee is better than being an independent contractor.²⁴
- 67% of voters have heard about misclassification of workers as independent contractors, allowing companies “to avoid certain costs, such as paying the minimum wage, providing benefits and making Social Security or Medicare contributions.”²⁵
- 84% of voters believe that misclassifying employees as independent contractors is a serious problem.²⁶
- 78% of voters (73% Republican) would “favor a proposal that would make it harder for companies to classify workers as independent contractors and increase fines and penalties for misclassification.”²⁷
- 71% of voters (67% Republican) would support holding the client, or upper-tier, company liable for its subcontractor’s unpaid wages, unemployment insurance contributions, workers’ compensation and Social Security taxes.²⁸

Smart Cities Prevail²⁹ in 2019 estimated that in 2017 a conservative **\$2.6 billion** in state income taxes and federal income, Social Security, Medicare taxes went unpaid in the U.S. construction industry. Those unpaid taxes were caused by construction employers paying **1.2 million construction workers off the books and misclassifying another 300,000 as independent contractors**. The study did not include unpaid federal and state unemployment contributions, city income or business taxes or losses due to contractors reporting a portion of their workers’ income.

Regional

Southern States

Researchers for the study *Build a Better South* interviewed 1,435 construction workers in Atlanta, Georgia, Charlotte, North Carolina, Dallas, Texas, Houston, Texas, Miami, Florida and Nashville, Tennessee.³⁰ They found that 32 percent of the workers were misclassified as independent subcontractors or failed to receive a 1099 tax form.³¹ The rate of misclassification in Charlotte was 17 percent,³² Houston 38 percent³³ and Miami 26 percent.³⁴ Injury rates in all six cities were “significantly higher” than the construction

²³ *Ibid.* p. 5.

²⁴ *Ibid.*

²⁵²⁵ *Ibid.* p. 6.

²⁶ *Ibid.*

²⁷*Ibid.* p. 7.

²⁸ *Ibid.*

²⁹ SmartCitiesPrevail.com, available at, StandingUpToTaxFraud.com.

³⁰ *Build a Better South*, by Dr. Nik Theodore, Bethany Boggess, Jack Cornejo and Emily Timm, p. ix (2017).

³¹ *Ibid.*, pp. x, 14 and 14 fn c.

³² *Ibid.* p. 28.

³³ *Ibid.*, p. 33.

³⁴ *Ibid.*, p. 37.

industry as a whole with the Nashville injury rate of 24 percent being the worst.³⁵ One in three construction workers who die on the job were killed in the five states in the study.³⁶ The amount of money workers lost in the six cities due to wage theft was \$29.8 million.³⁷

State Studies and Reports

***McClatchy news in 2014** ran a series called *Contract to Cheat*.³⁸ The series detailed fraud in a number of states. In three of those states, Florida, North Carolina and Texas, McClatchy calculated the degree of fraud in the construction industry. They reviewed certified payrolls from federal construction projects, interviewed workers, determined a misclassification rate and applied it statewide using US Census data.³⁹

| <u>State</u> | <u>Rate of Misclassification</u> | <u>Lost State & Federal Revenue (millions)</u> |
|----------------|----------------------------------|--|
| Florida | 15.5 % | \$400 ⁴⁰ |
| North Carolina | 35.2% | \$134 state, \$333 federal ⁴¹ |
| Texas | 37.7% | \$1,200 ⁴² |

*Interviews of over 300 construction workers in **Austin, TX in 2008 to 2009** found that 38 percent of them working on vertical construction projects were misclassified as independent contractors or paid unreported compensation, costing \$8.6 million in lost federal and unemployment taxes.⁴³

*A **2007 study done for the California Commission on Health and Safety and Workers' Compensation** disclosed that employers in all industries failed to report up to 23 percent of their payroll to workers' compensation carriers, resulting in \$100 billion in

³⁵ *Ibid.*, p. 39.

³⁶ *Ibid.*, p. 4.

³⁷ *Ibid.*, p. x.

