

*California Labor and Workforce Development Agency*



**Edmund G. Brown Jr.**  
Governor

# **Joint Enforcement Strike Force On the Underground Economy**

## **2011 Report**

**Employment Development Department  
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## **JOINT ENFORCEMENT STRIKE FORCE PROGRAM OVERVIEW AND HIGHLIGHTS**

This legislatively mandated report provides the annual 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 the 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, Department of Industrial Relations, and Department of Insurance. The Franchise Tax Board, Board of Equalization, Department of Justice, and Internal Revenue Service are not statutory partners but are encouraged to participate in the strike force.

The underground economy affects businesses and workers throughout the State of California. Businesses willfully avoid labor, licensing, and tax laws by dealing in cash and/or using other schemes to conceal their activities. These schemes allow businesses to mask their true tax liability from the various federal and State government licensing, regulatory, and tax agencies. This allows unlawful businesses to gain a competitive advantage over other businesses that report and pay their fair share of taxes. Furthermore, 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 that often increase their workers' risk for injury.

The underground economy is also referred to as tax evasion, tax fraud, cash pay, and payments under-the-table or off-the-books. The goals of the 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.

The following are specific enforcement teams, programs, or strategies undertaken by the JESF members to combat underground economic activities. This information includes various statistics on the accomplishments by the strike force. While the JESF is a cooperative effort among many agencies, the statistics within this report are limited to data from the EDD programs. Other participating agencies do not separately account for activities undertaken with JESF partners; therefore, those program statistics are not available for inclusion in this legislatively mandated report.

#### Employment Enforcement Task Force (EETF)

The EETF was the first program implemented by JESF and was created to help meet the legislative intent for this strike force. The goal of the 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 the EDD and the Department of Industrial Relations, Division of Labor Standards Enforcement.

In 2011, the EETF referrals to the EDD's audit program resulted in 22 fraud determinations and assessments totaling \$8,770,165 on 132 employers. 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.

#### Tax Enforcement Group

Another program that is focused on combating employment tax evasion is the Tax Enforcement Group. This program complements the EETF program by focusing efforts on the investigation of employers through the use of various database resources. The Tax Enforcement Group staff conducts investigations in situations where traditional on-site investigations are not practical or effective in detecting noncompliance. Staff utilizes techniques such as analyzing 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 likely existence of unreported wages and underground economy activities.

If noncompliance is substantiated by the Tax Enforcement Group investigator, the case is referred to EDD's Audit Program with the information obtained through the investigation. In 2011, the Tax Enforcement Group referrals to the EDD's Audit Program resulted in six fraud determinations and assessments totaling \$11,699,336.

### Questionable Employment Tax Practices

This project was initiated in 2007 and was based on a partnership between the EDD and the federal Internal Revenue Service. The Questionable Employment Tax Practices goal is to reduce the tax gap by identifying businesses that manipulate their payroll to avoid paying their full employment tax liabilities. The EDD uses Internal Revenue Service case information to issue assessments for amounts owed to the State. This multi-agency compliance approach presents a united effort to taxpayers and their representatives that both federal and State tax agencies work together to enforce tax laws. In 2011, the Questionable Employment Tax Practices issued assessments totaling \$82,157 on five employers.

### Criminal Tax Enforcement Program

The EDD also has a Criminal Tax Enforcement Program that focuses on the most serious payroll tax reporting violations committed by California business. The EDD staff assigned to this program work with the JESF partners to investigate and criminally prosecute these most egregious violators. The Criminal Tax Enforcement Program's key partner is the Department of Insurance, which is involved in almost all criminal prosecutions in filing joint charges. This program also works frequently with the Department of Industrial Relations, Division of Labor Standards Enforcement.

