

EMPLOYMENT DEVELOPMENT DEPARTMENT UNDERGROUND ECONOMY OPERATIONS

Background

Reports on the underground economy indicate that it imposes significant burdens on the State of California, on businesses that comply with the law and on workers who lose benefits and other protections provided by State law. The ultimate impact of the underground economy is erosion of the economic stability and working conditions in this State.

When businesses operate in the underground economy, they gain an unfair competitive advantage over businesses that comply with the law. This causes unfair competition in the marketplace and forces law-abiding businesses to pay higher taxes.

Employees of the businesses that do not comply are also affected. Their working conditions may not meet legal requirements, which can put them in danger. Their wage earnings may also be less than those required by law and benefits they are entitled to can be denied or delayed because their wages are not properly reported.

Consumers can also be affected when contracting with unlicensed businesses. Licensing provisions are designed to ensure minimum levels of skill and knowledge to protect the consumer.

Underground Economy Operations

To respond to employers that operate in the underground economy, in 1993 the Employment Development Department (EDD) formed the Underground Economy Operations (UEO). The UEO enforcement efforts are based upon a strategic blend of education, partnerships, and investigative activities. In the area of education, we actively pursue opportunities to make presentations to employer groups, trade associations, labor organizations, government agencies, and others that express interest in understanding what the underground economy is and how to combat it. To maximize our resources and increase overall program efficiency we have developed partnerships with various federal, State, and local agencies as well as trade and labor organizations.

Joint Enforcement Strike Force

In 1993, the Joint Enforcement Strike Force (JESF) was established by executive order. The JESF was later enacted into law by addition of Section 329 of the California Unemployment Insurance Code (CUIC). The purpose of the JESF is to develop and share information necessary to combat the underground economy; to

improve the coordination of enforcement activities; and to develop methods to pool, focus and target the enforcement resources of all JESF members in support of the enforcement activities of individual agencies. Members of the JESF include EDD, Department of Industrial Relations (DIR), Department of Consumer Affairs (DCA), Franchise Tax Board, Board of Equalization, Department of Justice, the Office of Criminal Justice Planning, and the Department of Insurance. The EDD was designated as the lead agency for the JESF. The JESF is empowered to form joint enforcement teams to utilize the collective investigative and enforcement capabilities of the participating members.

Employment Enforcement Task Force (EETF)

The EETF is the first joint enforcement project created by the JESF. Participating agencies include EDD and DIR with strong support from the Contractors' State License Board and the Bureau of Automotive Repair within DCA. The EETF agents from each agency jointly conduct onsite investigations of businesses by interviewing owners, managers, and workers to determine if businesses are in compliance with payroll tax, labor, and licensing laws. To minimize the disruption of compliant businesses, EETF conducts investigations only if there is reasonable belief of violations of the CUIC, Labor Code, and/or the Business and Professions Code.

The EETF has focused on numerous industries over time including construction, automotive repair, garment manufacturing, bars, restaurants, nightclubs, furniture manufacturers, adult entertainment establishments, bakeries, produce markets, car washes, pallet repair businesses, cabinet manufacturers, and janitorial and building maintenance. Although EETF focuses on industries known to have a high degree of noncompliance, investigations of businesses not included in the target groups are also investigated when underground economy activity is suspected.

Construction Enforcement Project (CEP)

The CEP was established to concentrate on the construction industry. The onsite investigation technique used for identifying tax and employment fraud, while effective in most industries, was not as effective in the construction industry. Unlike other industries, which have permanent business locations, construction businesses frequently change job sites. By the time information is developed that a contractor is probably operating in the underground economy, work at the job

site has often been completed, and an onsite inspection would not discover any labor law violations.

In this program, the staff develops nontraditional techniques to detect underground economy activity. Methods used to identify these businesses include the use of ratios (such as material to labor cost), Personal Income Tax information, and Form 1099 information. The techniques used are especially crucial for leads involving cash pay in the construction industry because traditional audit techniques are not always successful in identifying the unreported wages and contributions.

Janitorial Enforcement Project (JEP)

The EDD UEO began looking into the janitorial industry in the summer of 1998 as a result of information provided by the owner of a Southern California janitorial business. The results of the UEO work in 1998 and 1999 proved that significant noncompliance existed in the janitorial industry in Southern California.

Legislation required the Strike Force to include the janitorial and building maintenance industry as a targeted industry beginning in the 2000/2001 fiscal year. To meet this requirement, the JESF initiated the JEP in October 2000. The focus strategy for the JEP is to increase EDD resources devoted to the janitorial and building maintenance industry in both Southern and Northern California.

Targeted Industries Partnership Program (TIPP)

The TIPP was established in 1992 as a multi-agency enforcement and educational program targeting the garment manufacturing and agricultural industries. These industries have a history of labor law and payroll tax violations. The original TIPP partners include the United States Department of Labor, Wage and Hour Division, DIR, Department of Labor Standards Enforcement, and Occupational Safety and Health. The JESF staff from EDD was added to the TIPP in 1996. The EDD's participation in TIPP has been limited primarily to the garment manufacturing industry. This industry has a history of labor law and payroll tax violations.

Tax Enforcement Program

The UEO Tax Enforcement Program staff conduct investigations on many other industries where traditional on-site investigations are not a practical or effective method to detect employment tax evasion. The innovative non-traditional techniques such as ratio and database analysis are more effective for investigations of

very large businesses, with multiple locations or with no real physical establishment, and many service industry employers. The methods used in this program ensure that a complete economic picture of the businesses operations is developed.

Summary

The UEO has achieved significant enforcement results. Joint efforts have proven to be very effective. Collective enforcement capability allows participating agencies to address multiple rather than single violations of law. The multiple enforcement efforts with associated citations, penalties, and assessments have had a significant effect on underground economy businesses. The intent is to drive these businesses into the legitimate economy or to put them out of business. This reduces the pressure of unlawful competition on honest businesses.

The UEO continues to enjoy valuable communication links with business and labor organizations in industries prone to underground economy activity. Consequently, there is a broader awareness of compliance issues by members of these industries, which has helped uncover underground economy schemes employed in these industries.

The UEO staff also recognized the need to combine an ongoing educational program with enforcement activities. Staff has conducted outreach presentations to business and labor organizations throughout the State and to representatives of local government agencies. These presentations informed a large number of people about Strike Force activities and continue to be an excellent source for leads.

For More Information

If you would like additional information regarding this program, please contact the EDD Underground Economy Operations at (916) 227-2730 or visit our Web site at <http://www.edd.ca.gov/taxrep/txueoind.htm>.

To report a business that you believe is not complying with the payroll tax laws, please contact UEO at (916) 227-2730 or toll free at 1-800-528-1783. You may also E-mail UEO at ueo@edd.ca.gov, send a FAX to (916) 227-2772, or mail to:

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