³⁸ *Contract to Cheat*, McClatchy (September 4, 2014), available at:

<http://media.mcclatchydc.com/static/features/Contract-to-cheat/?brand=nao>

³⁹ *Contract to Cheat: How the Reporting was Done*, by Mandy Locke, News & Observer, McClatchy (September 4, 2014), available at: <http://media.mcclatchydc.com/static/features/Contract-to-cheat/Investigation-built-on-payroll-records.html?brand=nao>

⁴⁰ *Taxpayers and Workers Gouged by Labor-Law Dodge*, by Mandy Locke and Franco Ordonez (September 4, 2014) available at: <http://media.mcclatchydc.com/static/features/Contract-to-cheat/Labor-law-dodge-hurts-taxpayers-and-workers.html?brand=nao>

⁴¹ *NC's \$467 million problem: Abuse of Workers, Failure to Collect Taxes*, by Many Locke, David Raynor, Rich Rothacker and Franco Ordonez, McClatchy (September 4, 2014) available at: <http://media.mcclatchydc.com/static/features/Contract-to-cheat/467-million-dollar-problem.html?brand=nao>

⁴² *Tax Cheats are Widespread in Texas Construction Industry*, by Yamil Berard, , Star-Telegram, McClatchy (September 4, 2014) available at: <http://media.mcclatchydc.com/static/features/Contract-to-cheat/Tax-cheats-hit-hard-in-Texas-construction.html?brand=nao>

⁴³ *Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry*, by the Workers Defense Project, pp. 49-50 (2009).

underreporting.⁴⁴ Because carriers shift costs to customers that do pay what they should, responsible employers who have workers in dangerous occupations are paying eight times more than they should be paying.⁴⁵

***Wrongful classification of employees as an independent contractors and unreported compensation in the California construction industry grew 400 percent from 1972 to 2012.**⁴⁶ The total number of construction workers in 2011 that were wrongly classified or who received unreported compensation was 143, 900 or 17 percent of the state’s construction workforce.⁴⁷ Of that number, 104,100 received unreported compensation and 39,800 were wrongly classified.⁴⁸ The construction industry is divided into three sectors; construction of buildings, heavy and civil engineering and specialty trades, like drywall installers.⁴⁹ The sector with the most workers is specialty trades, and the degree of wrongful classification and non-reporting was 25 percent of that workforce.⁵⁰ Unreported-construction employees earn 52 cents for every dollar that a payroll employee is paid, and a wrongly classified 64 cents.⁵¹ If they were paid at the same rate as payroll employees, they would have earned an additional \$1.2 billion.⁵² The low wages of those workers leaves less of them in the middle class and harms the ability of the construction industry to recruit and retain skilled labor.⁵³ Losses in federal and state revenues and workers’ compensation premiums totaled over \$774 million in 2011.⁵⁴

| Program | Losses ⁵⁵ |
|--------------------------------|----------------------|
| Social Security | \$234,906,767 |
| Medicare | 54,937,873 |
| Federal Unemployment | 12,042,574 |
| State Unemployment | 62,219,966 |
| State Employment Training | 1,003,548 |
| State Disability Insurance | 145,709,411 |
| Workers’ Compensation Premiums | 264,080,672 |
| Total | \$774,900,810 |

⁴⁴ *Up to One Fifth of California Payroll Not Reported*, WorkCompCentral, by Jim Sams (April 30, 2007). This study was of all employers, and not just construction. *Fraud in Workers’ Compensation Payroll Reporting: How Much Employer Fraud Exists and How are Honest Employers Impacted: Report for the Commission on Health and Safety and Workers’ Compensation*, by Frank Neuhauser and Colleen Donovan, University of California, Berkeley (August 2007).

⁴⁵ *How Much Employer Fraud Exists*, pp. 1-3.

⁴⁶ *Sinking Underground; The Growing Informal Economy in California Construction*, by Yvonne Yen Liu, Daniel Flaming and Patrick Burns, Economic Roundtable, pp. 2, 7. (2014).

⁴⁷ *Ibid.*, pp1, 7

⁴⁸ *Ibid.*, pp1, 2.