## BACKGROUND INFORMATION AND PROGRAM HISTORY

### The Underground Economy

The underground economy affects businesses and workers throughout the State of California. Businesses willfully avoid labor, licensing, and tax laws by dealing in cash and/or using other schemes to conceal their activities and their true tax liability for government licensing, regulatory, and tax agencies. This allows them to gain a competitive advantage over other businesses that report and pay their fair share of taxes. 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 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* describes and estimates California's Income Tax Gap as, "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*, on 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."*

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 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 Legislative History**

As previously stated, the JESF was established 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.

The JESF was originally created via a Governor's Executive Order. Senate Bill 1490 (Chapter 1117, Statutes of 1994) codified the Executive Order by adding §329 to the CUIC. This legislation included 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 the EDD, Department of Industrial Relations, and Department of Consumer Affairs. The Department of Insurance Office of Criminal Justice Planning was formally added to the strike force by Assembly Bill 202 (Chapter 180, Statutes of 2001). However, the Office of Criminal Justice Planning no longer exists due to funding issues. The Franchise Tax Board, Board of Equalization, Internal Revenue Service, and Department of Justice are not required members by statute, but are encouraged to participate in the strike force. The EDD Director or designee serves as the chairperson for the strike force.

The JESF members recognize the importance of combining enforcement activities with an ongoing educational program. Member agency staff conducts outreach presentations to business and labor organizations throughout the State and to representatives of local government agencies. These presentations inform a large number of individuals and taxpayers about California's efforts and activities to prevent underground economic activities. The outreach efforts also are an excellent source for leads, as well as providing education to the employer community on how to comply with each agency's laws.

## **Employment Enforcement Task Force Operations**

The EETF was the first program implemented by JESF and was created to help meet the legislative intent for this strike force. In addition to the required statutory members, the Department of Insurance and the Department of Consumer Affairs (which includes the Contractors State Licensing Board, Bureau of Automotive Repair, and Bureau of Security and Investigative Services), also participate on the EETF teams.

Leads are received from other agencies, concerned 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 the EDD. When there is a reasonable belief that there is noncompliance with any licensing, labor or payroll tax laws, agents from each participating agency conduct joint inspections of business worksites to determine if there is cause for further enforcement action.

Since its inception, the 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 the 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 to businesses that comply with federal and State laws, the EETF conducts investigations only if there is reasonable belief that businesses are violating provisions of the CUIA, 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 access points where underground economic activity leads are obtained. These points include:

- Reports to the dedicated telephone hotline,
- Referrals submitted on the Internet webpage,
- Referrals made by other government agencies,
- Tips from industry sources, and
- Leads developed by the EETF investigators.

## **Tax Enforcement Group Operations**

The Tax Enforcement Group uses available data and income tax return analyses to initiate investigations when the more traditional and labor intensive on-site investigations are not practical. This allows agents to target their resources in a more cost-effective way producing a better return on investment. There are several component projects that focus on specific industries known to engage in underground economic activities. These industry specific projects include the following.

### Construction Enforcement Project

This project began as a pilot project in 1994 and was expanded statewide effective December 31, 1995. While the Construction Enforcement Project has continued since its initial implementation, it was expanded and re-focused to address the growing level of underground economic activity created by the recent economic and building industry downturn in 2011. The change to this project was partly due to leads reported from building industry trade organizations.

### Janitorial Enforcement Project

This was initiated by the EDD in 1998. The Tax Enforcement Group agents continue to utilize various investigative techniques and strategies to identify janitorial industry businesses operating in the underground economy.

### Public Works Enforcement Project

This project partners with labor organizations to ensure that employers who are required to pay prevailing wage amounts accurately report those wages to the EDD.

### Security Guard Enforcement Project

This project was implemented under the JESF to address underground economy and employment tax evasion in this industry. The Tax Enforcement Group investigators work cooperatively with the Department of Consumer Affairs' Bureau of Security and Investigative Services to obtain information identifying these noncompliant employers.

