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# **Underground Economy Benchmark Report (RCW 18.27.800)**

*Fiscal Year (FY) 2021 Annual Report to the  
Legislature*

December 2021



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# Executive Summary

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## Introduction

The Department of Labor & Industries (L&I), Department of Revenue (DOR), and the Employment Security Department (ESD) are pleased to provide this Fiscal Year 2021 (FY 2021) report on underground economy benchmarks, as required by Chapter 18.27.800 RCW. The three agencies share data and collaborate to uncover and take action against participation in the underground economy, such as tax misreporting and other forms of fraud, in order to protect consumers, workers, and employers who obey the law.

## Progress and achievements in Fiscal Year 2021

In FY 2021 (July 1, 2020 through June 30, 2021), the departments shared information on contractor registration, taxes, and other data to discover and hold accountable hundreds of bad actors in the underground economy. In general, this work included education, detection, targeted audit selection, prosecution, and debt collection. The agencies also collaborated on prevailing wage requirements and activities. It's *important* to note that the COVID pandemic decreased activities, compared to previous years. Yet, the work remained important and significant.

*Together, L&I, DOR and ESD:*

- Uncovered nearly 2,300 unregistered businesses and assessed over \$41.5 million in unpaid taxes, premiums, penalties and interest.
- Made certain unregistered employers knew payment options, requirements, and interest and penalty waivers.

*L&I:*

- Educated and trained more than 400 construction contractors through multiple webinars.
- Reminded consumers how to hire legitimate contractors through the “Protect My Home” campaign.
- Issued over 900 infractions to unregistered contractors.
- Assessed nearly \$11 million in premiums, penalties and interest to 550 unregistered accounts.
- Collected \$275.1 million in delinquent employer premiums.

*DOR:*

- Provided online outreach and assistance to consumers through SuspectFraud.com and led discussions with stakeholders on new and relevant ways to find leads in the underground economy.
- Registered over 360 non-compliant businesses.
- Assessed taxes totaling nearly \$30 million from over 260 businesses.
- Collected over \$63 million through its Tax Discovery Program.
- Recovered over \$30,000 in fraud-related dollars.

*ESD:*

- Found over 4,500 unreported or misclassified workers through audits.
- Assessed more than \$571,000 on unregistered accounts.
- Assigned auditors to pandemic-related high priorities—not returning to conduct audits until October 2020.

# Introduction

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The underground economy is the loose network of businesses and individuals that fail to register or report a significant part of their business activities with authorities, as required by law. They not only neglect to pay their fair share of taxes, workers' compensation premiums, and unemployment insurance contributions but they gain an unfair advantage over competitors. Consumers are also put at risk because there may be no bond or insurance to protect them from these bad actors.

Together, L&I, DOR, and ESD share data and collaborate in other areas to uncover and take action on tax misreporting and other forms of fraud that contribute to the underground economy. This report provides updated information about how hundreds of businesses in the underground economy are discovered and held accountable through shared information on contractor registration and taxes, and other electronic data. The agencies remain committed to working together and sharing information to prevent fraud and reduce the effects of the underground economy.

The three agencies, along with external stakeholders, participate on the Construction Underground Economy Advisory Committee to fight the underground economy in the construction industry. The committee's balance between business, labor, government, and consumer interests makes it possible to share information, which leads to new ideas and shared perspectives, improves collaboration, and strengthens key connections. The committee meets two times a year and the three agencies provide updates on current work, audit and compliance data, and stakeholder requests.

# Progress and Achievements in FY 2021

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This section describes progress and achievements of each of the three partner agencies in working together to prevent fraud and reduce effects of the underground economy in Washington.

## DEPARTMENT OF LABOR & INDUSTRIES HIGHLIGHTS

L&I protects the safety, health, and financial security of Washington's workers and citizens. As part of this responsibility, the department is committed to helping honest workers and businesses through education and outreach, and by cracking down on dishonest ones.

FY 2021 highlights include:

- **Education** – For first-time or lower-level violators, the focus is on education and coaching for voluntary compliance. Over the past year, L&I held many educational workshops, provided information online and proactively reached out to consumers to improve compliance through education.
- **Detection** – While education is the first step in increasing compliance, repeat violators and egregious bad actors get a more comprehensive and sustained focus aimed at stopping their violations. In the area of employer fraud and misreporting, L&I investigators pursued five misrepresentation penalties, totaling over \$1,250,000. Contractor compliance inspectors issued over 900 infractions to unregistered contractors.
- **Audit selection** – About 43 percent of employers are referred for audits and found to owe premiums remains. L&I keeps this percentage consistent by screening and refining referrals and focusing resources on those businesses most likely to be found out of compliance in an audit, while limiting the number of audits of businesses typically in compliance.
- **Prosecutions** – Staff investigated and referred three employer cases to the Attorney General's Office for possible criminal prosecution, though they filed no criminal charges in FY 2021.
- **Collections** – Collections staff collected \$275.1 million in delinquent employer premiums for workers' compensation insurance, though not all of this can be attributed to the underground economy.