⁴⁹ *Ibid.*, p. 12.

⁵⁰ *Ibid.*, pp 2, 12, 13.

⁵¹ *Ibid.* pp. 2, 11, 12.

⁵² *Ibid.*, p. 2.

⁵³ *Ibid.*, p. 2, 17, 18.

⁵⁴ *Ibid.*, p. 2.

⁵⁵ *Ibid.*, p. 31.

The **Colorado** Department of Labor And Employment’s annual report to the legislature in 2011 detailed its survey of misclassification in the state.⁵⁶ Audits done from June 2009 through December 2010 found 14.2 percent of the Colorado workforce was misclassified as independent contractors.⁵⁷ As a result, state losses were \$167 million in income tax revenues and \$744,359 in unemployment contributions.⁵⁸ When performing targeted audits, the Colorado Department of Labor found that 63.5 percent of the employers had misclassified workers resulting in \$13,382,671 in underreported unemployment premiums.⁵⁹ Construction was in the top five of the least compliant industries with 53.3 percent of employers misclassifying 20.1 percent of the total construction workforce.⁶⁰

*A **2001 Florida study** reported that in 1997 \$912 million in workers compensation premiums were paid by construction industry employers, and that an additional \$1.3 billion was lost due to employer premium fraud and the state’s exemption policies.⁶¹ Reforms were enacted in 2003 to reduce costs and toughen enforcement.

*A **2008 Florida Grand Jury report on fraud and check cashing businesses** cited a fraud scheme by ten contractors that resulted in **\$1 billion of unreported cash** being paid to construction workers over three years.⁶² The report concluded its discussion on money laundering by check cashing businesses engaged in workers compensation premium fraud by writing:

In the short term, it may be prudent for the legislature to inquire of the [construction] industry, when considering this Grand Jury’s recommendations, why they have apparently decided over the last few years to move increasingly to an all cash payroll.⁶³

⁵⁶ *House Bill 09-1310 Misclassification of Employees as Independent Contractors Annual Compliance Report, Colorado Revised Statutes Title 8, Article 72*, by Staff of the Colorado Department of Labor and Employment (June 2, 2011).

⁵⁷ *Ibid.* pp 3 and 9.

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*, p. 7.

⁶⁰ *Ibid.*, Exhibit A.

⁶¹ *A Study on the Magnitude of Loss of Workers’ Compensation Premiums in 1997 due to Employer Fraud and Exemptions in the Florida Construction Industry*, by Construction Concepts, Coble Ph.D, Hinze Ph.D. P.E., pp. 27-28 (March 2001).

⁶² *Eighteenth Statewide Grand Jury Case No. SC 07-1128, Second Interim Report of the Statewide Grand Jury: Check Cashers: A Call for Enforcement*, p. 13. (West Palm Beach, Florida, March 2008).

⁶³ *Ibid.* p. 14

***Illinois 2006:**⁶⁴

| | All Industries | Construction |
|----------------------------------|------------------------|------------------------|
| Degree employers who misclassify | 17.8% | 17.8% est |
| Unemployment taxes lost | \$ 53.7 million | \$ 2.5 million |
| State income taxes | \$ 248.4 million | \$ 17.3 million |
| Workers comp prem. | \$ <u>97.9 million</u> | \$ <u>34.8 million</u> |
| Total | \$400 million | \$54.6 million |

This study does not include the degree of unreported pay in the underground economy.⁶⁵

The report further states that the **nationwide rate of misclassification** in all industries has not been static; it grew by 42 percent from 2001 to 2002.⁶⁶

***Indiana 2010:**⁶⁷

From 2007-2008 the annual numbers are:⁶⁸

| | All Industries | Construction |
|-------------------------------------|------------------------|-----------------------|
| Degree employers who misclassify | 47.5% | not quantified |
| Number of employers who misclassify | 72,999 | 8,200 |
| Number of employees misclassified | 418,086 | 24,891 |
| Unemployment taxes lost | \$ 36.7 million | \$ 2.2 million |
| State income taxes | \$ 245.8 million | \$ 17.7 million |
| Local income taxes | \$ 99.8 million | \$ 7.2 million |
| Workers comp prem. | \$ <u>24.1 million</u> | \$ <u>8.4 million</u> |
| Total of losses | \$406.4 million | \$35.5 million |

