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Governor

Joint Enforcement Strike Force On the Underground Economy

2010 Report

**Employment Development Department
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EXECUTIVE SUMMARY

This report provides a summary of activities and outcomes from the Joint Enforcement Strike Force (JESF) on the Underground Economy in accordance with §329(d) of the California Unemployment Insurance Code (CUIC).

In October 1993, Executive Order W-66-93 established JESF to combat the underground economy by pooling resources and sharing data among the State agencies charged with enforcing licensing, labor, and payroll tax laws.

On January 1, 1995, §329 was added to the CUIC, which placed the provisions of the Executive Order into law. The JESF members are the Employment Development Department (EDD), which is the lead agency, Department of Consumer Affairs (DCA), Department of Industrial Relations (DIR), and the Department of Insurance (DOI). The Franchise Tax Board, Board of Equalization, Department of Justice, and the Internal Revenue Service are not part of the administration but are encouraged to participate in the strike force.

The underground economy affects businesses and workers throughout the State of California. Businesses that participate in the underground economy undercut their competitors by paying cash to avoid taxes and other required payments such as workers' compensation insurance and unemployment insurance. This allows them to gain a competitive advantage over other businesses that report and pay their fair share of tax liability. When a business operates in the underground economy, its workers may have difficulty qualifying for workers' compensation insurance coverage, state disability insurance, or unemployment insurance benefits when otherwise eligible. These employers may also fail to comply with labor and worker safety laws.

The goals of JESF are to:

- Eliminate unfair business competition.
- Protect workers by ensuring that they receive all benefits to which they are entitled by law relating to wages and hours, health and safety, and income replacement.
- Protect the consumer by ensuring that all businesses are properly licensed and that they adhere to the State's consumer protection regulations.
- Reduce the burden on law-abiding citizens and businesses by ensuring that all businesses and individuals comply with the State's licensing, regulatory, and payroll tax laws.
- Reduce the tax gap by increasing voluntary compliance with the State's payroll tax laws to maximize the State's General and Special Fund revenues.

JOINT ENFORCEMENT STRIKE FORCE (JESF) PROGRAM OVERVIEW

The Employment Enforcement Task Force (EETF) was created to serve the purpose of JESF. The goal of EETF is to identify and bring into compliance those individuals and businesses participating in the underground economy that are in violation of payroll tax, labor, and licensing laws. The EETF operates primarily through teams of Joint Enforcement Agents from EDD and DIR (Division of Labor Standards Enforcement [DLSE]). In addition, DOI and DCA (which includes the Contractors State Licensing Board, Bureau of Automotive Repair, and Bureau of Security and Investigative Services), also participate on EETF teams. Leads are received from other agencies, individuals, businesses, and calls to the established toll-free hotline. These leads are researched through various databases to determine if there are active licenses as required, workers' compensation insurance coverage, and registration with EDD. When there is a reasonable belief that there is noncompliance with licensing, labor or payroll tax law, agents from each participating agency conduct joint inspections of work sites of businesses to determine if there is cause for further enforcement action.

While the JESF is a cooperative effort among many agencies, the statistics within this report are limited to program result data from EDD programs and DLSE citation information. Other participating agencies do not separately account for activities undertaken with JESF partners; therefore, those program statistics are not available for inclusion in this report.

In 2010, EETF referrals to EDD's audit program resulted in 36 fraud determinations, uncovered unreported wages of \$49,670,386, and 2,745 unreported workers, and assessments totaling \$13,677,364 on 224 employers. As part of these joint enforcement efforts, DLSE issued 181 labor code citations totaling \$1,369,321.

Collectively, these efforts ensure that workers receive the benefits they are entitled to by law, provide a deterrent to employers who may consider participating in the underground economy rather than voluntarily complying, and provide additional General Fund and other fund revenues through subsequent collection of liabilities for each agency.

Another program that is focused on combating employment tax evasion is the Tax Enforcement Group (TEG). This program complements the EETF program by focusing efforts on the investigation of employers through the use of various database resources. The TEG staff conduct investigations in situations where traditional on-site investigations are not practical or effective in detecting noncompliance. Staff utilize techniques such as revenue-to-labor ratios typical for certain industries, various internal and external database analysis, income tax return analysis, discussions with workers, and other techniques to determine the existence of unreported wages and underground economy activities. If noncompliance is substantiated by the TEG investigator, the case is referred to the Audit Program with information uncovered through the investigation.