- **Prevailing Wage Program** – Education continues to be the priority: L&I held 11 workshops for more than 300 participants around the state. In enforcement, L&I issued more than 640 “strikes<sup>1</sup>” and debarred 132 companies from bidding on public works contracts.<sup>2</sup>

## Educating employers and consumers

L&I is committed to making it easy to do business with the department by providing training focused on contractor registration, like the *Employer’s Introduction to L&I* workshops, with more than 800 attendees this year, and *Contractor Training Days*. Adapting to the pandemic, L&I held webinars for more than 400 contractors statewide. Instructions and explanations of laws and rules are also offered online. For consumers, L&I rolled out an awareness campaign, [Protect My Home](#) on how to hire legitimate contractors, with important education on hiring smart, as well as being aware of common scams.

## Detecting dishonest business practices in construction registration

The most easily recognizable dishonest activity happens in construction. Contractors in the underground economy are typically either unregistered or underreport workers’ compensation responsibilities. This allows them to avoid paying their fair share of premiums. Unregistered contractors put consumers at risk and gain an unfair advantage over competitors that play by the rules.

L&I registers contractors, ensuring they get their required level of bonding and insurance coverage. This ensures some financial recourse for homeowners and suppliers who encounter fraudulent or incompetent contractors.

All contractors must have a valid Unified Business Identifier (UBI) number before applying to L&I and paying a registration fee.

Figure 1 shows the number of contractor registrations from 2011 to 2021. In FY 2021, the number of registrations returned to pre-pandemic levels, setting a new high of more than 65,000 registered contractors in Washington.

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<sup>1</sup> A strike is a notice of a violation of contractor registration, workers’ compensation or prevailing wage requirements

<sup>2</sup> If an employer does not pay a fine or receives a repeat notice of violation of contractor registration, workers’ compensation or prevailing wage requirements, the employer may be “debarred.” When contractors are debarred, they are not permitted to bid on public works projects for one to two years, or until fines are paid.

**Figure 1: Active contractor registrations, 2011-2021, as of June 30, 2021**

Fiscal Year	Contractors with UBI
2011	52,645
2012	51,492
2013	52,250
2014	52,755
2015	54,529
2016	56,652
2017	58,553
2018	63,300
2019	64,808
2020	63,200
2021	65,023

Source: Department of Labor & Industries

### **Contractor penalties**

L&I tracks companies that violate registration laws, misrepresent payroll or employee hours, or conduct business without an L&I certificate of coverage for workers' compensation insurance. In FY 2021, L&I's Construction Compliance Program issued more than 900 infractions to unregistered contractors. This program also penalizes those who submit false information in a contractor application, up to \$10,000. The program issued three such penalties in FY 2021.

L&I denies or suspends contractor registration for not complying with registration laws and rules. A contractor may have their registration suspended for days or weeks, sometimes multiple times per year. During FY 2021, L&I suspended more than 30,000 registrations for the following reasons:

- More than 21,000 cancelled their insurance.
- More than 9,300 cancelled their bond.
- Nearly 500 had unsatisfied judgements against their bond.
- 18 had impaired bonds.
- Nearly 150 had outstanding contractor registration infractions.

Contractors cited for failing to register may reduce their penalty if they voluntarily register and get a bond and insurance within 10 days after the citation. In FY 2021, 187 unregistered contractors took advantage of this option.

## Auditing businesses

While construction is the most visible industry for unregistered businesses to be operating, it also occurs in other industries. L&I audits employers in construction and elsewhere that have workers covered by workers' compensation, focusing on industries with a high injury rate. During FY 2021, L&I performed over 550 audits on unregistered accounts for almost \$11 million in assessed premiums and penalties. In consideration of the pandemic in FY 2021, more unregistered businesses were provided education and given the opportunity to come into voluntary compliance. As shown in Figure 2, of those 550 audits, 401 accounts were identified as owning premium or penalties totaling nearly \$11 million. About 65 percent were in construction, followed by service industries.

