Comments of the United Brotherhood of Carpenters and Joiners of America

101 Constitution Avenue, NW

Washington, DC 20001

Matthew F. Capece, Esq.

Representative of the General President

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**Construction Industry Tax Fraud Dramatically Reduces Government Revenue**

**and Undermines the American Dream**

The gap between what taxpayers pay to the federal government and what they should pay is over $450 billion a year.[[1]](#footnote-1) Our country is being starved of resources that can help build schools and reduce class sizes, improve infrastructure, increase funding for first responders, and help veterans without adding anything more to the deficit.

The construction industry has been exposed as a major contributor to tax losses—responsible for a conservative estimated loss of $8.4 billion a year in state and federal income taxes, unemployment insurance contributions and Social Security and Medicare taxes.[[2]](#footnote-2) Those losses are the result of a staggering 1.3 to 2.16 million construction workers being paid off the books or misclassified as independent contractors.[[3]](#footnote-3) That is 12.4 to 20.5 percent of the construction workforce.[[4]](#footnote-4) Contractors who break the law offload as much as $3.48 billion in federal employment taxes they are obligated to pay onto the backs of their workers and their families.[[5]](#footnote-5) In addition workers' compensation insurance carriers are cheated out of $2 billion in premiums.[[6]](#footnote-6)

As has been seen in various state reports, the construction industry leads the pack, with off-the-books payments more common than misclassification by more than two to one.[[7]](#footnote-7) Simply put, these practices amount to tax fraud, and in construction, it is not a small-job thing—it happens frequently on large commercial projects. Our investigations have revealed cases involving hundreds of workers. We have seen tax fraud on construction projects at schools, military bases, veteran’s hospitals,[[8]](#footnote-8) universities, convention centers, hotels and condominium towers. Many suffer because of these illegal practices, including workers, honest contractors and taxpayers.

It is obvious that voluntary compliance with our nation’s employment and tax laws is evaporating within the construction industry. It is the industry’s duty to become a good citizen by changing its destructive course. But lack of effective civil and criminal enforcement is also a major contributor to the crisis. Clearly, it is the duty of our government, at all levels, to protect law-abiding employers, their employees and taxpayers by collecting taxes owed.

**Billions in tax dollars are stolen every year**

Contractors engaged in tax fraud evade paying federal, state and local taxes, overtime and workers’ compensation premiums, and they shirk safety precautions.[[9]](#footnote-9) These illegal savings allow scofflaws to underbid law-abiding employers. Because of the fiercely competitive nature of the industry, tax fraud has led to a downward spiral. Employers in many markets are faced with either joining in or going out of business.

The intentionality of the conduct is unmistakable. Non-reporting overshadows misclassification, and a growing number of large construction companies use crooked subcontractors or law-breaking labor brokers, shell companies and check cashing stores in their schemes.[[10]](#footnote-10) Their violations of basic labor and employment tax laws gain them a competitive edge while they use their subcontract relationship with labor brokers or crooked subcontractors as a shield against liability.[[11]](#footnote-11)

The latest study by the IRS of taxes lost to misclassification was in 1984. Even then, the study disclosed, 15 percent of all employers misclassified their workforces, while the construction industry was the worst violator, at 19.8 percent.[[12]](#footnote-12) The resulting yearly loss in tax revenue, in 2006 dollars, was estimated at $2.72 billion for all industries.[[13]](#footnote-13)

More recent state and local studies of fraud in the construction industry have revealed even more staggering tax losses, making it obvious that the 2006 estimate was extremely conservative:

● In California there has been a 400 percent increase in illegal conduct since 1972, driving federal employment tax losses to $302 million in 2011 alone,[[14]](#footnote-14)

● $115 million in federal income and employment taxes were lost in Tennessee in 2006,[[15]](#footnote-15)

● $1.06 billion in federal income taxes was lost in Texas in 2012,[[16]](#footnote-16)

● $26.3 million loss of state taxes in New Jersey,[[17]](#footnote-17) and

● Twenty-five percent of New York City construction workers should be treated as employees but are not, leading to an $11 million loss in city income taxes.[[18]](#footnote-18)

The United States is not the only country facing this negative trend. Construction Industry tax fraud is a serious problem in Canada as well. The underground economy in Canada accounted for $45.6 billion of economic activity in 2013.[[19]](#footnote-19) The largest slice of that activity came from the residential construction industry, amounting to 27.8 percent of the total, or $12.7 billion, of the underground economy. [[20]](#footnote-20) A 2019 study of Ontario’s underground construction economy put the annual losses in federal and provincial tax revenue up to $3.1 billion.[[21]](#footnote-21)

**Workers, honest contractors and voters want to see an end to tax fraud**

Construction workers’ and their families lose significant earnings because of fraud. Unreported employees earn just 52 cents for every dollar paid to payroll employees, and misclassified workers earn only 64 cents.[[22]](#footnote-22) (That is, when they are paid at all; the construction industry is also a leader in the heinous practice of wage theft.)[[23]](#footnote-23) On top of it all, “self-employed” workers are expected to pay their income and employment taxes, their employers’ employment taxes and shoulder the burden of injury and unemployment. Undoubtedly, the loss of wages[[24]](#footnote-24) and safety net protections due to tax fraud is making the American dream for construction-worker families just that—a dream.