In 2010, TEG referrals to EDD's audit program resulted in 12 fraud determinations, uncovered unreported wages of \$48,472,525 million, and 2,792 previously unreported workers, and assessments totaling \$11,962,537.

The Questionable Employment Tax Practices (QETP) project, was initiated in 2007 between EDD and the Internal Revenue Service to achieve a reduction in the tax gap for both federal and state employment tax authorities. The EDD uses Internal Revenue Service case information to issue assessments for amounts owed to EDD. This multi-agency compliance approach presents a united effort to taxpayers and their representatives.

In 2010, QETP uncovered unreported wages of \$5,921,487, and 173 previously unreported workers, and issued assessments totaling \$1,218,893 million on 68 employers.

In addition, EDD has a Criminal Tax Evasion Program (CTEP) that focuses on the most serious payroll tax reporting violations committed by California employers, and works with JESF partners to investigate and criminally prosecute these most egregious violators. The CTEP partners with DOI on almost all of its criminal prosecutions in filing joint charges, and sometimes DLSE is involved as well.

BACKGROUND

The Underground Economy

“Underground economy” is a term that refers to those individuals and businesses that deal in cash and/or use other schemes to conceal their activities and their true tax liability from government licensing, regulatory, and tax agencies. Underground economy is also referred to as tax evasion, tax fraud, cash pay, and payments under-the-table or off-the-books.

The actual size of the underground economy is difficult to measure. A 2006 report issued by the Franchise Tax Board, *Tax Gap Plan: A Strategic Approach to Reducing California's Tax Gap* shows California's Income Tax Gap – “the total amount of taxes owed but not paid - of about 11 percent in a typical year. This equals approximately \$6.5 billion a year in unpaid taxes.” The General Accounting Office, the investigative arm of the United States Congress, conducted a study of tax year 2001 and found the federal tax gap to range from \$312 billion to \$353 billion. A February 2005 report, *California's Tax Gap*, prepared by California's Legislative Analyst's Office, estimates California's income tax gap to be \$6.5 billion.

Barron's Online featured the article, *Going Underground*, January 3, 2005. This article states in part: ‘America has two economies, and one is flourishing at the expense of the other. First, there's the legitimate economy, in which craftsmen are licensed and employers and employees pay taxes. Then there's the fast-growing underground economy, where millions of workers are paid off-the-books, their incomes largely untaxed. The best guess as to the size of the output of this shadow economy is about \$970 billion or nearly 9 percent that of the real economy. It should soon pass \$1 trillion.’

A 2002 report, *Workers Without Rights*, published by the Economic Round Table (a nonprofit, public-policy research organization in Los Angeles) states at least 28 percent of the workforce in Los Angeles County is engaged in the underground economy. This translates into \$1.1 billion in lost payments to the Social Security Administration, workers' compensation insurance premiums, and unemployment insurance contributions per year.

Reports on the underground economy indicate it imposes significant burdens on: (1) revenue needed to fund critical state programs, (2) businesses that comply with the law, and (3) workers who lose benefits and other protections provided by State law when the businesses they work for operate in the underground economy.

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

Workers of noncompliant businesses are also affected. Their working conditions may not meet the legal requirements, which can put them in danger. Their wage earnings may 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.

The ultimate impact of the underground economy is erosion of the economic stability and working conditions in this State.

Joint Enforcement Strike Force (JESF)

On October 26, 1993, JESF was established by Executive Order W-66-93. The purpose of JESF is to enhance the development and sharing of information necessary to combat the underground economy; improve the coordination of enforcement activities; and develop methods to pool, focus, and target the enforcement resources of all members in support of the enforcement activities of individual agencies.

Subsequent legislation, Senate Bill 1490 (Chapter 1117, Statutes of 1994), codified the Executive Order by adding §329 to the CUIC and established a January 1, 2000 sunset date. Senate Bill 319 (Chapter 306, Statutes of 1999) extended the sunset date to January 1, 2006. In 2004, Senate Bill 3020 (Chapter 685, Statutes of 2004) removed the sunset provision. Member agencies include EDD, DIR, DCA, DOI (added by Assembly Bill 202 effective January 1, 2002) and the Office of Criminal Justice Planning. The Franchise Tax Board, Board of Equalization, and Department of Justice are not part of the member agencies but are encouraged to participate in the strike force. The EDD Director is the chairperson.

