



Underground Economy Benchmark Report (RCW 18.27.800)

*Fiscal Year (FY) 2023 Annual Report to the
Legislature*

December 2023

Prepared by Departments of Labor & Industries, Revenue, and Employment Security

Available Online at Lni.wa.gov/LegReports

Table of Contents

Executive Summary	1
Introduction	5
Progress and Achievements in FY 2023	6
Department of Labor & Industries Highlights.....	6
Department of Revenue Highlights.....	12
Employment Security Department Highlights.....	15
Combined Agency Highlights.....	17
Conclusion	18

Executive Summary

Introduction

The Department of Labor & Industries (L&I), Department of Revenue (DOR), and the Employment Security Department (ESD) present the fiscal year (FY) 2023 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 law-abiding consumers, workers, and employers.

Progress and achievements in FY 2023

In FY 2023 (July 1, 2022, through June 30, 2023), 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, focused audit selection, prosecution, and debt collection. The agencies also collaborated on prevailing wage requirements and activities. It is important to note that the COVID-19 pandemic decreased activities compared to previous years, yet the work remained important and significant.

Together, L&I, DOR and ESD:

- uncovered more than 970 unregistered businesses and assessed nearly \$153 million in unpaid taxes, premiums, penalties, and interest; and
- made certain unregistered employers know payment options, requirements, and interest and penalty waivers.

L&I:

- educated and trained nearly 1,400 construction contractors offering in-person training events across the state;
- reminded consumers how to hire legitimate contractors through the “Protect My Home” campaign;
- issued more than 1,100 infractions to unregistered contractors;
- assessed over \$26.8 million in premiums, penalties, and interest to both registered and unregistered businesses;
- registered and assessed premiums for over 520 noncompliant businesses; and
- collected \$252.4 million in delinquent funds.

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 450 noncompliant businesses;

- assessed taxes totaling more than \$125.5 million from over 3,000 registered and unregistered businesses;
- collected over \$66 million through its Tax Discovery Program, including collections on assessments from prior years; and
- recovered more than \$25,000 in fraud-related dollars.

ESD:

- found over 6,600 unreported or misclassified workers through audits; and
- assessed more than \$668,000 on unregistered accounts. (ESD was restricted in its field work because of the pandemic during FY 23.)

Introduction

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, they gain an unfair advantage over competitors. Consumers are also 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.

One important subset of this work is the Construction Underground Economy Advisory Committee, which focuses on fraud in the construction industry. The three agencies, along with external stakeholders, participate on the committee. The committee's balance among 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.

Progress and Achievements in FY 2023

This section describes each partner agency's progress and achievements 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 residents. 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 2023 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 online and in-person 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 10 misrepresentation penalties, totaling more than \$2 million. Contractor compliance inspectors issued just over 1,100 infractions to unregistered contractors.
- **Audit selection** — About 71% of employers that are referred for audits are found to owe premiums. 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 four claimant fraud cases to the Office of the Attorney General for consideration for prosecution. Two cases have been sent to the Thurston County Prosecutor's Office.
- **Collections** — Collections staff collected \$233.1 million in delinquent employer premiums for workers' compensation insurance, though not all of this can be attributed to the underground economy. Employer premiums account for the vast majority of dollars identified as owing to the department and collected, totaling more than \$233.1 million of the total \$252.4 million collected in FY 2023.

- **Prevailing Wage Program** — L&I held 50 workshops for more than 1,900 participants to educate contractors about prevailing wage requirements. In enforcement, L&I issued more than 1,100 “strikes¹” and debarred 174 companies from bidding on public works contracts.²

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 and *Contractor Training Days* with nearly 1,400 attendees. Instructions and explanations of laws and rules are also offered online. For consumers, L&I conducts an ongoing awareness campaign, [Protect My Home](#), that provides education through paid advertising and public outreach events, including how to hire legitimate contractors and be aware of common scams using the [Hire Smart Step-by-Step](#) tools.

Detecting dishonest business practices in construction registration

The most easily recognizable dishonest activities happen in construction. Contractors in the underground economy are typically either unregistered or underreport workers’ compensation responsibilities. This enables 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 helps provide 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 2013 to 2023. In FY 2023, the number of registrations returned to pre-pandemic levels, setting a new high of more than 67,500 registered contractors in Washington.

