



MISCLASSIFIED

CONTRACT TO CHEAT

California tax cheats difficult to find

By BoNhia Lee

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CRAIG KOHLRUSS / THE FRESNO BEE

The Fresno Housing Authority uses public funds to build projects, including the Renaissance at Santa Clara. McClatchy viewed thousands of certified payroll documents from the Fresno Housing Authority and the city and county of Fresno between 2009 and 2012. The Bee found no indication that employees were misclassified as independent workers -- a clean sheet, something that's not as likely to happen in other parts of the country.

FRESNO, CALIF.— — By some estimates, thousands of California construction workers are left to toil in the shadows, exploited by contractors who use an illegal

scheme to save money and avoid paying employment taxes and workers compensation.

Finding the evidence, though, can be difficult. It's even more challenging to find it in Fresno County, where the dominating labor issue is wage theft.

Local agencies and state regulators say they scrutinize publicly funded projects to make sure workers are protected and that contractors play by the rules.

CONTRACT TO CHEAT

Workers don't have protections. Companies don't withhold taxes. Regulators don't seem to care. McClatchy reporters spent a year unraveling the scheme, using little-noticed payroll records that show how widespread this practice has become and what it costs us.

[Read the full series](#)

But regulators, labor unions and contractor groups say workers -- and the government programs designed to help them in hard times -- still get cheated.

A yearlong McClatchy investigation found the problem is especially prevalent in Southern states where unions are weak and state regulators turn a blind eye to the issue.

McClatchy's nationwide review of federally funded construction projects meant to jump start a recession-battered economy found widespread cheating among contractors on public projects. They break the law by treating workers, who should be employees, as independent contractors. That leaves workers without workers compensation insurance and employment taxes that often go unpaid.

The practice, known as misclassification, can save an employer 30% to 50% on payroll costs, the same as an employer who pays in cash. That allows the company to underbid a job by 25% and still make a profit.

At the same time, state and federal governments lose billions of dollars in tax revenue needed to pay for critical social service programs. Law-abiding businesses are forced to pay higher taxes and expenses while being at a

disadvantage in competing for jobs.

Misclassification is "part of undermining our economy -- illegally cutting costs and creating an unlevel playing field," said California state labor commissioner Julie Su. It's a problem that's been growing in the last 10 to 15 years, she said. "Employers are trying to find other ways to classify working people to increase profit."

In California, state labor agencies, economists and labor advocates acknowledge that misclassification does exist, but it's just one of a number of labor issues that aren't easy to uncover.

In Fresno, The Bee viewed thousands of certified payroll documents from the Fresno Housing Authority and the city and county of Fresno between 2009 and 2012. The Bee found no indication that employees were misclassified as independent workers.

Rates of misclassification in three states



Florida



North Carolina



Texas

	Florida	North Carolina	Texas
Rate of misclassification	15.5%	35.2%	37.7%
Total construction workers in state	522,741	278,919	805,895
Misclassifications found / workers surveyed	502 / 3,234	3,068 / 8,713	1,881 / 4,987
Total misclassified workers in state (estimate)	93,412	102,310	316,793

Source: Integrated Public Use Microdata Series 2011 Census records and McClatchy survey of workers. Estimated number derived from specific rates of misclassification over 12 specialties.

Under a Depression-era federal law called the Davis Bacon Act, contractors on government projects must file documents every week showing employees are fairly paid. But those documents provide only a small snapshot of how contractors handle wages and tax payments.

Cheating employers are smart, say California labor compliance officers and contractor trade organizations. They avoid detection by misidentifying employee trades to pay lower rates and shaving off work hours to avoid paying workers their full week's pay.

Some go as far as accompanying employees to the bank to retrieve money from a cashed check. Others simply underreport the number of employees they have on a job.

While these examples could be considered wage theft, they often go hand-in-hand with payroll violations, construction experts and state labor leaders say.

"It's a huge burden," said Bruce Wick, risk management director for the California Professional Association of Specialty Contractors, a Sacramento nonprofit representing speciality trade contractors and suppliers. "It's a burden obviously to all the governments who are not getting the tax revenue they should get and of course legitimate employers and contractors (who) are losing a lot of good business."