⁶⁴ *Economic Costs of Employee Misclassification in the State of Illinois*, Dept. Of Economics, Univ. Missouri-Kansas City, by Michael Kelsay, James Sturgeon and Pinkham, pp. 4 to 8 and 15 (December 2006) (Illinois Study). The rate of misclassification in construction used here is the rate of misclassification for all industries. The Illinois study was unable to quantify exactly the construction rate, because the state did not provide industry specific audit data. It is fair to assume that construction rate is at a minimum the same as the overall rate, and that it is probably higher, because the Illinois data is based only on random audits, and the data from the other states shows a greater incidence of misclassification in construction.

⁶⁵ Illinois Study, p. 2.

⁶⁶ *Ibid.*, fn. 1, p. 2.

⁶⁷ *The Economic Costs of Employee Misclassification in the State of Indiana*, Dept. of Economics, University of Missouri-Kansas City, by James Sturgeon and Michael Kelsay (2010).

⁶⁸ *Ibid.*, pp. 3-5.

Data for the study came from state unemployment-tax audits. The authors note that their study does not capture the underground economy, or workers paid in unreported-cash, thus their results may underestimate the true scope of the problem.⁶⁹

A bill was filed in the **Kentucky General Assembly in 2015** that referenced a study of misclassification using statistics from the state unemployment insurance audits. The analysis found that 26.4 percent of construction employers had misclassified workers as independent contractors.⁷⁰

In 2008 research was done in Kentucky of people with work-place injuries seeking emergency treatment.⁷¹ Twenty percent did not have workers compensation coverage, and 92 percent of them also did not have any health insurance.⁷² Within that number of the uninsured, 54.2 percent were in the construction industry.⁷³ The authors conclude:

Hiring practices that allow employers to avoid paying for both WC and health insurance have the effect of shifting the cost of injured workers' care to taxpayer-funded programs such as Medicaid's disproportionate share [sic] hospital funding.⁷⁴

***Maine study 2005:**⁷⁵

| | All Industries | Construction |
|----------------------------------|----------------|------------------------|
| Degree employers who misclassify | 11% | 14% |
| Unemployment taxes lost | not quantified | \$ 0.3 million |
| State income taxes | nq | \$ 4.3 million |
| Workers comp prem. | nq | \$ 6.5 million |
| FICA | nq | \$ <u>10.3 million</u> |
| Total | | \$ 21.4 million |

This study does not include the degree of unreported pay in the underground economy.⁷⁶

***Maine Unemployment Audits 2004-2007:**⁷⁷

A review of Main Department of labor unemployment audits for all industries showed that 29% of employers misclassified employees as independent contractors in 2004, 39%

⁶⁹ *Ibid.*, p. 3.

⁷⁰ H.B. 256, §1(b), 2015 Reg. Sess. (Ky. 2015)

⁷¹ *Disparities in Work-Related Injuries Associated With Worker Compensation Coverage Status*, Valerie, J. Nicholson, et. al. American Journal of Industrial Medicine (Author Proof document) (May 2008).

⁷² *Ibid.*, pp. 2-3.

⁷³ *Ibid.* p. 3.

⁷⁴ *Ibid.* p. 4.

⁷⁵ *The Social & Economic Cost of Employee Misclassification in the Maine Construction Industry*, Construction Policy Research Center, Labor & Worklife Program, Harvard Law School & Harvard School of Public Health, by Bernhard and Herrick, pp. 1-2 (April 2005) (Maine Study)

⁷⁶ Maine Study, p. 1.

⁷⁷ Exec. Order No. 23 FY 08/09, Office of the Governor ME (January 14, 2009)

in 2005, 43% in 2006 and 41% in 2007. Most of the misclassification in 2006 was by construction employers.