It should be noted that reports of businesses that do not have workers' compensation insurance and have a physical business location that can be visited are typically referred to the EETF for action, while reports that would benefit from further data analysis are referred to the Tax Enforcement Group. For examples of the Tax Enforcement Group activities related to the JESF efforts, please refer to Attachment A.

### **Questionable Employment Tax Practices Program Operations**

The Questionable Employment Tax Program was initiated in 2007 as a collaborative effort between the EDD and the federal Internal Revenue Service. As previously stated, the goal of the program is to reduce the tax gap that exists between businesses that comply with tax laws and those businesses that operate illegally in the underground economy.

A Memorandum of Understanding was created to allow for exchange of case information between the EDD and the Internal Revenue Service. The EDD uses Internal Revenue Service case information to issue assessments for payroll taxes and associated penalties and interest owed to the EDD. This saves significant time that would otherwise be needed to conduct a full tax audit, which allows work from both tax agencies to be leveraged to save staff time and generate revenue.

### **Criminal Tax Enforcement Program Operations**

The EDD's Investigation Division has created the Criminal Tax Enforcement Program, which is a specialized law enforcement unit that investigates criminal violations of the CUIC. To accomplish this mission, this law enforcement unit provides investigative services to prevent and detect fraud committed against California's unemployment insurance, state disability insurance, and other programs administered by the EDD. This unit works with law enforcement throughout California, along with the other JESF partner agencies, in initiating a search warrant, interviewing witnesses, and conducting other criminal investigative activities.

This unit focuses on the most serious payroll tax reporting violations committed by California employers and also works with federal and county prosecutors to convict individuals who commit serious violations of tax and benefit fraud. The EDD Criminal Tax Enforcement Program is staffed by sworn peace officers who have worked on other 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.

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

This section includes information that is mandated by §329(d) of the CUIIC, which requires this report to include information and data related to the underground economy and the JESF efforts.

**Blatant Violations and Noncompliance**

The §329(d)(1) of the CUIIC requires this legislatively mandated report to include “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.”

Employment Enforcement Task Force Program Results Calendar Year 2011

Number of Joint Inspections	324
Number of EDD Audit Referrals	177
Number of EDD Audits Completed	132
Number of Fraud Penalty Cases	22
Total Amount In EDD Audit Assessments	\$8,770,165
Average Amount of an EDD Audit Assessment	\$66,441

Tax Enforcement Group Results Calendar Year 2011

Number of EDD Audit Referrals	87
Number of EDD Audits Completed	67
Number of Fraud Penalty Cases	6
Total Amount In EDD Audit Assessments	\$11,699,336
Average Amount of an EDD Audit Assessment	\$174,617

Questionable Employment Tax Practices Program Results Calendar Year 2011

Number of EDD Audits Completed	5
Total Amount In EDD Audit Assessments	\$82,157
Average Amount of an EDD Audit Assessment	\$16,431
Number of Previously Unreported Employees	45

## Criminal Tax Enforcement Program Results Calendar Year 2011

	# of Cases	Amount of Tax Liability
Payroll Tax Evasion Cases in Progress	186	\$47,023,693
EDD Criminal Complaints Filed	27	\$7,948,481
EDD Criminal Prosecutions Completed	18	\$3,269,475

### **Publicity and Marketing Outreach Strategies**

The §329(d)(2) of the CUIC requires this report to include actions taken by the strike force to publicize its activities. The JESF accomplishes this in several ways as cited below.

- The EDD web page includes information on the underground economy. This web page provides the viewer with data, access to prior reports, program and operation information, etc. The Web Page address is:  
[http://www.edd.ca.gov/Payroll\\_Taxes/Underground\\_Economy\\_Operations.htm](http://www.edd.ca.gov/Payroll_Taxes/Underground_Economy_Operations.htm)

In calendar year 2011, there were 16,226 accesses or "hits" to this web page.