Employment Enforcement Task Force (EETF)

The EETF program was created to serve the purpose of JESF. Participating agencies include EDD, DIR, DLSE, Contractors State License Board, Bureau of Automotive Repair, Bureau of Security and Investigative Services, and DOI. The goal of EETF is to identify and bring into compliance those individuals and businesses participating in the underground economy that are in violation of payroll tax, labor, and licensing laws. Since its inception, EETF has focused on the construction, automotive repair, garment manufacturing industries, bars, restaurants, nightclubs, furniture manufacturers, and other industries where on-site inspections can be done. Although EETF focuses on industries known to have a high degree of noncompliance, investigations of businesses not included in the target group are also conducted when underground economy activity is suspected.

The EETF agents from each agency jointly conduct on-site 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, Business and Professions Code, and/or the California Insurance Code.

A system for identifying businesses that are suspected of operating in the underground economy was designed and implemented. There are five major sources of leads: telephone hotline numbers, internet webpage referrals, other government agencies, industry sources, and leads developed by EETF investigators.

In addition, EDD has CTEP that focuses on the most serious payroll tax reporting violations committed by California employers, and works with JESF partners to investigate and prosecute these most egregious violators. The CTEP partners with DOI on almost all of its criminal prosecutions by filing joint charges, and sometimes with other member agencies as well. The CTEP (as sworn peace officers) participates on employer/workers' compensation task forces in

Orange, Riverside, San Bernardino, San Diego, Ventura and Central Valley counties to identify and prosecute employer fraud, including workers' compensation, payroll tax, personal income tax, prevailing wage, and licensing violations. The CTEP partners with DOI, DIR, and DCA to do joint surveillance, serving of search warrants, and collectively work with the California Office of the Attorney General and/or the Department of Justice to file joint criminal complaints.

The JESF members recognize the importance of combining enforcement activities with an ongoing educational program. Member Agency staff conduct outreach presentations to business and labor organizations throughout the State and to representatives of local government agencies. These presentations inform a large number of people about JESF activities and continue to be an excellent source for leads, as well as providing education to the employer community on how to comply with each agency's laws.

For examples of EETF activities related to JESF efforts, please refer to Attachment A.

Tax Enforcement Group (TEG)

The TEG administers several programs under JESF. These programs include:

- The Construction Enforcement Project began as a pilot project in 1994 and was expanded statewide as of December 31, 1995.
- The Janitorial Enforcement Project was initiated by EDD in the summer of 1998 as a result of information provided by the owner of a Southern California janitorial business. In 1998, 3 underground economy janitorial businesses were audited, and in 1999, 16 additional underground economy janitorial businesses were audited.

Assembly Bill 613 (Chapter 299, Statutes of 1999) required JESF to include the janitorial and building maintenance industry as a targeted industry beginning in State Fiscal Year (SFY) 2000-01. To meet this requirement, EDD initiated the Janitorial Enforcement Project in October 2000 and devoted the equivalent of three audit staff. The JESF used the SFY 1998-99 experience in Southern California as a model to develop an approach to identify noncompliance in the janitorial industry throughout California.

- The Public Works Enforcement Project which partners with labor organizations to ensure that employer's who are required to pay Prevailing Wage amounts accurately report those wages to EDD.
- Security Guard Enforcement Project was implemented under JESF to address underground economy and employment tax evasion in this specific industry. The TEG investigators work cooperatively with DCA's Bureau of Security and Investigative Services. This effort was initiated at the request of leaders in the Security Guard Industry who contacted EDD to share information on employers in this industry who were able to under-cut the competition in the bidding process due to the savings from using cash pay and not properly reporting and paying employment taxes.

Additionally, TEG staff investigate businesses in a variety of industries in an effort to detect payroll tax fraud and noncompliance. The TEG conducts desk investigations through the use of various databases and income tax return analysis to uncover noncompliant and fraudulent activity within the employer community. Reports of underground economy activities on businesses in a variety of industries are received via the JESF hotline. These leads are referred for investigation by either TEG or EETF. Leads that do not have workers' compensation

insurance and have a physical business location that can be visited are referred to EETF. Leads that are best served by a desk investigation are referred to TEG.