***Maryland study 2009:**

Written testimony from the Maryland Governor’s Office puts the number of employers who fail to properly classify at 20 percent for all industries to as high as 25 percent in some industries.⁷⁸ The cost to the state is a \$22 million a year loss to the unemployment trust fund and \$81 million in unpaid state income taxes.

***Massachusetts study 2004:⁷⁹**

| | All Industries | Construction |
|----------------------------------|----------------------|---------------------|
| Degree employers who misclassify | up to 19% | up to 24% |
| Unemployment taxes lost | \$ 35 million | \$ 3.9 million |
| State income taxes | \$ 152 million | \$ 6.9 million |
| Workers comp prem. | \$ <u>91 million</u> | \$ <u>7 million</u> |
| Total | \$ 278 million | \$ 17.8 million |

This study does not include the degree of unreported pay in the underground economy.⁸⁰

***Michigan 2008 study:⁸¹**

30 percent of employers underreport their employee payroll by misclassifying employees as self employed or underreporting payroll. 8 percent of Michigan employees are misclassified as self-employed or receive undeclared income from their employers, resulting in \$1.5 billion in unreported payroll to state unemployment insurance annually.⁸² 26 percent of construction employers misclassify employees or pay unreported payroll, 24% of trucking employers and 56% of security-guard firms.⁸³ **Construction employers, though, were much more likely to engage in fraud by**

⁷⁸ Testimony of Carolyn Quattrocki, Deputy Legislative Officer, Thomas Perez, Secretary of labor, Licensing and Regulation, Vicki Schultz, Senior Advisor for Consumer Protection, Labor Licensing and Regulation on House Bill 819, Workplace Fraud Act of 200; House Economic Matters Committee, p. 2, (March 3, 2009).

⁷⁹ *The Social & Economic Cost of Employee Misclassification in Construction*, Construction Policy Research Center, Labor & Worklife Program, Harvard Law School & Harvard School of Public Health, by Bernhard and Herrick, p. 1 (December 2004) (Massachusetts Study).

⁸⁰ Massachusetts Study, p. 1.

⁸¹ *The Social and Economic Costs of Employee Misclassification in the Michigan Construction Industry*, Dale L. Belman and Richard Block, School of Labor and Industrial Relations, Michigan State University (2008) (Michigan Study).

⁸² Michigan Study, p. 5.

⁸³ *Ibid.*,p. 7

paying workers off the books rather than routine misclassification as an independent contractor.⁸⁴

| | All Industries ⁸⁵ | Construction ⁸⁶ |
|----------------------------------|------------------------------|----------------------------|
| Degree employers who misclassify | 30% | 26% |
| Unemployment taxes lost | \$ 17 million | \$ 2.5 million |
| State income taxes | \$ 20-33 million | \$ 2.2-3.7 million |
| Social Security | \$ 34-57 million | nq |
| Fed. Income Tax | \$ 58-96 million | nq |
| Total | \$ 129-203 million | |

***Minnesota 2007 study:**⁸⁷

| | All Industries | Construction |
|-------------------------------------|----------------|--------------|
| Degree of employers who misclassify | 14% | 15% |

Within construction, the study found that 31% of drywall employers misclassify their employees as independent contractors.⁸⁸

This study does not include the degree of unreported pay in the underground economy.⁸⁹

***New Jersey 2016 study**

The study used 2014 statistics.⁹⁰

The estimated of the **size of underground construction economy averaged at \$645 million and could be as high as \$1.2 billion.**⁹¹ The construction underground economy is made up of **23,000 workers paid off-the-books and 11,600 wrongly classified** as 1099 independent contractors.⁹² As much as \$528 million was paid in wages to those two groups.⁹³ **The lost state personal income taxes resulting from off-the-books payments**

⁸⁴ Of those who run afoul of the law, 38% misclassified and 62% didn't report payroll at all. *Ibid.*, p. 9.

⁸⁵ *Ibid.*, p. 5 and 10.