**Figure 2: FY 2021 audit results on unregistered or previously registered businesses**

Industry Sector Description	Accounts Assessed	Dollars Assessed
Construction	257	\$2,413,157
Service	95	\$8,014,662
Other*	39	\$287,417
Retail	6	\$16,840
Wholesale trade	1	\$89
Manufacturing	3	\$22,593
<b>Total</b>	<b>401</b>	<b>\$10,754,758</b>

\*"Other" sectors, such as agriculture and forest products. Source: Department of Labor & Industries

## Prosecuting illegal activity

Investigations staff investigated and referred three employer cases to the Attorney General's Office for possible criminal prosecution. There were no criminal filings in FY 2021.

## Collecting debt resulting from violations

Inspectors in the Contractor Compliance program are L&I's eyes and ears in the field for all types of violations. They confirm worker counts, compare them with reported numbers, and refer cases to auditors. They refer potential violations of workers' compensation, prevailing wage, and DOR rules and laws to the appropriate staff or agencies.

Figure 3 shows the number of underground economy violations issued, contractors referred to collections, and contractors referred for auditing from FY 2016 to FY 2021. These numbers have remained relatively stable, even with increased construction activity, which may indicate a cap on workload capacity with current resources and processes.

**Figure 3: Contractor Compliance Program results**

Compliance Action	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Underground Economy Violations Issued	2,030	2,103	2,108	2,420	2,092	1,832
Contractors Referred to Collections Program	1,749	1,710	1,763	1,919	1,504	1,395
Contractors Referred to Audit Program	1,508	1,494	1,710	1,775	1,243	1,080

Source: L&I Contractor Registration Program

### Prevailing Wage Program

L&I’s Prevailing Wage Program is important to ensure fairness for both legitimate contractors and employees. Prevailing wage is the minimum hourly rate for wages, benefits, and overtime that contractors must pay workers on public projects. It ensures workers on public works projects receive a standard rate of wages and benefits for their trade or occupation in their county and that all contractors competing for public works projects pay at least minimum rates.

#### Education and outreach

L&I focuses on improving compliance by educating employers and workers. In FY 2021, the Prevailing Wage program conducted 11 workshops around the state, reaching more than 300 contractors, businesses, and workers.

#### Violations, strikes and debarments

When contractors commit certain violations, the Prevailing Wage program can issue fines and strikes. If a fine is not paid, or additional strikes are received, the company may be debarred which prevents them from participating in public contracts. A contractor can be debarred for one or any combination of the following:

- Violating contractor registration law
- Misrepresenting hours/premiums or failing to obtain a certificate of coverage for industrial insurance
- Violating apprenticeship law

Strikes are reported under the law in which the violation occurred. For contractor registration and workers’ compensation insurance, strikes are cumulative. For example, contractors may receive strikes under the prevailing wage law for violations of contractor registration law (Chapter 18.27 RCW); industrial insurance law (RCW 51.48.020(1) or RCW 51.48.103); or apprenticeship law (Chapter 49.04 RCW). Any combination of two strikes under these laws results in a one-year debarment.

For prevailing wage law, only violations of the same type count toward debarment. Violations of public contracts laws<sup>3</sup> stand alone and do not need to be combined with another violation. Two strikes for paperwork violations under RCW 39.12.050 result in a one-year debarment, and two strikes for failure to pay the prevailing rate of wage under RCW 39.12.065 result in a two-year debarment.

As shown in Figure 4, L&I issued 641 strikes and debarred 132 contractors in FY 2021. This is roughly twice the number of debarments compared to recent prior years.

**Figure 4: Prevailing wage strikes and debarments**

Violation	FY 2019		FY 2020		FY 2021	
	Strikes	Debarments	Strikes	Debarments	Strikes	Debarments
Contractor Registration	860	47	584	34	401	48
Industrial Insurance	78	3	1,303	5	208	11
Contractor Registration and Industrial Insurance	N/A*	22	0	30	0	67
Prevailing Wage: Failing to File Wage Report/False Filing	7	5	10	6	22	5
Prevailing Wage: Failing to Pay Prevailing Wage	3	0	5	1	10	1
<b>Total</b>	<b>948</b>	<b>77</b>	<b>1,902</b>	<b>76</b>	<b>641</b>	<b>132</b>

\*Strikes are reported in each category violated but may result in debarment. Source: Prevailing Wage Program

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<sup>3</sup> RCW 39.12.050, which refers to false filings or failure to file forms such as intents, affidavits, or certified payroll reports; and RCW 39.12.065, which refers to failure to pay prevailing wages.