"And it's unfair to workers who are not protected by workers compensation, labor laws, California Division of Occupational Safety and Health laws and are driven underground because they're afraid to file taxes," Wick said.

The California Franchise Tax Board estimates the state's tax gap -- the difference between what is owed and what is paid -- for personal and business taxes is about \$10 billion a year across all industries.

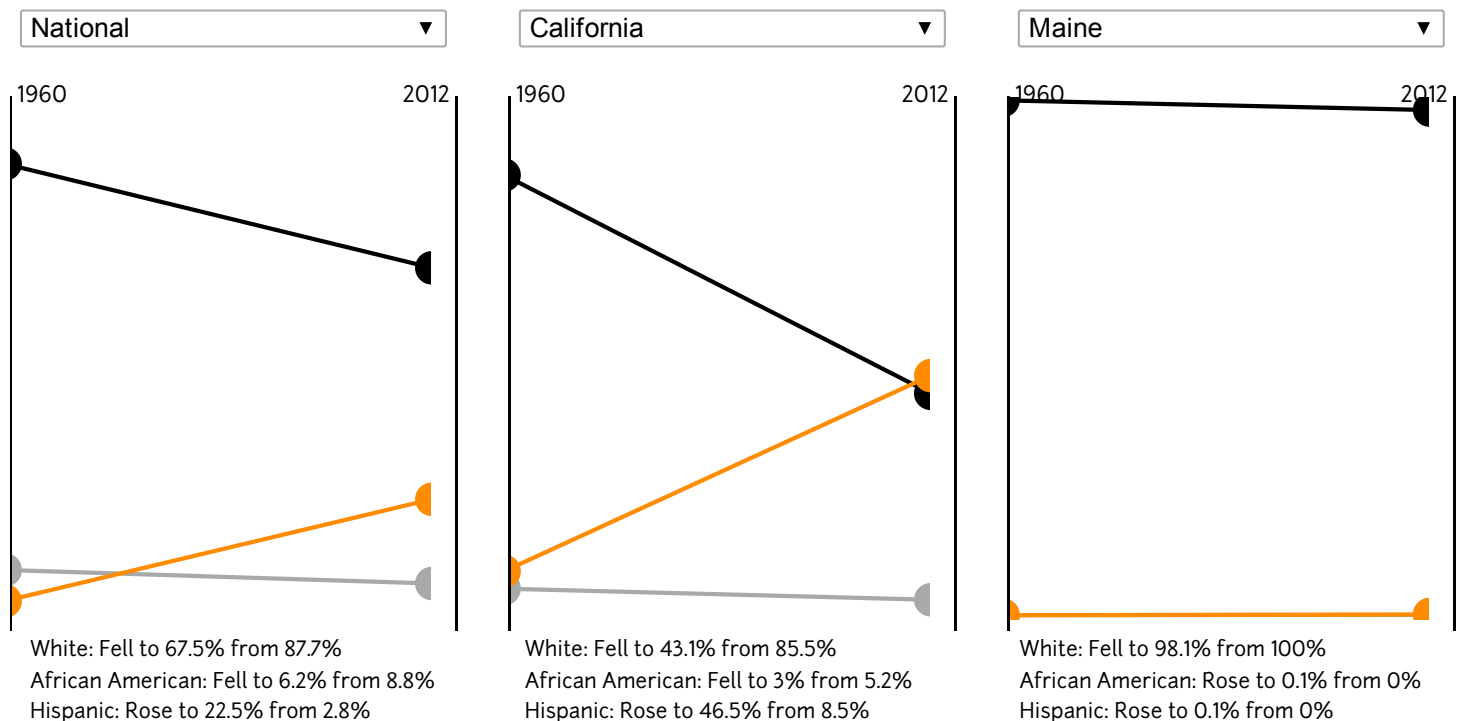
A study on the growing number of California's unreported workers and independent contractors released Labor Day weekend estimates the total tax gap among those workers in the \$152 billion construction industry, which includes residential construction, was more than \$774 million in 2011. The study, which was funded by the United Brotherhood of Carpenters, was prepared by the

Economic Roundtable, a public benefit research organization based in Los Angeles.