¹ A strike is a notice of a violation of contractor registration, workers’ compensation, or prevailing wage requirements.

² 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. However, they may continue to perform construction for private entities.

Figure 1: Active contractor registrations, 2013-2023, as of June 30, 2023

Fiscal Year	Contractors with UBI
2012	52,250
2013	52,755
2014	54,529
2015	56,652
2016	58,553
2017	63,300
2018	64,808
2019	63,200
2020	65,023
2022	66,838
2023	67,500

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 2023, L&I's Construction Compliance Program issued more than 1,100 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 2023.

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 2023, L&I suspended more than 35,000 registrations. The below highlights some of reasons:

- More than 2,200 canceled their insurance.
- More than 10,000 canceled their bond.
- More than 580 had unsatisfied judgments against their bond.
- 35 had impaired bonds.
- 32 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 date of the citation. In FY 2023, 189 unregistered contractors took advantage of this option.

Auditing businesses

Construction is the most visible industry regarding unregistered businesses; however, this 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 2023, L&I performed more than 520 audits on unregistered businesses for over \$6.8 million in assessed premiums and penalties. Approximately 65% were in construction, followed by 22% in service industries.

Prosecuting illegal activity

Staff investigated and referred four claimant fraud cases to the Office of the Attorney General for consideration for prosecution. Two cases have been sent to the Thurston County Prosecutor's Office.

Identifying and 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 discover through spot checks of construction worksites and inspection of contractors based on referrals. 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 2 shows the number of underground economy violations issued, contractors referred to collections, and contractors referred for auditing from FY 2018 to FY 2023. These numbers were reduced during the pandemic, when inspectors were not physically visiting jobsites regularly. They are now showing some slight increase as compliance activities increase.

Figure 2: Contractor Compliance Program results

Compliance Action	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Underground Economy Violations Issued	2,108	2,420	2,092	1,832	1,998	2,497
Contractors Referred to Collections Program	1,763	1,919	1,504	1,395	1,248	1,279
Contractors Referred to Audit Program	1,710	1,775	1,243	1,080	1,021	1,282

Source: L&I Contractor Registration Program

Prevailing Wage Program

L&I's Prevailing Wage program is important to ensure fairness for 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 the county in which they work 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 2023, the Prevailing Wage program conducted 50 workshops online and around the state, reaching more than 1,900 awarding agencies, 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; or
- 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 laws³ 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 3, L&I issued 1,124 strikes and debarred 174 contractors in FY 2023. This is roughly twice the number of strikes compared to prior years.

Figure 3: Prevailing wage strikes and debarments

Violation	FY 2021		FY 2022		FY 2023	
	Strikes	Debarments	Strikes	Debarments	Strikes	Debarments
Contractor Registration	401	48	401	48	675	59
Industrial Insurance	208	11	208	11	491	7
Contractor Registration and Industrial Insurance	0	67	0	67	0	101
Prevailing Wage: Failing to File Wage Report/False Filing	22	5	22	5	17	15
Prevailing Wage: Failing to Pay Prevailing Wage	10	1	10	1	7	3
Total	641	132	641	132	1,124	174

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

³ 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 2023, DOR’s Compliance and Audit divisions continued focus on investigating, assessing, and registering both in-state and out-of-state businesses.