## DEPARTMENT OF REVENUE HIGHLIGHTS

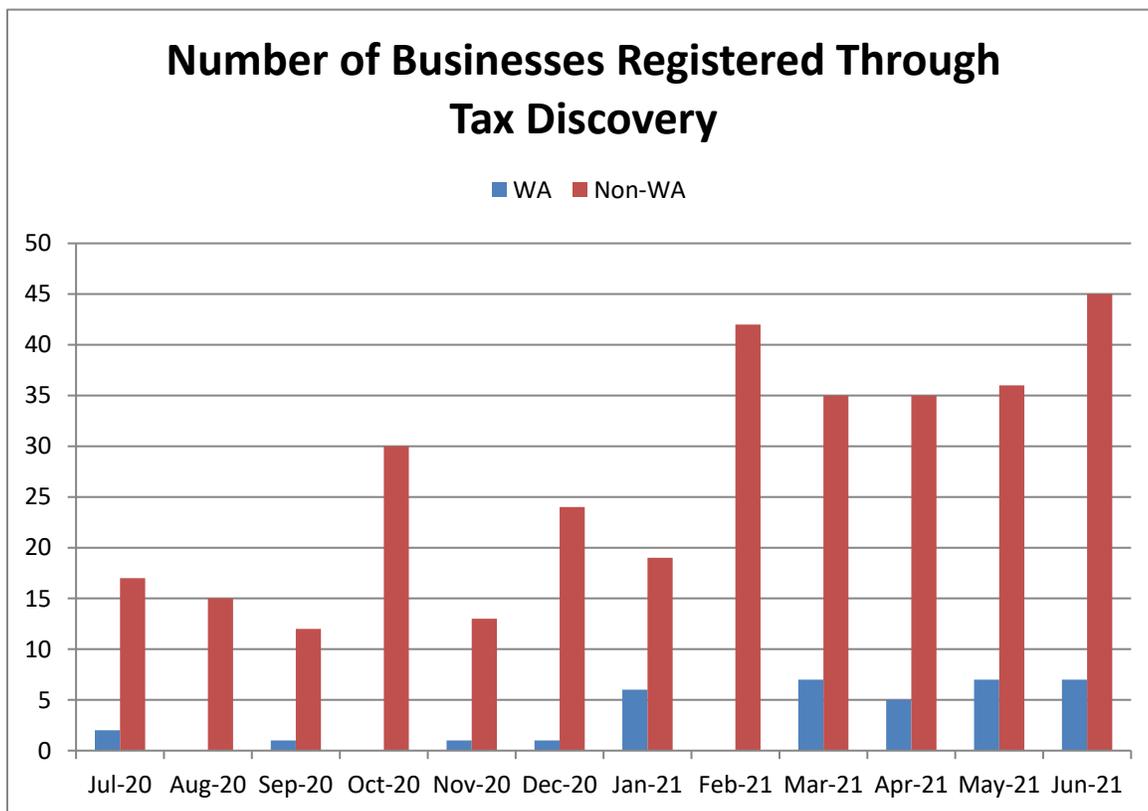
In FY 2021, DOR’s Compliance and Audit divisions continued focus on investigating, assessing and registering both in-state and out-of-state businesses.

In March of FY 2020, the Governor’s state of emergency from the COVID pandemic halted enforcement of collections and assessments—resulting in a significant drop for FY 2020 and 2021. Staff assisted taxpayers with voluntary compliance and making payment arrangements.

DOR investigated over 1,100 businesses in FY 2021, 360 of which were registered through Tax Discovery. Nearly 100 owed taxes—with over \$29 million assessed against them. This included:

- Nine in-state businesses assessed over \$80,000.
- 90 out-of-state businesses assessed over \$28.9 million.

**Figure 5: Number of businesses registered through tax discovery in FY 2021**



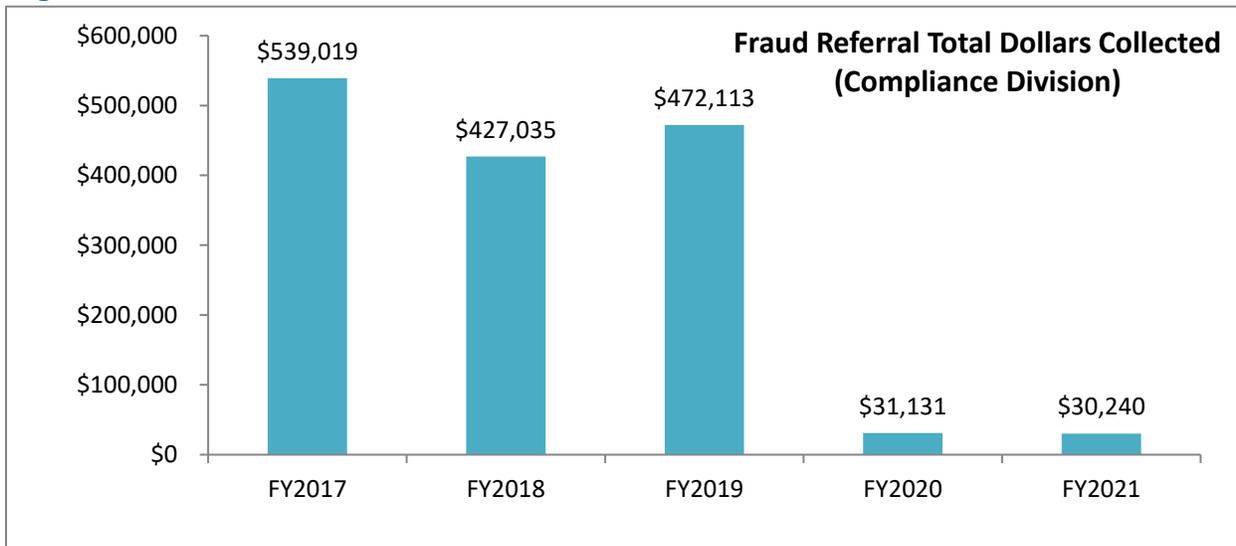
NOTE: In March, FY 2018, DOR replaced its aging tax and licensing systems with a new, integrated system. This affected the agency’s work and reporting—some variances occurred since implementation. Source: Department of Revenue