More Hispanics, fewer whites in construction work

Over the past 50 years, the number of construction workers who are white fell, supplanted by Hispanic workers. California saw the biggest swing; Hispanic workers now outnumber whites on construction sites.

Meanwhile, Maine has seen the smallest shifts since 1960. In 2012 more than 98 percent of construction workers in the state were white.



That breaks down to a loss of \$301 million in taxes to the federal government and \$473 million to the state, the report said.

"Employers who are cheaters, who are gaming the system, are able to thrive, which squeezes out responsible, high-road employers and brings down the level of wages and working conditions for everyone in addition to squeezing the public purse to some extent," said researcher Yvonne Yen Liu, who co-wrote the report.

Close monitoring

Fresno Housing Authority leaders believe they are keeping a close eye on payrolls and the conduct of the construction companies they hire.

The authority has a stake, said executive director Preston Prince, because it provides residents with construction-related job training in the hope that they are hired by the companies that build the authority's affordable housing and homeless developments.

"We have this public trust" to make sure workers are protected, Prince said. "I feel like we're following the right steps. If that's not the case, we'd love to know."

Fresno Housing Authority Projects

The housing authority built or renovated four developments between 2009 and 2012.



The Fresno Bee

The housing authority built three new developments for low-income families and the homeless between 2009 and 2012: Renaissance at Santa Clara in downtown Fresno, and Renaissance at Alta Monte and Parc Grove Commons, both in central Fresno. The agency also spent more than \$1 million on renovations to Pacific Garden in southeast Fresno.

Prince can count on one hand the inconsistencies with payroll records over the last six to eight years. Most times it involved a contractor who incorrectly identified an employee's trade, Prince said.

One such problem surfaced on the housing authority's Renaissance at Santa Clara project, where a contractor listed workers installing prefabricated metal fence panels, gates and stairs as laborers instead of ironworkers.

The mistake, discovered during a federal Housing and Urban Development audit, meant each worker was underpaid nearly \$17 per hour. The workers have since been paid back wages, according to HUD.

No workers on the project were misidentified as independent contractors, however, a HUD official said.

The housing authority and the city and county of Fresno all have labor compliance officers, field technicians and engineers who monitor weekly payroll documents and conduct interviews at construction sites to make sure employees are paid correctly and treated fairly.

The authority goes a step further by sending its development project coordinator, who oversees payroll, to training seminars hosted by HUD once a year to stay on top of labor laws and issues.

A tight screening of each contractor also helps to weed out the bad players, Prince said. Contractors are required to submit a qualification statement that lists past work experience. References are called.

Business names are also run through a database that lists businesses flagged for work violations, said Michael Duarte, the authority's senior development manager.

The housing authority's last four large general contractors were Ashwood Construction, Quiring General and Zumwalt Construction, all of Fresno, and Brown Construction of Sacramento. None of the authority's contractors have popped up on the HUD list, Duarte said.

But Prince and the other government agencies admit that while they monitor payrolls and job sites, they are not always checking to see if employers label their employees as independent contractors.

"The bigger issue is, yes, we're looking to see are they getting their wages or dollars and fringe benefits -- whether it's the actual fringe benefits or the cash compensation," Prince said.

Fresno County's senior engineering technician, Darren Findley, is in charge of checking payrolls for county projects such as road resurfacing, sewer installation, storm drainage and park improvements.

Looking for signs of misclassification

Regulators inspect payroll reports to make sure companies are paying wages deemed decent enough by federal labor officials. They are missing a sign of potential abuse. The government officials checking the records ignore signs that companies are treating workers who ought to be employees as independent contractors. The clues are clear: company owners leave blank boxes for withholding taxes. Some write instead "pays own taxes" or "1099" or "paid cash."



Properly filed payroll form

Show proper payroll form

Hide notes

Show possible misclassification

County field inspectors help Findley interview construction workers. An engineer, whose task it is to make sure construction projects are built according to the approved plans, also checks in with construction employees.

"I'm not the police, but we want correct payrolls," said Findley, who makes sure the hourly rates for workers are correct and that fringe benefits are paid. "I'm checking to make sure x plus y equals z."