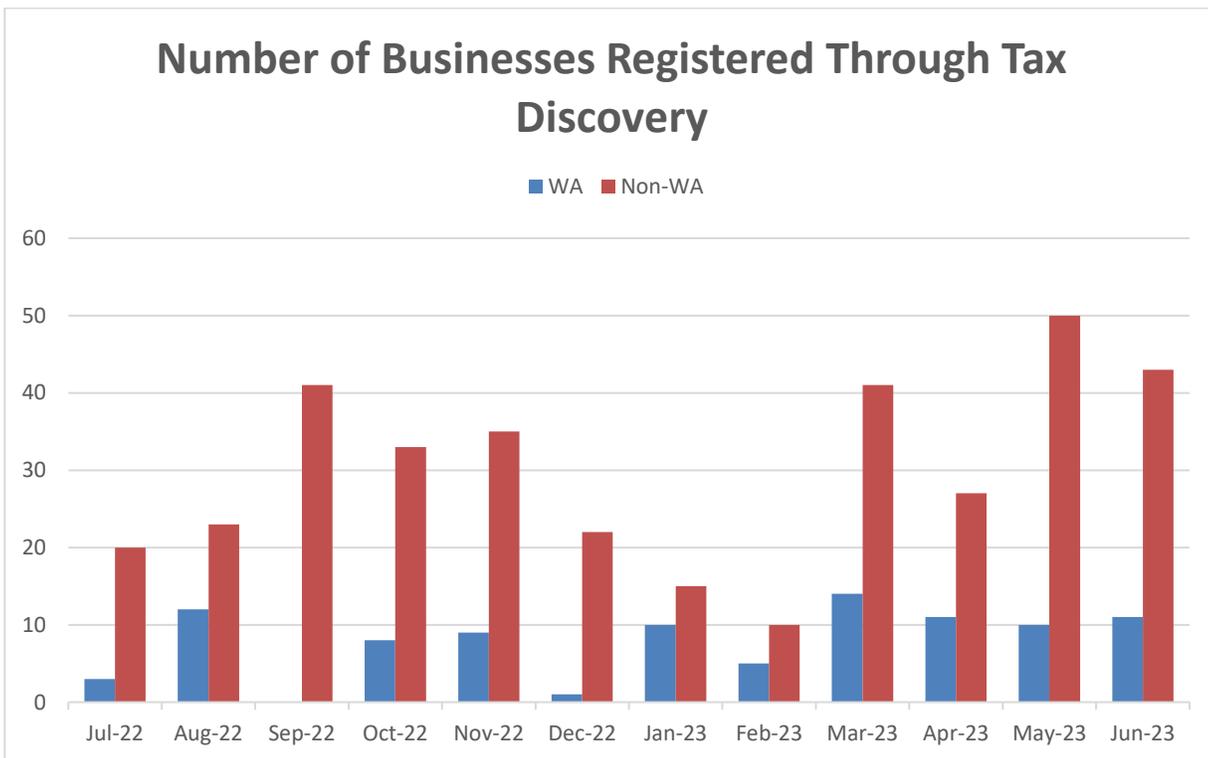
In March 2020, the Governor’s state of emergency from the COVID-19 pandemic halted enforcement of collections and assessments, which resulted in a significant drop for FY 2020, 2021, and 2022. Staff assisted taxpayers with voluntary compliance and making payment arrangements.

In FY 2023, staff’s focus shifted to enforcement on accounts that fell through on payment arrangements and getting businesses in compliance as they emerged from the pandemic economy.

DOR investigated more than 3,000 businesses in FY 2023, 454 of which were registered through Tax Discovery. Additional Tax Discovery cases led to businesses voluntarily registered; over 460 of these Tax Discovery cases owed taxes — with more than \$125.5 million assessed against them. This included:

- Voluntarily Registered/Registered businesses assessed over \$88 million.
- Unregistered businesses assessed more than \$37.5 million.