- The EDD also has a variety of information sheets and publications available to the public, businesses, and taxpayers. These publications include:
  - ✓ Joint Enforcement Strike Force Brochure, DE 665
  - ✓ Informational Sheet on Employment Enforcement Task Force, DE 631
  - ✓ Informational Sheet on EDD Underground Economy Operations, DE 631UEO
  - ✓ Underground Economy Operations Lead Referral / Complaint Form, DE 660

### **Informant Contacts**

The §329(d)(3) of the CUIC also mandates this report include information on the efforts made by the strike force to establish an advertised telephone hotline for receiving referrals from the public. This section also 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, the 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 from individuals wanting to provide lead information.

In 2011, the JESF toll-free hotline received 462 contacts from informants wishing to provide information on potential underground economy activities. The hotline is marketed on the EDD's public web page under "Report Fraud." This hotline is marketed during presentations given by the 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 Informational Sheets available to the public, on the Internet, and at EDD Public Service Counters.

In addition to the allegations received via the toll-free hotline, the JESF received 3,023 leads or referrals from informants directly using the on-line "Report Fraud" Internet feature. This feature is accessible in two formats, an automated fill-in referral form or a simple e-mail link to the Underground Economy Operations mail box. These two Internet features can be accessed on the EDD Home Page at the following addresses.

- <https://askedd.edd.ca.gov/asp/frmFraud.aspx>, or
- [ueo@edd.ca.gov](mailto:ueo@edd.ca.gov).

All of these avenues allow individuals to provide information on businesses operating in the underground economy.

### **Information Sharing**

The §329(d)(4) of the CUIC requires this report to include procedures for improving information sharing among the agencies represented on the strike force.

Businesses operating in the underground economy constantly develop new schemes to avoid detection of their illegal activities. As these new schemes are identified by the JESF members, information regarding the schemes is shared with member agencies, business associations, and labor organizations. There is an ongoing need for the JESF staff to be aware of the various types of schemes used in industries prone to underground economy activity. This knowledge transfer 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 §329(d)(5) of the CUIC also requires this report to include steps taken by the strike force to improve cooperation among participating agencies, reduce duplication of effort, and improve voluntary compliance.

Cooperative efforts among JESF member agencies continue to evolve and grow stronger. The operations of the Employment Enforcement Task Force have forged closer ties and improved coordination of enforcement activities among EDD, Department of Industrial Relations, and Department of Consumer Affairs. Among the Department of Consumer Affairs programs, the Contractors State License Board, Bureau of Automotive Repair, and Bureau of Security and Investigative Services have been active participants in the Employment Enforcement Task Force 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. A coordinated effort now exists that involves not only the JESF member agencies, but also other local, federal, and State entities. Cooperative efforts are expected to continue and grow as the operations of the JESF become more successful and as other agencies become more aware that cooperative efforts produce successful results.

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

## **Recommendations for Statutory Changes**

The §329(d)(6) of the CUIC requires this report to provide any recommendations for any statutory changes needed to accomplish the goals described in paragraph (7) of subdivision (c).

The §329(a) of the CUIC cites 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 statutory JESF member agencies.

## BLATANT VIOLATOR CASES

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

### Employment Enforcement Task Force Blatant Violator Cases

- An EDD EETF agent and a Department of Industrial Relations Deputy Labor Commissioner conducted an inspection of a restaurant in Orange County. The inspection was initiated as part of a targeted compliance check of restaurants in the Huntington Beach area. At the time of the inspection, the business was registered with the EDD and had correctly reported employees from early 2003 through 2007.