⁸⁶ *Ibid.*, p. 9-10.

⁸⁷ *Misclassification of Employees as Independent Contractors*, Office of the Legislative Auditor, State of Minnesota, pp 15 and 18 (November 2007).

⁸⁸ *Ibid.*, p. 20.

⁸⁹ Minnesota Study, p. 15.

⁹⁰ *The Underground Construction Economy in New Jersey*, by Oliver Cooke, Deborah Figart and John Foonjian, Stockton University William J. Huges Center for Public Policy, p. 8 (June 2016).

⁹¹ *Ibid.*

⁹² *Ibid.*, p. 9. If compared to the number of construction workers in the residential sector, the 35,000 workers misclassified and paid off the books represent 14 percent of the residential construction workforce.

⁹³ *Ibid.*, p. 3.

and misclassification could be as high as \$19.6 million.⁹⁴ \$3.1 million to \$6.7 million in unemployment taxes were also unpaid.⁹⁵

***New Jersey 2007**

In testimony before Congress, New Jersey’s Labor & Workforce Development Commissioner David J. Socolow reported that a sample audit of 2.2% of employers uncovered **42%, in all industries, misclassifying employees as independent contractors** or paying them cash “off the books.”⁹⁶ Those 2006 audits found 25,000 misclassified workers and **\$565 million in unreported wages.**

***New York state study 2007:⁹⁷**

| | All Industries | Construction |
|--------------------------------|----------------|--------------|
| Degree employees misclassified | 10.3% | 14.8% |
| Unemployment taxes lost | \$176 million | nq |

*A sense of **the size of unreported-cash pay in the underground economy** can be found in the **Fiscal Policy Institute’s study of the residential construction market in New York City.** They compared residential building permits and FW Dodge construction activity data to construction employment from 2000 to 2005.⁹⁸ Conservatively, New York City had 82,000 residential construction workers in 2005. 30,000 of those construction workers were employed illegally.⁹⁹ (13,000 may have been misclassified and the other 17,000 were completely off the books.¹⁰⁰) That means that a minimum of 21 percent of New York City residential construction workers received unreported pay. The numbers were worse in the city-funded affordable-housing construction market, where up to two thirds of the 13,350 construction workers were employed illegally.¹⁰¹

⁹⁴ *Ibid.*, p 9.

⁹⁵ *Ibid.*, p 3.

⁹⁶ *Congressional Probe Look sat Misclassified Workers*, by Michael Whiteley, [Workcompcentral](#) (August 1, 2007).

⁹⁷ *The Cost of Worker Misclassification in New York State*, Cornell Univ., ILR School, by Donahue, p. 2 (February 2007) (New York Study).

⁹⁸ *The Underground Economy in the New York City Affordable Housing Construction Industry*, Fiscal Policy Institute (New York City Housing), p. 1, 9. (April 2007).

⁹⁹ New York City Housing, pp. 1, 10-12.

¹⁰⁰ *Ibid.*

¹⁰¹ *Ibid.*, pp. 1, 8-9.

*The **Fiscal Policy Institute also released a study in December 2007 on illegal employment practices in the entire New York City construction market.**¹⁰² Like the study of the residential market, this study captures workers who are improperly misclassified as well as those paid unreported compensation.¹⁰³ The study made the following findings of losses in 2005:¹⁰⁴

| | |
|---|------------------------|
| Total number of construction workers: | 200,000 |
| Number misclassified or paid off the books: | 50,000 |
| Health care cost shifting: | \$ 148 million |
| Fed income tax lost: | \$ 43.5 million |
| Fed employment tax/comp. premium lost: | \$ 271.6 million |
| New York state income tax lost: | \$ 15.2 million |
| New York City income tax lost: | \$ <u>11.0 million</u> |
| Total cost: | \$ 489.3 million |

FPI further estimates that fraud in New York City will cost the \$557 million in 2008.