For examples of TEG activities related to JESF efforts, please refer to Attachment A.

Questionable Employment Tax Practices Program

The Questionable Employment Tax Program was initiated in 2007 as a collaborative approach between EDD and the Internal Revenue Service. The goal of the program is to achieve a reduction in the tax gap for both federal and state employment tax authorities. A Memorandum of Understanding was created to allow for exchange of case information between EDD and the Internal Revenue Service. The EDD uses Internal Revenue Service case information to issue assessments for amounts owed to EDD, saving significant time associated with conducting an audit and sending a strong message to the employer community on the risks of non-compliance. Increased collaboration will also leverage existing resources, achieve increased voluntary compliance, and send a consistent message to all taxpayers. This multi-agency compliance approach presents a united effort to taxpayers and their representatives.

Criminal Tax Evasion Program (CTEP)

The CTEP within EDD's Investigation Division is a specialized law enforcement unit which enforces the provisions of the CUIC. To accomplish this mission, the Investigative Division provides investigative services to prevent, detect, and investigate violations of fraud committed against the California Unemployment Insurance, Disability Insurance, and other programs administered by EDD. Working with law enforcement throughout California, along with JESF partner agencies, CTEP works to enforce the CUIC on the most noncompliant businesses who strive to evade their employment tax obligations using underground economy schemes.

SUMMARY OF INFORMATION REQUIRED BY SECTION 329 (d) OF THE CALIFORNIA UNEMPLOYMENT INSURANCE CODE (CUIC)

This section includes information that is mandated by §329(d) of the CUIC which states: “The report shall include, but not be limited to, all of the following.”

Blatant Violations and Noncompliance

The CUIC §329(d)(1) states: “The number of cases of blatant violations and noncompliance with tax and cash-pay laws identified, audited, investigated, or prosecuted through civil action or referred for criminal prosecution” shall be reported.

2010 Employment Enforcement Task Force Program Results

Joint Inspections	220
EDD Audit Referrals	219
EDD Audits Completed	224
Fraud Penalty Cases	36
EDD Audit Assessments	\$13,677,364
EDD Average Audit Assessment	\$61,060
Previously Unreported Wages	\$49,670,386
Previously Unreported Employees	2,745
DLSE Labor Code §226* Citations	43
DLSE Labor Code §226 Citation Amounts	\$629,500
DLSE Labor Code §3700* Citations	105
DLSE Labor Code §3700 Citation Amounts	\$651,000
Other DLSE Labor Code Citations	33
Other DLSE Labor Code Citation Amounts	\$88,821

*226 = No statements of earnings and deductions

*3700 = No workers’ compensation insurance

2010 EDD Tax Enforcement Group Results

EDD Audit Referrals	166
EDD Audits Completed	154
Fraud Penalty Cases	12
EDD Audit Assessments	\$11,962,537
EDD Average Audit Assessment	\$77,679
Previously Unreported Wages	\$48,472,525
Previously Unreported Employees	2,792

2010 EDD Questionable Employment Tax Practices Program Results

EDD Audits Completed	68
EDD Audit Assessments	\$1,218,893
EDD Average Audit Assessment	\$17,925
Previously Unreported Wages	\$5,921,487
Previously Unreported Employees	173

2010 EDD Criminal Tax Evasion Program Results

Enforcement Activity	Number of Cases	Dollar Amount of Tax Liability
Payroll Tax Evasion Cases in Progress	186	\$50,670,527
EDD Criminal Complaints Filed	11	\$2,885,307
EDD Criminal Prosecutions Completed	16	\$2,057,458

Publicity

The CUIIC §329(d)(2) states: "Actions taken by the strike force to publicize its activities" shall be reported.

- EDD Web Page - http://www.edd.ca.gov/Payroll_Taxes/Underground_Economy_Operations.htm – 14,906 accesses or "hits" in 2010
- EDD Information Sheets

The JESF members have not tracked specific incidences and benefits derived from joint efforts regarding publicity.

Internet Sites

The EDD's Underground Economy Operations Web page address is:

http://www.edd.ca.gov/payroll_taxes/underground_economy_operations.htm#joint_enforcement_strike_force.