Beginning in 2008, the employer reported significantly less employees each quarter. During the inspection, the team determined that there were 20 to 25 employees working at the business location. A subsequent EDD audit revealed that the employer was out of compliance by underreporting the number of workers employed by the business, as well as, the total amount of payroll. The EDD tax auditor determined that the employer failed to report subject wages of \$937,180 paid to 25 unreported employees. The employer was assessed \$304,306 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

- An EDD EETF agent and a Department of Industrial Relations Deputy Labor Commissioner conducted an inspection of a bar in the City of Visalia. The lead was provided by an EDD Collections Representative from the Fresno Collections Office. The business was registered with the EDD at the time of the inspection, but was underreporting their payroll. During calendar year 2008, the business had filed payroll tax returns reporting zero payroll for the entire year. The Department of Industrial Relations issued a citation for no workers' compensation insurance in the amount of \$1,000 for one employee who was working behind the bar at the time of the inspection. Two bartenders and a corporate officer were also later identified during the investigation. The employer was assessed \$38,484 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD EETF agent and a Department of Industrial Relations Deputy Labor Commissioner conducted an inspection of a dry cleaner in Los Angeles County. The lead was initiated by the Department of Industrial Relations' Division of Labor Standards Enforcement for potential payroll and workers' compensation violations and allegations of cash pay over several years. At the time of the inspection, the employer was registered with the EDD, but was underreporting the number of workers as well as the total amount of the payroll. The EDD auditor determined that the business failed to report subject wages in the amount of \$643,822 and 14 unreported employees. The employer was assessed \$172,063 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 in the community of La Jolla. This was a random inspection of construction sites in that geographical location. The entity was a corporation, but was not registered with the EDD at the time of the inspection. The corporation operated as a general building contractor, and 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 six years. The EDD tax auditor determined that the employer failed to report subject wages and was assessed \$185,947 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

### **Tax Enforcement Group Blatant Violator Cases**

- An EDD Tax Enforcement Group agent conducted an investigation based upon an anonymous complaint that was filed against a security guard company. The complaint alleged that the business was paying cash to its security guard staff. The Tax Enforcement Group agent secured information from the JESF partnering agency of Bureau of Security and Investigations Services showing that the business was licensed for four security guards. During the investigation, the guards informed the Bureau of Security and Investigations representative that they did not have a security guard registration and that they were currently employed by the employer. The case was referred to the EDD's Anaheim Area Audit Office to conduct a tax audit. The audit revealed that the employer failed to report subject wages in the amount of \$3,726,000 for 50 additional employees. The employer was assessed \$1,162,515 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD Tax Enforcement Group agent conducted an investigation of a Los Angeles area garment manufacturer based upon information obtained from the United States Department of Labor. The Department of Labor investigation provided detailed information showing that the business was paying cash to its garment workers. The case was referred to the Van Nuys Area Audit Office where a tax audit was conducted. The audit determined that the employer failed to report subject wages on 63 additional employees. The employer was assessed \$1,098,614 for unpaid payroll taxes, penalties, and interest, including fraud penalties.
- An EDD Tax Enforcement Group agent conducted an investigation of a construction contractor based upon information received from the Department of Insurance, regarding a workers' compensation insurance audit. The workers' compensation audit revealed that the employer was paying over \$500,000 in wages to California employees, but had only claimed \$25,000 in California wages. The workers' compensation insurance auditor was told that all employees were paid in cash. The Tax Enforcement Group investigator secured information from the JESF partnering agency and the case was referred to the San Jose Area Audit Office.

The audit was conducted at the employer's place of business in Arizona. The audit revealed that the employer failed to report subject wages in the amount of \$554,954 for 32 additional employees. The employer was assessed \$826,326 for unpaid payroll taxes, penalties, and interest, including fraud penalties.

- An EDD Tax Enforcement Group agent conducted an investigation based upon a complaint filed by a former employee against a magazine publishing company. The complaint alleged that the business was not reporting wages paid to its publication staff. The case was referred to the San Bernardino Area Audit Office to conduct an audit. The audit revealed that the employer failed to report subject wages for 52 employees. The employer was assessed \$185,825 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 examples of cases that JESF member agencies worked together to prosecute in 2011.