Figure 4: Number of businesses registered through tax discovery in FY 2023

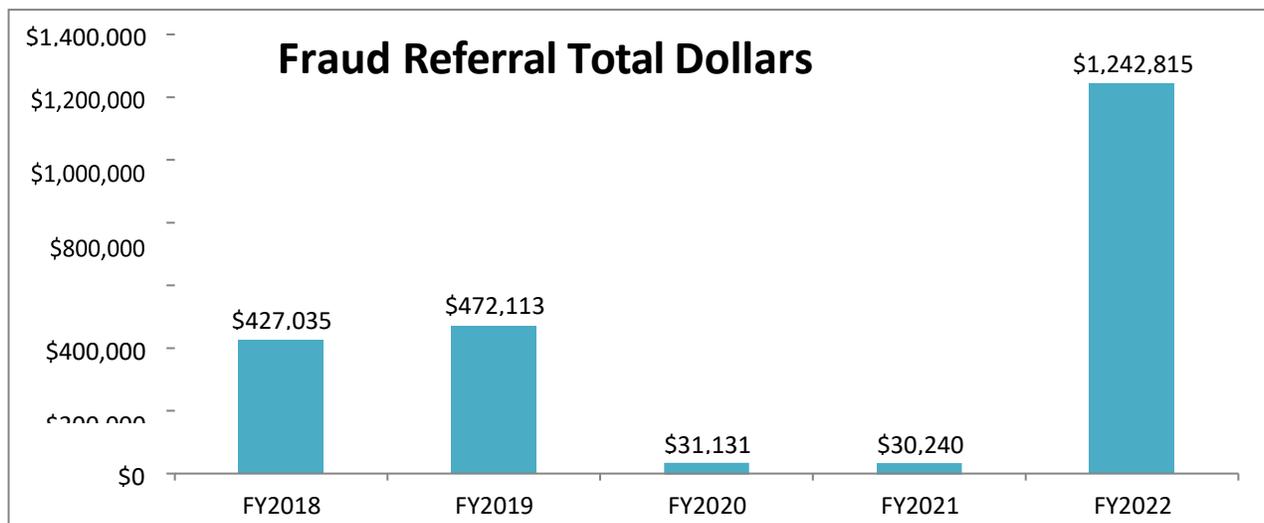


In addition to finding and addressing unregistered businesses, DOR’s Compliance and Audit divisions refer and investigate fraud cases. The Compliance Division investigates unlicensed vehicles, vessels, and airplanes. DOR continues to focus on education and enforcement to reduce noncompliance and ensure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

DOR provides a variety of methods for making fraud referrals, which enable private citizens and other agencies to report cases in which they believe fraud is being committed.

In March 2020, the department halted this work during the Governor’s state of emergency, with a significant drop in the collections for both FY 2020, 2021, and 2022. Beginning in January 2023, staff returned to referring these referrals out to field staff, and work on these types of accounts has resumed. With turnover in our Tax Discovery staff, there is a learning curve as we train new staff.

Figure 5: Fraud referral total dollars collected



Source: DOR

The bulk of fraud referrals continues to be received via the internet through the Suspect Fraud website. In FY 2023, more than 93% of fraud referrals were made via the website. Combined agency efforts are beginning to update and improve the fraud referral website so that the public will be able to access it through a gov.wa site. It is still early in the planning phases, but we recognize the importance and popularity of using this method to report suspected fraud cases.

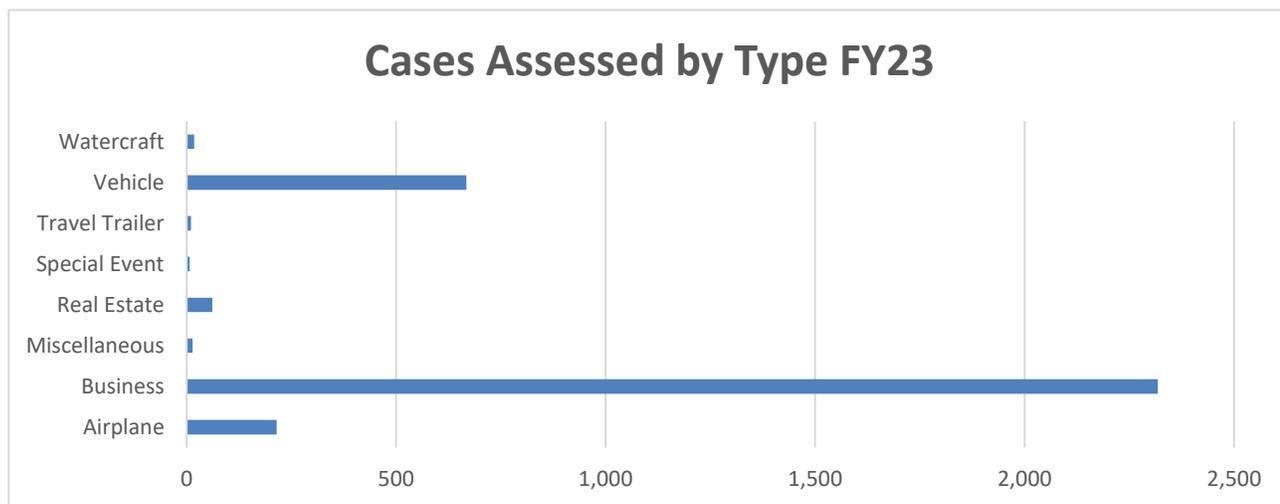
Figure 6: FY 2023 Fraud referral sources



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 is important to note that as resources are dedicated to projects, referrals and collections increase.