*The Fiscal Policy Institute updated its 2007 **New York City fraud report in June of 2013.**¹⁰⁵ The report found that 70,300 construction workers, or 46 percent of the total New York City construction workforce of 152,700, were misclassified as independent contractors or paid off the books,¹⁰⁶ resulting in the following losses:¹⁰⁷

| | |
|--|------------------------|
| Workers comp. premiums: | \$ 235.0 million |
| Unemployment contribution: | \$ 44.5 million |
| FICA:* | \$ 141.6 million |
| NY State disability:* | \$ 2.0 million |
| Health care cost shifting: | \$ 165.4 million |
| Fed personal income tax lost: | \$ 57.0 million |
| New York state personal income tax lost: | \$ 24.7 million |
| New York City personal income tax lost: | \$ <u>17.1 million</u> |
| Total losses: | \$ 687.3 million |

*These numbers calculated from the Appendix.

***Ohio 2009 study:**

¹⁰² *Building Up New York, Tearing Down Job Quality: Taxpayer Impact of Worsening Employment Practices in New York City's Construction Industry*, Fiscal Policy Institute (New York City Construction) (December 2007).

¹⁰³ New York City Construction, p. 1.

¹⁰⁴ *Ibid.*, pp. 1, 20-21.

¹⁰⁵ *The Economic and Fiscal Cost of Employer Fraud in the New York City Construction Industry*, Fiscal Policy Institute (June 2013).

¹⁰⁶ *Ibid.*, p. 3.

¹⁰⁷ *Ibid.*, pp. 6-9 and 11.

The Ohio Attorney General’s office did a study on the size and cost of misclassification based on 2005 unemployment-tax audits and findings in other state studies.¹⁰⁸

| | |
|------------------------------------|------------------------|
| Number of misclassified employees: | 459,000 ¹⁰⁹ |
| State Unemployment taxes lost: | \$ 100 million |
| Workers comp. premiums | \$ 510 million |
| State income taxes | \$ 180 million |
| <u>Local income taxes</u> | <u>\$ 100 million</u> |
| Total annual loss | \$ 890 million |

In addition, they estimated that the lost federal Social Security and Medicare taxes are \$500 to 600 million and federal income taxes are \$500 million.¹¹⁰

***Pennsylvania 2008 study**

9 percent, 580,000, workers are misclassified as independent subcontractors annually, costing the unemployment compensation trust fund over \$200 million a year in lost revenue.¹¹¹ The cost to the worker’s compensation system is \$81 million in lost premiums.¹¹²

This study does not include the degree of unreported pay in the underground economy.¹¹³

***Tennessee 2010 study**

Researchers found that up to 38,680 construction workers, 21 percent of the construction workforce, were misclassified as independent contractors or paid unreported compensation in 2006.¹¹⁴ The losses were \$14 million to the state unemployment trust fund in 2006, \$91.6 million in workers’ compensation premiums and \$115.4 million in federal income and employment taxes.¹¹⁵

***Texas 2013 study**

¹⁰⁸ *Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local Governments in Ohio* (February 18, 2009)

¹⁰⁹ *Ibid.*, p. 19.

¹¹⁰ *Ibid.*, p. 22.

¹¹¹ Testimony of Patrick T. Beaty, Deputy Secretary for Unemployment Compensation Programs, Pennsylvania Department of Labor and Industry, before the House of Representatives Commonwealth of Pennsylvania, Labor Relations Committee on HB 2400, The Employee Misclassification Prevention Act, p. 3 (April 23, 2008) (hereinafter *Beaty*).

¹¹² Testimony of Timothy L. Wisecarver and Bruce Decker, Pennsylvania Compensation Rating Bureau, Summary of Testimony before the House of Representatives Commonwealth of Pennsylvania, Labor Relations Committee on HB 2400, The Employee Misclassification Prevention Act, p. 3 (April 23, 2008).

¹¹³ *Beaty*, p. 3.

¹¹⁴ *Misclassified Construction Employees in Tennessee*, Dr. William Canak and Dr. Randal Adams, pp. iv and vi (January 15, 2010).

¹¹⁵ *Ibid.*, p. v.