- The EDD Investigation Division and the California Department of Insurance Fraud Bureau conducted a joint criminal investigation of a general contractor in Santa Clara County. It was alleged that the employer intentionally misclassified all office personnel, laborers, framers, and unlicensed construction workers as independent contractors. The employer also did not report the employees and their wages to the insurance carriers for workers' compensation purposes.

The Santa Clara County District Attorney's Office prosecuted the employer. On February 14, 2011, the employer was convicted of §2109, 2110.5, 2117.5, 2118.5 of the CUIIC and §11880(a) and 11760(a) of the California Insurance Code. The employer was sentenced to one year in county jail to be served as home detention through electronic monitoring, and three years of formal probation. The employer was also ordered to pay the EDD, State Compensation Insurance Fund, and First Comp Insurance (insurance carrier) \$815,743.26, \$594,293.22, and \$170,280 in restitution respectively. Full restitution of \$1,580,317 was received prior to sentencing.

- The EDD Investigation Division and the Santa Clara County District Attorney's Office conducted a joint criminal investigation against two owners of a shuttle and limo service company in Santa Clara County. It was alleged that the employers intentionally failed to report acknowledged employees' wages, failed to remit deductions withheld from the employees' wages, and failed to pay contributions due on the employees' wages to the EDD. The employers also incorrectly reported employees' wages to the insurance carriers.

On July 30, 2009, the main subject was convicted of §2117.5, 2118.5 of the CUIIC, §11880(a), §11760(a) of the California Insurance Code, and §19706 of the California Revenue and Taxation Code. The main subject was sentenced on February 28, 2011, to serve 10 years in State prison and pay EDD, State Compensation Insurance Fund, Franchise Tax Board, and First Comp Insurance \$925,206, \$1,180,710, \$541,258, and \$109,522 in restitution, respectively.

The other subject was convicted on April 1, 2009, of §2118.5 of the CUIIC, §11880(a), §11760(a) of the California Insurance Code, and §19706 of the California Revenue and Taxation Code. This subject was sentenced on May 19, 2009, to serve one year in County jail, five years of formal probation, and pay EDD, Franchise Tax Board, Insurance Corporation of America, and First Comp Insurance \$780,000, \$657,798, \$181,680, and \$98,028 in restitution, respectively.

- The EDD Investigation Division and the Orange County District Attorney's Office conducted a joint criminal investigation of a tree service and gardening contractor in Orange County. It was alleged that the employer intentionally underreported wages of acknowledged employees to the EDD. The employer also intentionally did not report other employees and their wages. The employer also withheld payroll taxes from the employees' wages and did not remit the taxes withheld to the EDD. The employer also misreported wages and employees to the State Compensation Insurance Fund for workers' compensation purposes. The Orange County District Attorney's Office prosecuted the employer.

On November 7, 2011, the employer was convicted of §2118.5 of the CUIIC, and §11880(a) of the California Insurance Code. The employer was sentenced to ten years of formal probation. The employer was ordered to pay the EDD and the State Compensation Insurance Fund \$494,564.00 in restitution. The EDD received \$113,749.72 at sentencing.

- The EDD Investigation Division and the Orange County District Attorney's Office conducted a joint criminal investigation of a roofing contractor in Orange County. It was alleged that the employer intentionally underreported wages to EDD, and did not report additional employees and their wages to the EDD in order to avoid paying the proper payroll taxes. The employer also did not report the wages and employees to the State Compensation Insurance Fund for workers' compensation coverage. The Orange County District Attorney's Office prosecuted the employer.

On November 30, 2011, the employer was convicted of §2117.5 of the CUIIC, and §11880(a) and §11760 of the California Insurance Code. The employer was sentenced to serve five years in State prison. The employer was ordered to pay the EDD and State Compensation Insurance Fund \$1,320,176 and \$30,039,584 in restitution respectively. This is purported to be the largest known Workers' Compensation Premium Fraud case in California history.



**Edmund G. Brown Jr.**  
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**LABOR AND WORKFORCE DEVELOPMENT AGENCY**

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**Director**  
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