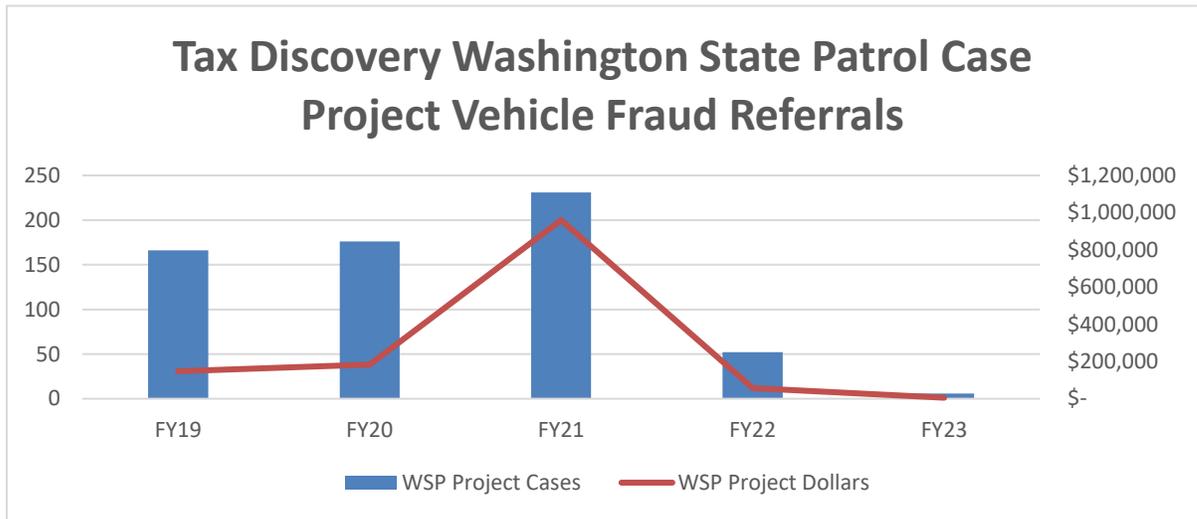
Figure 7: Tax discovery case type



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. In FY 2023, a total of 352 cases were investigated, with six of these resulting in assessments. Agents work each of these cases; however, their investigations do not always lead to a tax liability.

Figure 8: Tax discovery WSP case project vehicle fraud referrals, FY 2019-2023



Source: DOR

EMPLOYMENT SECURITY DEPARTMENT HIGHLIGHTS

The Employment Security Department (ESD) continued identifying employers who failed to report or underreport employees for unemployment insurance. ESD dedicated up to five full-time employees in five audit regions to this purpose.

Underground economy auditors also assisted with benefits fraud.

Underground economy compared to other audits with misclassified employees

Underground economy audits were consistently more productive than other ESD audits in locating misclassified employees. Underground economy audits found about 92 misclassified employees per audit, compared to 22.8 misclassified employees per audit for all other audits.

Figure 9: Underground economy audits

Quarter	Audits with misclassified employees**	Misclassified employees	Employees per audit
Q3 2022	25	591	23.6
Q4 2022	14	165	11.8
Q1 2023	16	311	19.4
Q2 2023	25	930	37.2
Total	80	1,997	*25

*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 10: All other audits

Quarter	Number of audits with employees found	Number of misclassified employees	Employees per audit
Q3 2022	222	1,394	6.3
Q4 2022	182	1,217	6.7
Q1 2023	223	1,255	5.6
Q2 2023	181	767	4.2
Total	808	4,633	*5.7

*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 to electronically file quarterly unemployment tax reports. Employers have two options to file electronically. Each is tailored to a business’s specific needs. In FY 2023, more than 98% 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; and
- 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, which enables 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, comprise 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 among all parties. Since the pandemic, the Field Services and Public Safety division at L&I has been working to re-establish this council.

Results from auditing unregistered businesses

In FY 2023, DOR, ESD, and L&I found and audited over 970 unregistered or previously registered businesses. In these cases, the agencies “involuntarily registered” the businesses as part of the auditing process. The three agencies assessed nearly \$153 million in taxes, penalties, and interest on the previously unregistered firms. Due to differences in the three agencies’ regulatory authority, each agency audits 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 in the construction industry.
- ESD tends to focus on industries with higher unemployment rates.

Conclusion

CONTINUING THE PARTNERSHIP

During FY 2023, L&I, DOR, and ESD shared information on contractor registration, taxes, and other data to discover and hold accountable hundreds of businesses and individuals that 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 ongoing problems and focus future efforts to address those issues.