If there is a problem, the county, like the housing authority, will approach the prime contractor with questions and a request to fix it. Findley said no major problems have occurred in the two years he has worked with the department.

The state agencies that enforce labor and tax laws rely on random audits and employees to report suspicious activity.

The state Employment Development Department conducted 862 audits and investigations during the fiscal year 2013-14 and reclassified more than 11,000 workers who were not reported as employees or were considered independent contractors, the department said.

Seventy-nine of those audits were performed by the Fresno Area Audit Office in communities between San Joaquin County in the north to Kern County in the south and in the mountain areas on the Valley's eastern edge. Nearly 500 workers were reclassified by employers, including those treated as independent contractors.

California construction companies are more likely not to report employees than to misclassify them as independent contractors, according to the Economic Roundtable's report.

The group studied labor force statistics between 1972 and 2012 to determine the size of the "informal" economy or the number of unreported construction employees and those labeled independent contractors.

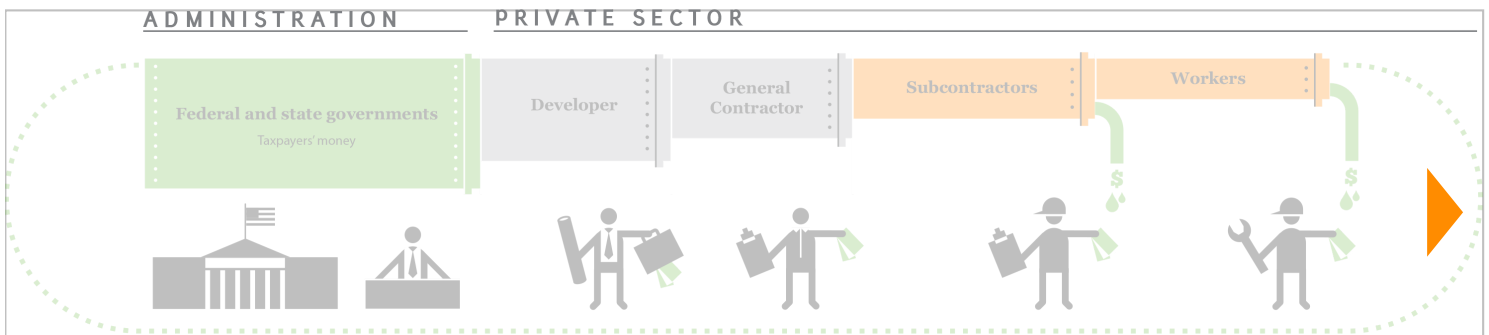
The study found more than 104,100 construction jobs unreported in 2011, compared to nearly 40,000 misclassified.

While the report did not say why contractors would choose one move over the other, researcher Liu guessed that misclassification requires "more paperwork and going through the motion of saying this worker is an independent worker, whereas not reporting, you don't do anything at all."

How the money flows

A broken pipeline

- 1: GOVERNMENT STIMULUS. Washington sent \$840 billion to communities across the country to jump-start construction projects - and the economy. Federal funds flowed as businesses earned contracts and workers made money.



GRAPHIC: ALVARO VALINO, SPECIAL TO MCCLATCHY

Uncovering violations

Interviews with labor compliance officers from local unions and statewide advocacy groups turned up few instances of misclassification in the central San Joaquin Valley and more cases of wage theft or underreporting employees.

Steve Bridges, a Central Valley field supervisor for the Foundation for Fair Contracting, a joint labor-management cooperative committee founded in Fresno and now based in Sacramento to educate the construction industry, recalls finding misclassification only once -- on a water meter installation project in Reedley five years ago.

A Louisiana contractor, who did not have workers compensation insurance as required in California, labeled its employees as independent contractors on payroll sheets, paying them by piecework for a total of about \$50 a day, Bridges said.

"I contacted the State Contractors License Board," Bridges said. "They went down and issued a fine for \$22,000." The state labor commission fined the company \$405,000, he said.

Tom Holsman, chief executive officer for the Associated General Contractors of California, said most contractors are in compliance with labor laws, which are extensive here compared to other states. Those who don't follow the rules don't understand the law or the difference between an employee and an independent contractor, he said.

