

Construction Industry Tax Fraud Dramatically Reduces Government Revenue and Undermines the American Dream

Executive Summary

The gap between what U.S. taxpayers pay to the federal government and what they should pay is over \$450 billion a year. 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 is a major contributor to these losses—which amount to a conservative estimate of \$8.4 billion in unemployment insurance contributions and state and federal taxes every year. Less conservative estimates put the losses at \$17.3 billion. Construction is an ignominious leader in the illegal practices of paying workers off-the-books and intentionally misclassifying employees as independent contractors. Of the two, off-the-books payments dominate by more than two to one, so the willfulness of the misconduct is unmistakable. Research found a staggering 1.3 to 2 million construction workers paid off the books and misclassified. Those crooked contractors illegally offload \$3.48 billion of their federal employment tax obligations onto the backs of workers and their families. Workers' compensation insurers are ripped off to the tune of \$2 billion. Moreover, many contractors use crooked subcontractors or labor brokers to evade their legal responsibilities.

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. These illegal savings allow scofflaws to underbid law-abiding employers.

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. The resulting yearly loss in tax revenue in 2006 dollars was estimated at \$2.72 billion. More recent state 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;
- \$115 million in federal income and employment taxes were lost in Tennessee in 2006;
- \$1.06 billion in federal income taxes was lost in Texas in 2012;
- \$26.3 million in state taxes is lost yearly in New Jersey;
- \$50.7 million in business taxes are lost in Wisconsin because of the unlawful conduct of construction contractors, and \$8.3 million in income taxes;
- \$59.9 million in income taxes are lost in Illinois,
- Minnesota loses \$65 million; and
- New York City loses \$11 million per year in city income taxes.

Construction Industry tax fraud is a serious problem in Canada as well. The underground economy in Canada accounted for \$61.2 billion of economic activity in 2018. The residential

construction industry is responsible for 26.2 percent of the total, or \$13 billion. A 2019 study of Ontario's underground construction economy put the annual losses in federal and provincial tax revenue up to \$3.1 billion.

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

Construction employees paid off the books earn just 52 cents for every dollar paid to payroll employees; misclassified workers earn only 64 cents.

Law-abiding construction employers want enforcement improved because they are tired of losing work to outlaws and seeing their taxes and workers' compensation insurance costs rise while their unlawful competitors prosper.

Democratic, Republican and Independent voters want a clamp-down on employment abuses. Seventy percent believe that the increased use of subcontracted labor is bad for workers and 84 percent said it was a serious problem. Fully 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.

Stopping tax fraud 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. Many employers will not correct their behavior even after receiving an IRS SS-8 determination that they have misclassified employees as independent contractors. Misclassification and off-the-books employment further compound tax losses, because sole proprietors pay significantly less of their tax obligations than they should.

Another significant problem is that law enforcement frequently focuses only on crooked subcontractors or labor brokers, because they are easier to pursue. But contractors can readily replace them. For enforcement to be effective, contractors hiring law-breakers must be held accountable, either through conspiracy, joint employer findings or vicarious liability. Lawmakers in California, the District of Columbia, Maryland and Nevada have met the challenge by making upper-tier contractors automatically liable for the wage theft committed by their subcontractors.

We all benefit when we fight construction industry tax fraud

The construction industry has been corrupted with unlawful business practices that are growing and have claimed a wide swath of victims. Billions in federal, state and local taxes are going uncollected. Workers, honest businesses and taxpayers deserve protection.

Law enforcement agencies need to be given the resources to do their jobs effectively. They also 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 hiring 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.