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Underground Economy Operations

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Report Payroll Tax Fraud

The Employment Development Department (EDD) has a charge to investigate businesses that avoid paying payroll taxes, many of which are part of the underground economy. If you would like to help us protect workers and create a level playing field for business competition, the EDD offers several methods for reporting such businesses:

- Call our toll-free hotline: 1-800-528-1783
- Fax: 916-227-2772
- Submit a [Fraud Reporting Form online](#)
- Mail us a [UEO Lead Referral/Complaint Form](#), available in English ([DE 660](#)) and Spanish ([DE 660/S/](#)).
- [Help Us Fight Fraud, DE 2370](#)

Definition of "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 taxing agencies. Underground economy is also referred to as tax evasion, tax fraud, cash pay, tax gap, payments under-the-table, and off-the-books.

What Does It Cost You?

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. Reports on the underground economy indicate it imposes significant burdens on: (1) the State of California, (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.

Business:

When businesses operate in the underground economy, they illegally reduce the amount of money expensed for insurance, payroll taxes, licenses, employee benefits, safety equipment, and safety conditions. These types of employers then gain an unfair competitive advantage over businesses that comply with the various business laws. This causes unfair competition in the marketplace and forces law-abiding businesses to pay higher taxes and expenses.

Workers:

Employees of the businesses that do not comply are also affected. Their working conditions may not meet the legal requirements, which can put them in danger. Their wage earnings may also 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:

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 is erosion of the economic stability and working conditions in this State. Our pamphlet *Paying Cash Wages "Under the Table"...Is It Really Worth the Risk?* outlines some of the costs and effects of cash pay on your business, your employees, and taxpayers in general. It is available in both English ([DE 573CA](#)) and Spanish ([DE 573CA/S/](#)).

EDD's Underground Economy Operations

The EDD is concerned about workers who lose benefits and other protections provided by state law when the businesses that 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 the law. This causes unfair competition in the marketplace and forces law-abiding businesses and every citizen in California to pay higher taxes. EDD's Underground Economy Operations (UEO) organization was established in 1993 to implement and administer the activities of the Joint Enforcement Strike Force. The mission of UEO is to reduce unfair business competition and protect the rights of workers by:

- Coordinating the joint enforcement of tax, labor, and licensing laws.
- Detecting and deterring payroll tax violations in the underground economy. This includes unreported cash pay, wages reported on Forms 1099, and unreported/unpaid payroll tax deductions.
- Conducting research to identify strategies to increase compliance with payroll tax laws.
- Educating customers on UEO programs to increase compliance with payroll tax laws.

Significant UEO Program Efforts

The UEO has three significant UEO program focus areas: the Employment Enforcement Task Force, the Economic and Employment Enforcement Coalition, and the Construction Enforcement Project.

Employment Enforcement Task Force (EETF)

Participating agencies in the EETF include:

- Employment Development Department (EDD)
- Department of Industrial Relations (DIR)
- Contractors State License Board (CSLB)

The goal of EETF is to identify and bring into compliance those individuals and businesses in the underground economy who are in violation of payroll tax, labor, and licensing laws.

The EETF agents from each agency jointly conduct on-site inspections 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, the EETF conducts investigations only if there is a reasonable belief of violations of the Unemployment Insurance Code, Labor Code, and/or the Business and Professions Code.

Employment Enforcement Task Force Program Results

Result	2006	2007
Joint Inspections	423	451
Previously Unreported Employees	4,278	4,200
Unreported Wages	\$85,176,694	\$100,871,656
Payroll Tax Audits	308	405
Payroll Tax Assessments	\$10,597,950	\$13,478,705

Labor Code Citation Amounts	\$2,390,950	\$3,621,400
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To learn more about the EETF program, see our *Information Sheet: Employment Enforcement Task Force*, available in both English (DE 631) and Spanish (DE 631/S/).