Construction companies and workers were interviewed by researchers in Austin, Dallas, Houston, San Antonio and El Paso.¹¹⁶ Research data was also consulted. The report concluded that 41 percent of the construction workforce, or over 300,000 construction workers, in Texas are either paid unreported compensation or wrongly classified as independent contractors,¹¹⁷ costing the state an estimated \$54.5 million in lost unemployment contributions.¹¹⁸ The resulting federal income tax loss is \$1.06 billion.¹¹⁹

***Vermont 2007 study**

The Vermont Department of Labor, assisted by the Department of Banking, Insurance, Securities & Health Administration studied (1) the feasibility of having an on-line proof of coverage database through the National Council of Compensation Insurance (2) the extent and nature of class code and independent contractor misclassification and (3) the effectiveness of current Vermont law to counter misclassification.¹²⁰ Most of the answers came from a survey of the top 9 workers' compensation insurers in the state.¹²¹ They concluded that it is feasible to have an on-line proof-of-coverage open to the public.¹²² Also, they found that insurance companies don't believe that class-code misclassification is a serious problem.¹²³ They do believe that independent contractor misclassification is a problem and that it is a particular problem in the construction industry.¹²⁴ The insurers say that misclassification of class codes and especially employees as independent contractors raises premium costs.¹²⁵ Regarding current statutes, the Department of Labor recommends a uniform definition of independent contractor for its unemployment and workers compensation codes.¹²⁶

***Washington 2007 study:¹²⁷**

In-state and out-of-state business registered with the IRS but not with Washington in 2004 cost the state \$274 million in unpaid taxes (that includes taxes for workers compensation coverage). Unpaid taxes for Washington employers are \$101.3 million. Industry breakdowns for these employers are available.

¹¹⁶ *Build a Better Texas: Construction Working Conditions in the Lone Star State*, Workers Defense Project and Community Engagement at University of Texas at Austin, p. I (2013).

¹¹⁷ *Ibid.*, p. ii, 13.

¹¹⁸ *Ibid.* pp. iii. 40, 45, 46 and 56.

¹¹⁹ *Ibid.*, p. 46.

¹²⁰ *Vermont Department of Labor Study Required by Act 57 (S 196) 2007 Legislative Session: The Misclassification of Workers in Vermont's Workers' Compensation System*, p. 3 (December 2007).

¹²¹ *Ibid.* p. 21.

¹²² *Ibid.* at p. 3.

¹²³ *Ibid.* at pp. 3 and 15.

¹²⁴ *Ibid.* at pp. 4 and 15-16

¹²⁵ *Ibid.* at p. 15.

¹²⁶ *Ibid.* at pp. 4-5 and 9-10

¹²⁷ *Unregistered Business Study: Joint Report of the Washington State Dept. of Revenue, Washington State Dept. of Labor and Industries and the Washington State Employment Security Dept.*, pp. 2, 3-7, 11-17 and 19 (November 2007).

In 2001, and additional \$183 million of unpaid taxes can be added for business that are neither registered with the IRS and Washington. Industry breakdowns for these employers are not available.

Breakdown in millions:

| | In&Out of State All Industries | In-State All Ind. | In-State Construction |
|------------------|-----------------------------------|----------------------|--------------------------|
| State income tax | \$ 225.0 | \$ 52.0 | \$ 1.0 |
| State unemplmnt | \$ 14.8 | \$ 14.8 | \$ 3.4 |
| workers comp. | \$ 34.5 | \$ 34.5 | \$ 8.7 |
| Total | \$ 274.3 | \$101.3 | \$13.1 |

The study cites construction as an area where the number is probably higher, because they don't have an industry breakdown of the employers who aren't registered (don't pay taxes) to either the federal and state. Construction is cited as a focus for enforcement.

A report released by the Wisconsin Misclassification Task Force disclosed that 44% of workers of companies audited by unemployment tax were reclassified as employees.¹²⁸

¹²⁸*Report of the Worker Misclassification Task Force Submitted to Secretary Roberta Gassman, Department of Workforce Development, pp. 6-7 (2009).*