Informant Contacts

The CUIIC §329(d)(3) states: "Efforts made by the strike force to establish an advertised telephone hotline for receiving referrals from the public" shall be reported.

The CUIIC §329 empowers JESF to establish procedures for soliciting referrals from the public, including, but not limited to, an advertised telephone hotline.

In an effort to improve customer service and make it easier for the public to report violations of payroll tax, labor, and licensing law, JESF established a toll-free hotline in 1997. The number is (800) 528-1783. This number can be reached 24 hours a day, 7 days a week. Outside of business hours, or when the line is engaged, an automated voice mail system answers the phone and records messages with lead information. In 2010, the JESF toll-free hotline received 503 contacts from informants wishing to provide information on potential underground economy activities. The hotline is marketed on EDD's public web page under "Report Fraud," during

presentations given by EDD's Taxpayer Education and Assistance Program, and by other EDD staff when appropriate. Additionally, the JESF Hotline and other JESF contact information is publicized on several EDD Information Sheets available to the public via the internet and at EDD Public Service Counters.

In addition to the allegations received via the toll-free hotline, JESF received 3,023 contacts from informants directly from the internet via the fraud reporting function which is accessed from the EDD Home Page at <https://askedd.edd.ca.gov/asp/frmFraud.aspx>, email at ueo@edd.ca.gov, written correspondence, and fax. All of these avenues allow individuals to provide information on businesses operating in the underground economy.

Information Sharing

The CUIIC §329(d)(4) states: "Procedures for improving information sharing among the agencies represented on the strike force" shall be reported.

Underground economy businesses constantly develop new schemes to avoid detection of their illegal activities. As these new schemes are identified, information regarding the schemes is shared with member agencies, business associations, and labor organizations. There is an ongoing need for JESF staff to be aware of the various types of schemes used in industries prone to underground economy activity. This knowledge facilitates the development of detection and enforcement techniques necessary to stop the illegal activities. Information is shared as follows:

- ❑ On-the-job experiences
- ❑ Informal ad-hoc joint management meetings
- ❑ Semi-annual management meetings with member agencies

Cooperation

The CUIIC §329(d)(5) states: "Steps taken by the strike force to improve cooperation among participating agencies, reduce duplication of effort, and improve voluntary compliance" shall be reported.

Cooperative efforts among JESF member agencies continue to evolve and grow stronger. The operations of EETF have forged closer ties and improved coordination of enforcement activities among EDD, DIR, and DCA. Among DCA programs, the Contractors State License Board, Bureau of Automotive Repair, and Bureau of Security and Investigative Services have been active participants in EETF operations. These partnerships and joint operations have improved program results in all the participating agencies, thereby providing the agencies with incentives for continued cooperation and expansion of existing relationships.

During the past several years, Memoranda of Understanding have been developed to facilitate the sharing of information and databases across enforcement partner agencies and to enhance cooperation and joint enforcement of labor, tax, and licensing laws.

Strides have been made in increasing cooperation among all licensing, labor law, and payroll tax enforcement agencies. A coordinated effort now exists that involves not only JESF member agencies, but also other local, federal, and State entities. Cooperative efforts are expected to continue and grow as the operations of JESF become more successful and as other agencies become more aware that cooperative efforts produce successful results.

Recommendations for Statutory Changes

The CUIIC §329(d)(6) states: “Recommendations for any statutory changes needed to accomplish the goals described in paragraph (7) of subdivision (c)” shall be reported.

The CUIIC §329(a) includes as one of the participating JESF members, the Office of Criminal Justice Planning. The Office of Criminal Justice Planning was defunded in 2005. It is recommended that §329(a) be amended to remove the Office of Criminal Justice Planning from the listing of JESF member agencies.