In addition to finding and addressing unregistered businesses, DOR’s Compliance and Audit divisions refer and investigate fraud cases. The Compliance Division investigates unlicensed vehicles, vessels, and airplanes. DOR continues to focus on education and enforcement to reduce non-compliance and ensure a local presence is maintained.

DOR provides a variety of methods for making fraud referrals, which allow private citizens and other agencies to report cases where they believe fraud is being committed. After a significant increase in FY 2015, collections dropped off in FY 2016—simultaneous to suspension of the *Suspect Fraud* campaign<sup>4</sup>. Since then, the agencies are collectively focused on a narrower audience—directed at the business community through a marketing firm. This reflects a shift in emphasis from consumers toward the business community.

In FY 2017, collections again increased, with some larger assessments resulting from referrals. In FY 2018, DOR configured and implemented a new system, which resulted in a drop in collections as employees learned the new system. In March of FY 2020, the department halted this work during the Governor’s state of emergency, with a significant drop in the collections for both FY 2020 and 2021.

**Figure 6: Fraud referral total dollars collected**



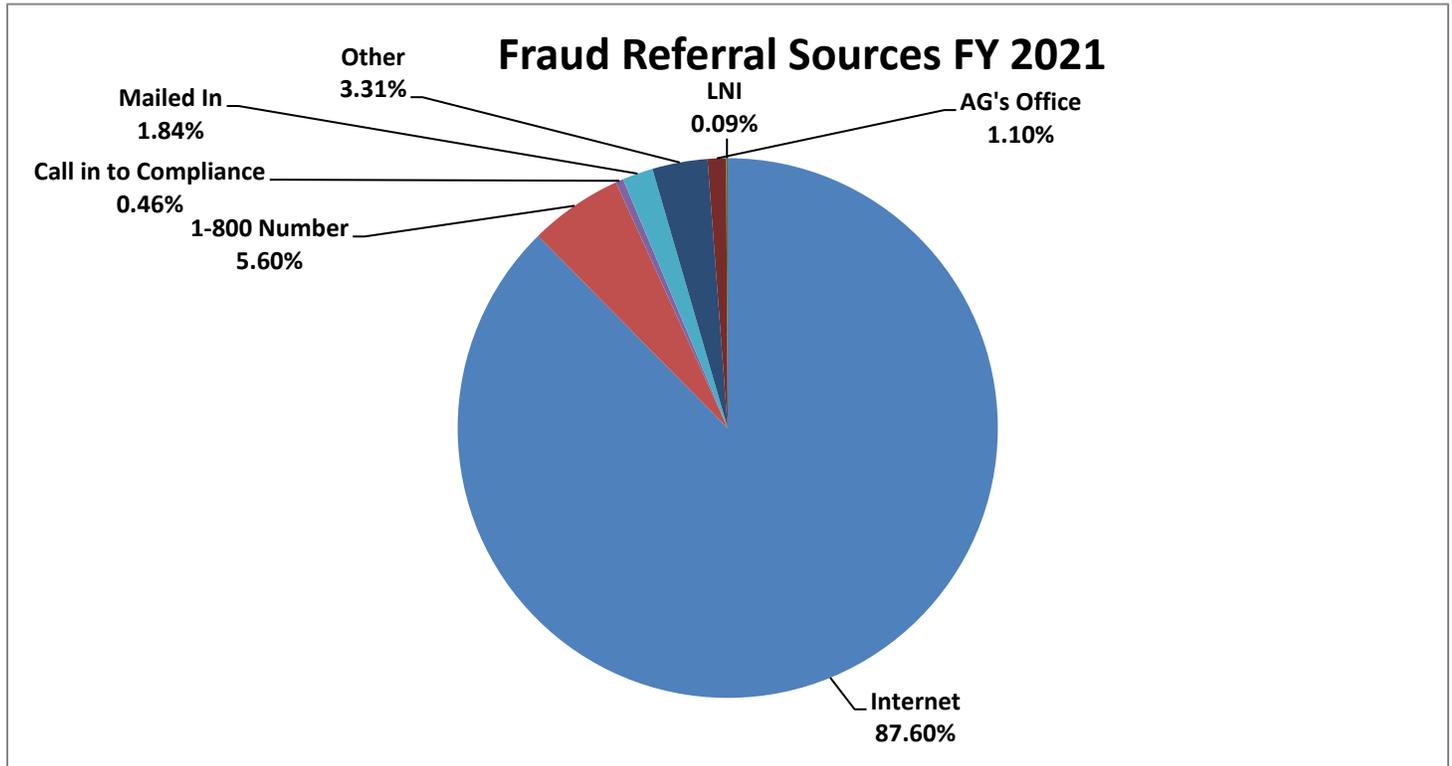
Source: DOR

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<sup>4</sup> L&I, DOR, and ESD sponsored the statewide Suspect Fraud campaign to encourage the public to report fraud.

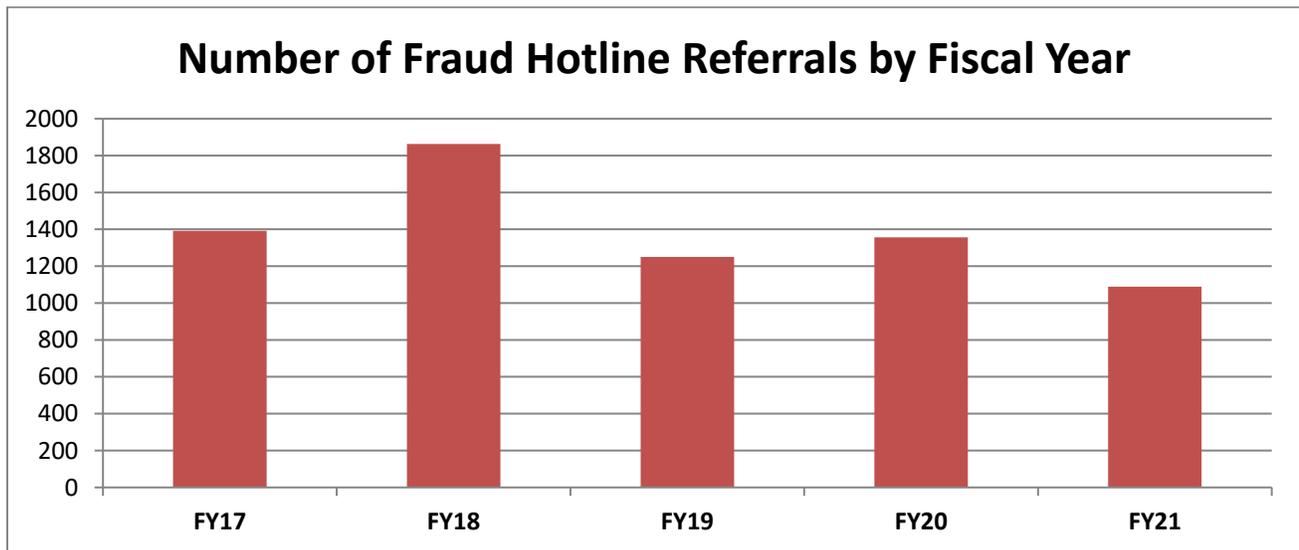
The bulk of fraud referrals are received via the internet and the toll-free hotline but the percentages shifted over the past two fiscal years. In FY 2021, over 87 percent of fraud referrals were made via the website, a significant increase from FY 2020.