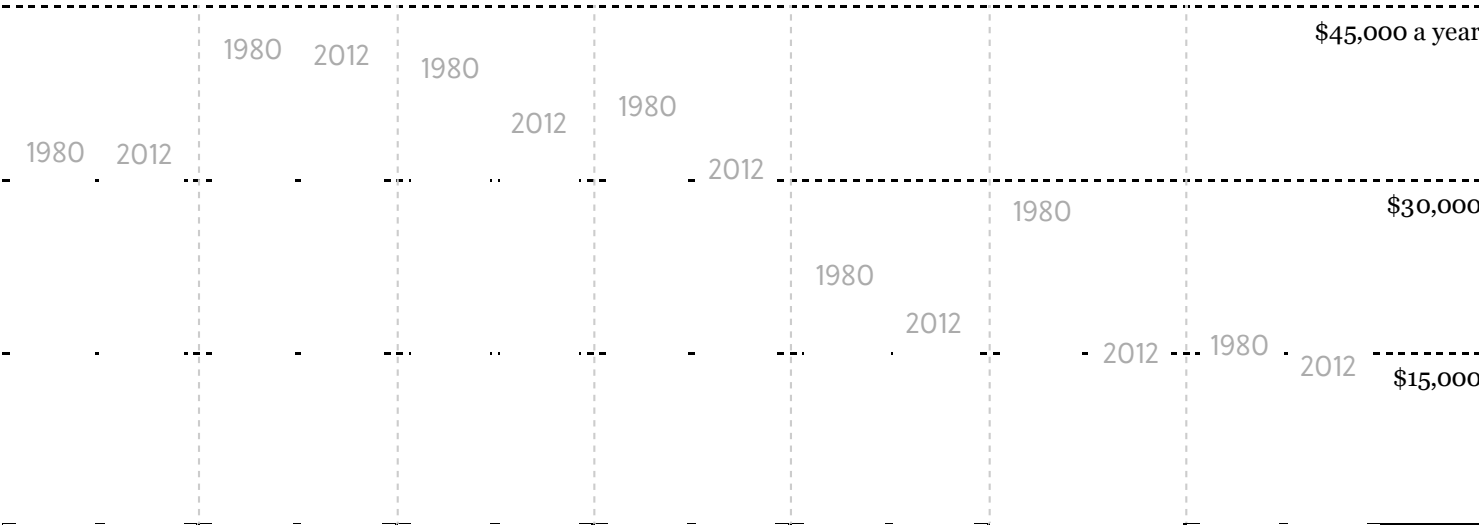
"This law went from seven steps to about 22 steps in the last five years," Holsman said. "It just created the opportunity for people and employers to misunderstand, not to maliciously avoid or purposely avoid (the law), but rather just not understand."

California leaders have stepped up their efforts to combat labor and payroll violations.

The Department of Industrial Relations' Labor Enforcement Task Force is a 2012 reincarnation of an earlier coalition that was created with the "idea that different entities should work together to share information and uncover multiple violations in the same workplace," said Su, the state labor commissioner.

Construction wages: 1980 and now

Since 1980, construction wages have remained at about \$34,000 a year since 1980—adjusted for inflation. Drywall installers saw average wages fall by about 40 percent, the biggest decrease, while construction supervisors saw less than a 1 percent drop in their wages since 1980.



All Construction	Supervisors	Electricians	Plumbers	Carpenters	Drywall installers	Painters
-0.68%	-0.87%	-11.7%	-14.28%	-17.43%	-41.27%	-10.27%

environment for all businesses. The members include the Development Department, the Contractors State License Board and the California Department of Insurance.

The Employment Development Department has its own Joint Enforcement Task Force with the same members, including the Department of Industrial Relations.

"Violations do not occur in isolation," Su said. "We found that many of the employers who engage in one type of violation -- let's say they underreport the number of employees -- fail to pay minimum wage or overtime, or misclassify."

"You uncover one violation," she said, "and it's often a doorway into multiple violations."

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We want to know your thoughts and experiences with misclassification. Share your feedback directly with the reporter at (559) 441-6495, blee@fresnobee.com or @bonhiale on Twitter.

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