BLATANT VIOLATOR CASES

The following examples of blatant violation cases detected by the Joint Enforcement Strike Force (JESF) include the most flagrant cases where schemes were used by businesses to avoid payroll tax, labor, insurance, and licensing laws; and where Employment Development Department (EDD) found fraud or intent to evade payment of payroll taxes:

Employment Enforcement Task Force (EETF) Blatant Violator Cases

- An EDD EETF agent and a Deputy Labor Commissioner of Department of Labor Standards Enforcement (DLSE) conducted an inspection of a restaurant business. The inspection was initiated as part of a restaurant sweep in the San Jose area. At the time of the inspection, the restaurant was registered with EDD as a corporation. The corporation simultaneously operated five restaurants and a night club. During the inspection, the team observed five employees working at the business location. The DLSE agent issued a Notice to Discontinue for failure to provide daily time records. A subsequent EDD audit revealed that the employer had been out of compliance for a period of four years. The EDD tax auditor determined that the employer failed to report subject wages of \$7,294,667 paid to 41 unreported employees. The employer was assessed \$1,700,427 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD EETF agent and a Deputy Labor Commissioner of DLSE conducted an inspection of a security guard firm. The lead was initiated from a DLSE wage claim alleging that the employer was not paying wages or insufficient wages, and paying some employees in cash. The employer is registered with EDD, but was underreporting the number of workers as well as the total amount of the payroll at the time of the inspection. An EDD audit examination revealed that there were two entities via a Unity of Enterprise and both businesses had been out-of-compliance for four years. The EDD auditor determined that both businesses combined failed to report subject wages in the amount of \$15,596,419 and 21 unreported employees. The employer was assessed for a combination of \$4,240,650 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD EETF agent and a Contractors' State License Board investigator conducted a joint inspection of a construction company. The inspection was initiated as part of a random inspection of construction sites in that geographical location. The entity was a corporation and was registered with EDD at the time of the inspection. The corporation operated as a general building contractor, Class B, specializing in custom residential homes; eight workers were observed at the time of the inspection. A subsequent EDD audit revealed that the employer had been out of compliance for a period of four years. The EDD tax auditor determined that the employer failed to report subject wages paid to 14 unreported employees. The employer was assessed \$203,791 for unpaid payroll taxes, penalties, and interest, including fraud. The employer is the registered owner of two other businesses with EDD and has outstanding liabilities of \$376,000.
- An EDD EETF agent and a Deputy Labor Commissioner of DLSE inspected a garment manufacturing business. The lead was initiated from a DLSE wage claim that also alleged that the employer was operating without the required garment manufacturer license. The DLSE investigator issued a citation in the amount of \$31,000 for paying wages in cash without deduction statements. A subsequent EDD audit revealed that

the employer failed to report subject wages paid to 28 employees in the amount of \$680,000. The employer was assessed \$279,820 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

- An EDD EETF agent, Alcohol Beverage Control agent and police officers from the Santa Ana Police Department conducted an inspection of a bar/nightclub operation. The lead was provided by the Alcoholic Beverage Commission investigators resulting from their surveillance work that showed the employer had unreported workers. The inspection revealed that the employer was underreporting his employees as 15 additional workers were found on the premises. A subsequent EDD audit was conducted and the audit revealed that the employer failed to report subject wages in the amount of \$1,760,000. The employer was assessed \$485,409 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD EETF agent, the Alcoholic Beverage Control agent, Deputy Labor Commissioner of DLSE, and police officers from the Temecula Police Department conducted an inspection of a bar and nightclub. The lead was provided to EDD by the Temecula Police Department. The business was registered with EDD at the time of the inspection, but was underreporting the number of workers and the amount of payroll. The DLSE Investigator issued a citation for \$8,000 for eight workers working without a valid worker's compensation policy. A subsequent EDD audit was conducted and the audit revealed that the employer failed to report subject wages in the amount of \$750,611 for 19 additional employees. The employer was assessed \$194,747 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

Tax Enforcement Group (TEG) Blatant Violator Cases

- An EDD TEG agent completed an investigation on a private charter air service in southern California. The TEG agent determined that the business was registered with EDD at the time of the investigation, but was underreporting the number of workers and the amount of payroll. Based on the information obtained from the informant, the workers being paid as independent contractors provided the same type of services as some acknowledged and reported workers. The case was referred to the San Bernardino Area Audit Office. The audit revealed that the employer failed to report subject wages in the amount of \$9,776,493 for 33 employees. The employer was assessed \$866,173 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD TEG agent conducted an investigation on a commercial electrical contractor doing business in the Los Angeles area. This investigation was initiated due to a lead received from the Office of Contract Compliance of the City of Los Angeles. The TEG agent obtained copies of Certified Payroll Reports from a Public Works Contract which the employer had completed. This information provided clear evidence that the employer was not in compliance with EDD reporting requirements. The case was referred to the Anaheim Area Audit Office where an audit was conducted. The audit revealed that the employer failed to report subject wages in the amount of \$4,963,274 for 28 employees. The employer was assessed \$319,546 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD TEG agent initiated an investigation on a construction company located in northern California. This investigation was the result of information provided to the Franchise Tax Board from an informant who stated that the employer had advised the employees that they would not be receiving W-2s. In addition to the information