**Figure 7: FY 2021 Fraud referral sources**



Source: DOR

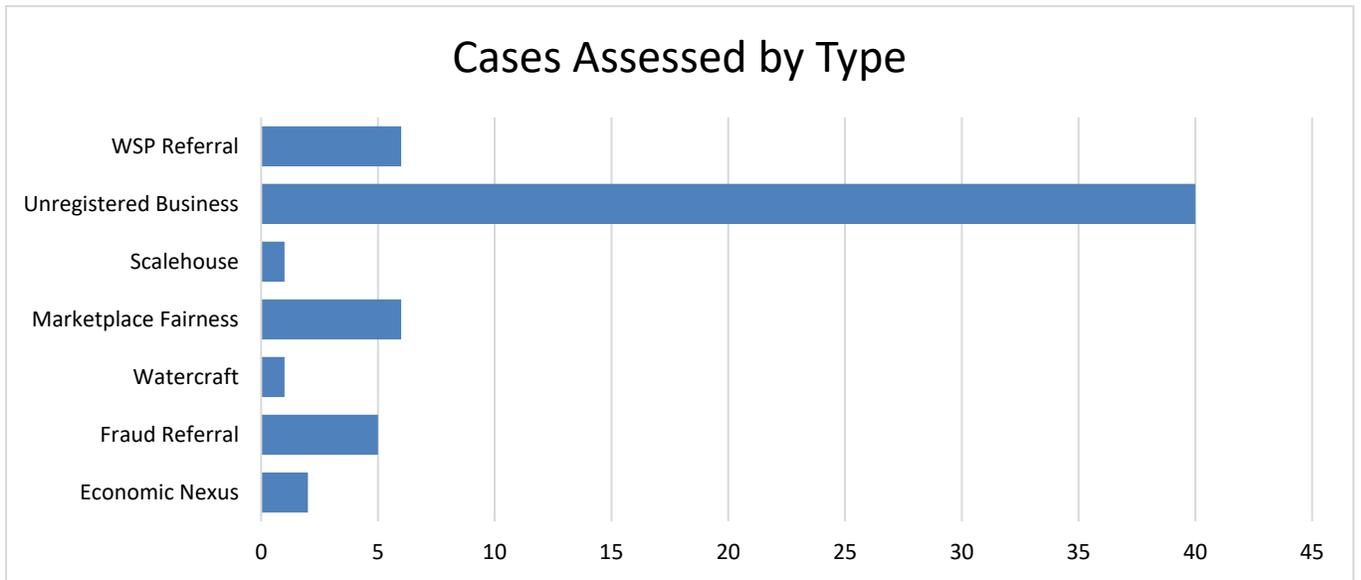
**Figure 8: Number of fraud hotline referrals by fiscal year, FY 2017-2021**



Source: DOR

Referrals for cases from the underground economy come from investigations, shared information with other agencies, and fraud complaints. Unregistered businesses continue to be the largest portion of the tax discovery cases. It's important to note that as resources are dedicated to projects, referrals and collections increase.

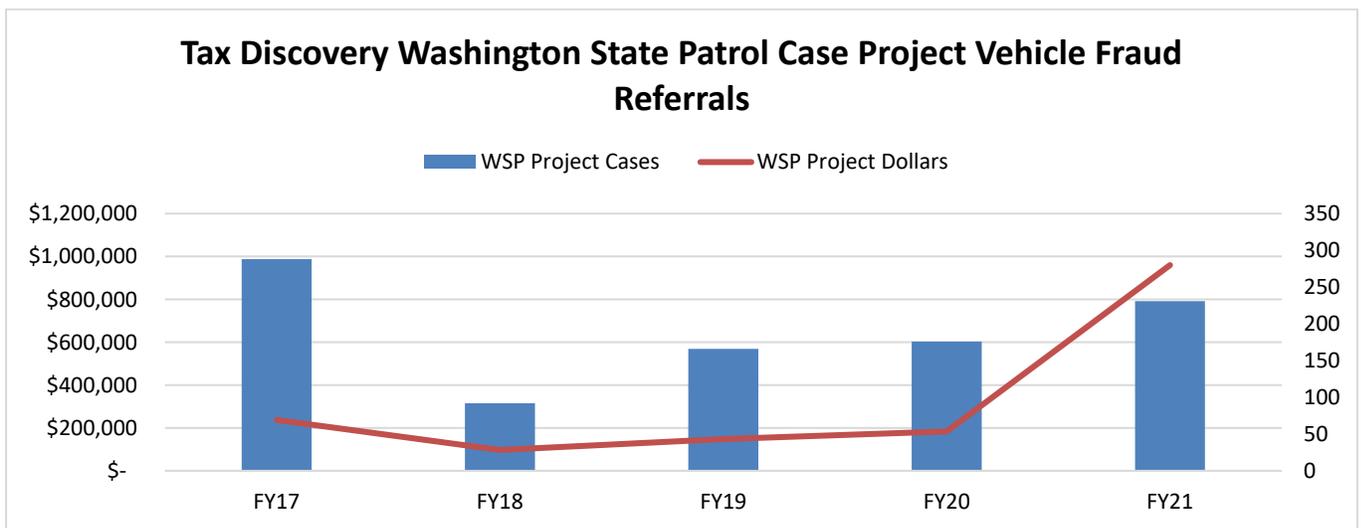
**Figure 9: Tax discovery case type**



Source: Department of Revenue

The Washington State Patrol (WSP) refers cases for investigation related to vehicle fraud, such as registering a vehicle out of state to avoid paying sales or use tax.