Worker advocates are not alone in calling for more rigorous law enforcement. Many employers in the industry want it as well.[[25]](#footnote-25) Law-abiding contractors are tired of losing work to outlaws and seeing their taxes and workers’ compensation insurance costs rise while their unlawful competitors prosper.

The desire to clamp down on employment abuses is supported by Democratic, Republican and Independent voters.[[26]](#footnote-26) Seventy percent of voters believe that the increase in the use of subcontracted labor is bad for workers and 84 percent said it was a serious problem.[[27]](#footnote-27) An overwhelming 71 percent of voters (67 percent among Republicans) want to see upper-tier companies held liable for their subcontractors’ unpaid wages, unemployment insurance contributions, workers’ compensation and Social Security taxes.[[28]](#footnote-28) Clearly, workforce abuses are seen by voters as a threat to their economic well-being, and they want something done about it.

**Stopping tax fraud is challenging for law enforcement**

Stopping tax fraud in the construction industry is challenging for law enforcement. The growth of illegal activity coexists with an Internal Revenue Service that is increasingly incapable of meaningful enforcement. Cases of egregious employment tax violations have tripled while enforcement resources for the IRS have diminished.[[29]](#footnote-29) Consequently, those who violate employment-tax laws feel emboldened. Many employers do not correct their behavior, even after receiving an SS-8 determination from the IRS stating that they have misclassified employees as independent contractors.[[30]](#footnote-30) Misclassification and off-the-books employment further compound the tax losses that already occur among sole proprietors, who have been found to pay significantly less of their tax obligations than they should.[[31]](#footnote-31)

A primary law-enforcement flaw is that various law enforcement agencies frequently operate in “silos.” That is, they fail to share critical information or coordinate their investigations. For instance, a 2009 report from the Government Accountability Office criticized the Occupational Safety and Health Administration and the Wage and Hour Division, both within the U.S. Department of Labor (USDOL), for not sharing information and working together.[[32]](#footnote-32) Some states have gotten the message and formed task forces to break out of the silo mentality.[[33]](#footnote-33) There is an attempt at better coordination within the federal government as well. The USDOL and the IRS have signed a memorandum of understanding, but lack of coordination is still an issue.[[34]](#footnote-34)

Another significant problem is that law enforcement frequently focuses solely on crooked subcontractors or labor brokers, because they are low-hanging fruit and easier to pursue. But contractors can readily replace them. Accordingly, for enforcement to be effective, agencies must hold contractors who hire law-breakers accountable, either through conspiracy, joint employer findings or vicarious liability. Lawmakers in California, the District of Columbia, Maryland and Nevada have met this challenge by making upper-tier contractors automatically liable for the wage theft committed by their subcontractors.[[35]](#footnote-35)

**We all benefit when we fight construction industry tax fraud**

The construction industry has been corrupted by an epidemic level of unlawful business practices that have ballooned to claim a wide swath of victims. Billions in federal, state and local taxes are going uncollected. Workers, honest businesses and taxpayers deserve protection.

An array of measures need to be taken. Law enforcement agencies need to be given the resources to do their jobs effectively, and they need to break out of their silos and work together. Immigration reform is needed so workers will not fear standing up for their rights. Upper-tier contractors must be held accountable. The economic advantage for contractors who hire law-breakers must be taken away. Otherwise, tax fraud will continue to grow and billions will continue to be lost—billions of tax dollars that could improve our security, reduce the deficit, rebuild our crumbling infrastructure, build schools and secure the American dream for our children.

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3. *Id at 3-4.* [↑](#footnote-ref-3)
4. *Id.* [↑](#footnote-ref-4)
5. *Id at 5.* [↑](#footnote-ref-5)
6. *Id.* [↑](#footnote-ref-6)
7. See, *Contract to Cheat*, McClatchy, September 2014. This multi-part series explored fraud in construction, principally on tax-payer funded projects, in eight states ; Yvonne Yen Liu and Daniel Flaming, *Sinking Underground; The Growing Informal Economy in California Construction*, 1,2, 7 (2014) ; Dale Belman and Richard Block, *The Social and Economic Costs of Employee Misclassification in the Michigan Construction Industry*, School of Labor and Industrial Relations, Michigan State University, 9 (2008). Both available at StopTaxFraud.net. [↑](#footnote-ref-7)
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14. Liu*, supra* note 7 at 31. [↑](#footnote-ref-14)
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