provided by the informant, the TEG agent discovered that this employer was claiming significantly more "Cost of Labor" on their Franchise Tax Board Personal Income Tax Return than wages being reported to EDD. The case was referred to the Oakland Area Audit office. The audit revealed that the employer failed to report subject wages in the amount of \$1,180,001 for 38 additional employees. The employer was assessed \$138,910 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

- An EDD TEG agent conducted an investigation on a painting contractor doing business in the San Francisco Bay Area. This investigation was initiated due to a complaint by the Work Preservation Fund [a private, non-profit labor-management cooperative program formed in 1977 to promote fair contracting in public construction through contract compliance] alleging that workers were being incorrectly reported. Workers who worked on the public works jobs were not reported on the Certified Payroll Reports and there were workers on the Certified Payroll Reports who had not worked on the Public Works jobs. The TEG agent found discrepancies in the wages reported to EDD and those reported on the Certified Payroll Reports prompting further investigation into the activities of the business. The case was referred to the Oakland Area Audit Office where an audit was conducted. The audit revealed that the employer failed to report subject wages in the amount of \$3,545,847 for 39 additional employees. The employer was assessed \$425,089 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD TEG agent conducted an investigation on a plumbing contractor doing business in the San Jose area. The TEG investigation was triggered by a claim filed in the United States District Court for the Northern District of California for unpaid overtime. The TEG investigation revealed that the employer had paid cash wages to the workers and concealed these payments as reimbursements or donations. The case was referred to the San Jose Area Audit Office where an audit was conducted. The audit revealed that the employer failed to report subject wages in the amount of \$3,749,383 for 14 additional employees. The employer was assessed \$315,132 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

JESF Joint Criminal Prosecution Cases

The JESF member agencies refer cases to their respective criminal investigation organizations. The following are two examples of cases that JESF member agencies worked together to prosecute in 2010.

- The EDD Investigation Division and the California Department of Insurance conducted a joint criminal investigation of a trucking and excavating contractor in San Francisco County. It was alleged that the employer intentionally underreported wages of acknowledged employees to EDD and intentionally did not report additional employees and their wages to EDD. Additionally, the employer withheld payroll taxes from the employees' wages and did not remit the taxes withheld to EDD. The employer also misreported wages and employees to State Compensation Insurance Fund (SCIF) for workers' compensation purposes. The San Francisco County District Attorney's Office prosecuted the employer. On June 9, 2010, the employer was convicted of CUIC §2110.5 and California Insurance Code §11880(a), and was sentenced to one year in the county jail to be served as home detention in Idaho through electronic monitoring. The employer was also sentenced to five years formal probation. The employer was ordered to pay EDD and SCIF \$629,235 and \$280,764 in restitution, respectively. The employer submitted a payment of \$500,000 towards restitution at sentencing. The EDD

received \$235,000 of the \$500,000 as an “upfront” payment. The employer was ordered to pay interest at 10 percent per year on the remaining restitution balance and pay at least \$12,000 per year towards restitution to be distributed between EDD and SCIF.

- The EDD Investigation Division and the California Department of Insurance conducted a joint criminal investigation of a general contractor in Sacramento County. It was alleged that the employer intentionally underreported wages to EDD and did not report additional employees and their wages to EDD to avoid paying the proper payroll taxes. The employer also did not report the wages and employees to insurance carriers, SCIF, and Zenith Insurance Company. The Sacramento County District Attorney’s Office prosecuted the employer. On April 13, 2010, the employer was convicted of CUIIC §2117.5 and California Insurance Code §11880(a) and §11760, and was sentenced to serve 120 days community service and placed on 3 years informal probation. The employer was ordered to pay EDD, SCIF, and Zenith Insurance Company \$168,526, \$90,000, and \$6,406 in restitution, respectively. The EDD restitution payment of \$168,526 was received on April 19, 2010.

This report was prepared by the Tax Branch of the California Employment Development Department

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