**Figure 10: Tax discovery WSP case project vehicle fraud referrals, FY 2017-2021**



Source: Department of Revenue

## EMPLOYMENT SECURITY DEPARTMENT HIGHLIGHTS

The Employment Security Department (ESD) continued identifying employers who failed to report or underreported employees for unemployment insurance. Up to seven full-time employees in five audit regions were dedicated to this purpose. Underground economy auditors also assisted with various tasks such as benefits fraud and blocked benefit claims.

### Underground economy compared to other audits with misclassified employees

Underground economy audits were consistently more productive than all other ESD audits in locating misclassified employees. Underground economy audits found about 16.5 employees per audit, compared to 3.6 employees per all other audits finding previously misclassified employees.

**Figure 11: Underground economy audits**

Quarter	Audits with Misclassified Employees**	Misclassified Employees	Employees Per Audit
3/20	0	0	0
4/20	31	334	10.8
1/21	24	447	18.6
2/21	4	195	8.8
<b>Total</b>	<b>59</b>	<b>976</b>	<b>*16.5</b>

\*Number of employees per audit equals the number of misclassified employees divided by the number of audits with misclassified employees found.

\*\*Number of audits may vary depending on ESD staffing levels at any given time. Source: ESD

**Figure 12: All other audits**

Quarter	Number of Audits with Employees Found	Number of Misclassified Employees	Employees Per Audit
3/20	48	75	1.6
4/20	279	665	2.4
1/21	381	2280	6
2/21	295	573	1.9
<b>Total</b>	<b>1,003</b>	<b>3,593</b>	<b>*3.6</b>

\*Number of employees per audit equals the number of misclassified employees divided by the number of audits with misclassified employees found. Source: ESD

## Electronic reporting

ESD encourages employers electronically file quarterly unemployment tax reports. There are currently two options for employers to file reports electronically—each option tailored to specific business needs. In FY 2021, over 95 percent of employers filed their tax reports electronically.

## Identifying unregistered employers

ESD's underground economy auditors are not currently traveling and searching for unregistered employers. In addition to receiving tips from other state agencies, the auditors use a variety of tools to identify fraudulent employers, including:

- A toll-free fraud hotline.
- An online fraud reporting tool.
- In-house special investigations.
- Benefit redetermination units that investigate and resolve issues about benefit claims.

## Employer education

As in previous years, ESD looks for opportunities to educate employers on tax liability issues and tax reporting requirements. One of the educational tools the agency uses is the ESD voluntary audit program, allowing employers to request an audit (and education) from ESD on correct tax reporting procedures. If the audit results in any findings, ESD waives any penalties associated with the audit.

## COMBINED AGENCY HIGHLIGHTS

Representatives of L&I, DOR, and ESD, along with business, labor, government, and consumer representatives, make up the Construction Underground Economy Advisory Committee. This committee provides an efficient way to share information, leads to new ideas and shared perspectives, and improves collaboration between all parties. The committee held two virtual meetings in 2021, in May and October, to coordinate efforts and share information.

## Results from auditing unregistered businesses

In FY 2021, DOR, ESD and L&I found and audited nearly 2,300 unregistered or previously registered businesses. In these cases, the agencies “involuntarily registered” the businesses as part of the auditing process. The three agencies assessed over \$41.5 million in taxes, penalties, and interest on the previously unregistered firms. Due to differences in the regulatory authority of the three agencies, they each tend to audit different types of businesses.

- DOR may audit all businesses in the state, regardless of whether they have workers. DOR also has a much stronger role in auditing out-of-state businesses in Washington.
- Both L&I and ESD audit only employers with workers covered by workers' compensation or unemployment insurance.

- L&I tends to focus on industries with a high injury rate and has specific additional regulatory authority over the construction industry.
- ESD tends to focus on industries with higher unemployment rates.

## Conclusion

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### CONTINUING THE PARTNERSHIP

During fiscal year 2021, L&I, DOR, and ESD shared information on contractor registration, taxes, and other data in order to discover and hold accountable hundreds of businesses and individuals who do not comply with the law. In addition to protecting consumers, workers, and employers through this activity, the agencies assist construction contractors and other business owners in meeting state requirements.

In addition to increasing compliance, enforcing state laws, and providing education and assistance, the three agencies will continue to work together and with their stakeholders to provide meaningful information and data to identify new or on-going problems and focus future efforts to address those issues.