



UNITED BROTHERHOOD OF CARPENTERS AND JOINERS OF AMERICA

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

Executive Summary

The gross tax gap between what U.S. taxpayers pay to the federal government and what they should pay for tax years 2020 and 2021 was \$688 billion. 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 \$10 billion in unemployment insurance contributions and state and federal taxes every year. 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 1.1 to 2.1 million construction workers paid off the books and misclassified. Those crooked contractors illegally offload \$5.13 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 \$5 billion. Construction workers and their families are cheated out of \$1.9 billion a year in overtime pay.¹ As a consequence, a construction worker classified as an independent contractor earns up to \$19,526 in wages and job benefits less in a year than a construction employee. All told, criminal contractors shave as much as \$12 in costs by breaking the law. Moreover, many contractors use crooked subcontractors or labor brokers to evade their legal responsibilities.

Indeed, the situation has become so alarming that the U.S. Department of the Treasury's Financial Crimes Enforcement Network has issued a notice to banks and other financial institutions directing them to report instances of suspected fraudulent transactions of contractors who are account holders.

The losses are not limited to lost revenues and wages. The illegal and low-road employment practices in the construction industry have forced 39 percent of construction worker families to rely on social safety net programs to make ends meet. That cost is a staggering \$28 billion a year. Simply put, taxpayers are subsidizing contractors' abuse of the workforce.

Billions in tax dollars are stolen every year.

¹ *Id.*

Contractors engaged in employer 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.

A sampling of state tax losses also demonstrates the severity of the problem:

- New York \$179.4 million,
- Pennsylvania \$82.3 million,
- Texas \$76.4 million,
- Georgia \$68.1 million,
- Connecticut \$38.8 million,
- Alabama \$28.5 million, and
- Iowa \$28.4 million.

Construction industry employer 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. The revenue losses in Quebec due to fraud in the construction sector amount to \$1.5 billion. In British Columbia the losses come to \$308 million when accounting for taxes that go unpaid by independent operators.

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 has been starved of resources for decades. Cases of egregious employment tax violations have tripled. Under the Inflation Reduction Act, funding for IRS enforcement has been increased, but that increase is being steadily chipped away by Congress. 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 lawbreakers must be held accountable, either through conspiracy charges, joint employer findings or joint and several liability. Lawmakers in California, the District of Columbia, Maryland, New York, Illinois, Minnesota and other states 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, 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 to incentivize them to hire honest subcontractors. Workers' compensation insurers need to change their practices that enable employer premium fraud. The economic advantage for contractors who hire law-breakers must be taken away. Otherwise, employer 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.