Economic and Employment Enforcement Coalition (EEEC)

The EEEEC - a partnership of State agencies tasked with identifying the worst offenders via targeted enforcement actions throughout the state. Members of the EEEEC build upon their individual expertise to create a team of enforcement officials with better information, access, and ability than previous efforts have produced. This team consists of investigators and auditors from:

- Department of Industrial Relations, Division of Labor Standards Enforcement (DLSE)
- Division of Occupational Safety and Health (DOSH)
- Employment Development Department (EDD)
- Department of Consumer Affairs, Contractor's State License Board (CSLB)
- United States Department of Labor (USDOL)

Each EEEEC agency is an expert in its particular field; together, the agencies collaborate to:

- Educate business owners and employees on state and federal labor, licensing, and employment laws.
- Conduct vigorous and targeted enforcement against labor law violators.
- Restore competitive equality to law-abiding businesses to help level the playing field.
- Protect the health, safety, and benefit rights of workers.

The EDD staff within EEEEC participate in on-site inspections, focusing on identifying possible non or under-reporting of wages (or of workers), which may result in a subsequent tax audit of the employer. The EDD staff are also key participants in the EEEEC outreach and education seminars.

With fluency in a variety of languages, the EDD Job Services staff are also critical partners in the EEEEC, assisting with interviewing non-English speaking workers as well as providing rapid response services to those workers who may be displaced when an employer must shut down (for example, due to serious Labor Code violations). These services may include referrals to local employment and training resources including One-Stop Career Centers.

EEEC activities were originated in August 2005.

Economic and Employment Enforcement Coalition Program Results

Result	2006	2007
Joint Inspections	907	822
Previously Unreported Employees	1,726	6,238
Unreported Wages	\$26,764,287	\$117,751,978
Payroll Tax Audits	95	310
Payroll Tax Assessments	\$3,661,678	\$17,272,880
Labor Code Citation Amounts	\$2,928,200	\$6,038,220

Construction Enforcement Project (CEP)

The EDD recognizes that the vast majority of construction contractors are honest business people who operate legitimately within the law and properly report payroll taxes. However, there are some contractors who do not properly report, and this impacts both workers and law-abiding contractors. The CEP was developed because usual techniques for identifying tax and employment fraud were not as effective in the construction industry. Unlike other industries that have permanent business locations, construction businesses have constantly changing job sites. By the time information is developed that a contractor is probably operating in the underground economy, work at the job site has often been completed and an on-site inspection would not discover any labor law violations.

The CEP uses a variety of investigative techniques to identify contractors who avoid payroll taxes. When a CEP investigator develops evidence of underground economy activities, a payroll tax audit referral is made to the EDD Audit Program. The CEP goal is to develop techniques that will maximize the detection of construction industry employers operating in the underground economy.

Construction Enforcement Project Program Results

Result	2006	2007
Previously Unreported Employees	1,844	3,281
Unreported Wages	\$61,131,685	\$88,725,228
Payroll Tax Audits	107	147
Payroll Tax Assessments	\$7,036,592	\$10,220,583

Joint Enforcement Strike Force

On October 26, 1993, the Governor signed Executive Order W-66-93, which created the Joint Enforcement Strike Force on the Underground Economy. The Governor subsequently signed Senate Bill 1490, which placed the provisions of the Executive Order into law as Section 329 of the California Unemployment Insurance Code, effective January 1, 1995.

The EDD is the lead agency for the Strike Force, and the Director of EDD is the chairperson. The Strike Force is responsible for enhancing the development and sharing of information necessary to combat the underground economy, to improve the coordination of enforcement activities, and to develop methods to pool, focus, and target enforcement resources. The Strike Force is empowered and authorized to form joint enforcement teams when appropriate to utilize the collective investigative and enforcement capabilities of the Strike Force members.

In addition to EDD, the other Strike Force members are:

- Department of Consumer Affairs 1-800-952-5210
- Department of Industrial Relations
Minimum Wage, Safety, and Work Violations 1-888-275-9243
- Department of Insurance 1-800-927-HELP (4357)
- Franchise Tax Board Tax Informant Hotline: 1-800-540-3453
- Board of Equalization 1-888-334-3300
- Department of Justice 1-800-952-5225

The Employment Development Department is an equal opportunity employer/program.
Auxiliary aids and services are available upon request to individuals with disabilities.
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