



**Joint Legislative Taskforce
on the
Underground Economy in the Construction Industry
October 31, 2007**

Employment Security Department Audit and Collections Staff

Unit	Location	Staff FTE	Budget	Funding Source
Underground Economy	Olympia	4	\$276,000	P&I Account
SUTA Dumping	Olympia	6	\$471,000	P&I Account
Large Employer Audits	Olympia	2	\$157,000	FUTA Tax
District Tax Offices	Statewide		\$8,343,780	FUTA Tax
Bellevue		13		
Bellingham		5		
Lynnwood		9		
North Seattle		11		
South Sound Tacoma		23		
Spokane		8		
Tri-Cities		5		
Vancouver		7		
Wenatchee		6		
Yakima		5		
TOTAL		104	\$9,247,780	

Operating Units

The Underground Economy Unit focuses on locating businesses that have not registered with the Department.

The State Unemployment Insurance Tax Act (SUTA) Dumping Unit investigates businesses that are registered with ESD but may be changing business structures or reporting employees as independent contractors to avoid paying taxes.

The Large Employer Audits Unit and District Tax Office staff conduct general tax compliance audits. Companies may be selected for audits randomly as part of federally required sampling of 2% of employers per year or as part of a targeted audit program that focuses on industries that may misclassify or underreport workers. Companies may also be audited if an employee files a claim for benefits where the employer has not reported wages, or as the result of a tip or lead.

These staff spend approximately 50 percent of their time on audits. Other duties include collections and taxpayer assistance.

Funding Sources

Penalty and Interest (P&I) Account funds are generated from the penalties and interest paid by employers who file late, incomplete, or incorrect tax reports and penalties and interest due from claimants who must pay back unemployment insurance benefits to which they were not entitled. The P&I Fund does not include tax receipts nor does it include any benefit repayments.

The Federal Unemployment Tax Act (FUTA) requires all employers to pay federal unemployment tax to the US Treasury. These funds are administered by the US Department of Labor which distributes the money to states according to formulas based on population, workload, and economic conditions.

Barriers to Effective Enforcement

The size of enforcement activities are limited by the amount of funds available. The large majority of ESD funds are received from the federal government, allocated by formula. The formula for audit expenses is driven from the 2% audit standard for existing employer accounts and does not take into account efforts to identify businesses operating in the underground economy that are not registered with ESD. The Legislature has appropriated funds from the Penalty and Interest Account to enhance ESD enforcement efforts. This fund source is also used to pay for a variety of other ESD activities.

As ESD has mentioned during past taskforce presentations, there is currently high demand for auditors in the private sector. Private accounting firms and firms employing internal audit staff pay significantly higher wages than state agencies. It is difficult to recruit and retain skilled auditors given the wage differential.

Impacts of the Cash Labor Economy

Cash payments are a concern to ESD if businesses working “off the books” have employees. However, businesses accepting cash are generally relatively small, with few employees. Enforcement activities would yield a proportionately small return. Given limited resources, ESD has not made pursuing cash businesses a priority. It is relatively difficult to determine how much in wages to assess when cash payments to workers are involved. In these situations, ESD tracks the amount of cash withdrawals from the employer’s bank accounts. Absent documentation for the purpose of the withdrawal, ESD determines the withdrawals have been paid as wages and bases tax assessments on these amounts.