Little Hoover Commission - Underground Economy
Employment Development Department's (EDD's)
Employment Tax Administration and
Criminal Investigation Programs

Please find our Department's responses to the questions from the Little Hoover Commission on the Underground Economy. The responses in this document include both the employment tax administration and criminal investigation programs of the EDD. The final question requested of both programmatic areas was the same, and we are presenting a consolidated response following the program area responses below.

Employment Tax Administration

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What is the range of approaches EDD takes in combating the negative effects of the underground economy on California, its industries and its workforce?

To help restore economic stability and to improve working conditions and consumer and worker protection for the State of California, as part of the Joint Enforcement Strike Force (JESF), the EDD and participating State government enforcement agencies strive to:

- Eliminate unfair business competition and protect workers by ensuring they receive all benefits to which they are entitled to by law as they relate to wages and hours, health and safety, and income replacement;

- Protect the consumer by ensuring that all businesses are properly licensed and adhere to the state's consumer protection regulations;

- Reduce the burden on law-abiding citizens and businesses by ensuring all businesses and individuals comply with the state's licensing, regulatory, and payroll tax laws; and

- Reduce the tax gap by increasing voluntary compliance with the state's payroll tax laws to maximize the state's General and Special Fund revenues.

Each State government enforcement agency has distinct laws and regulations they specialize in and must enforce, and the EDD enforces the laws of the California Unemployment Insurance Code (CUIC). While the mission and goals of the enforcement agencies to combat the underground economy are the same, the technical specialty under each is unique; thus, the need for collaboration and partnerships is critical to be effective for the State of California.

The EDD's Tax Branch mission is to work with employers to collect state employment taxes and data to support the employment security, child support, and Personal Income Tax programs. The EDD is committed to reducing unfair business

competition and protect the rights of workers by coordinating the joint enforcement of tax, labor, and licensing law, detecting and deterring employment tax violations in the underground economy, and educating customers to increase compliance with tax laws. The EDD has field presence throughout the State and also conducts out-of-state audits to provide enforcement, education, and assistance.

The EDD takes a blended approach to combating the underground economy through the following:

A. **Outreach and Education** – The EDD has a variety of methods for outreach and education targeted and accessible to employers, employees, tax professionals, and the general public. The outreach and education is tailored towards encouraging and maximizing voluntary compliance and deterring businesses from operating in the underground economy. The specific methods are defined in further detail in response to the question later in this document regarding the EDD's outreach and education efforts.

B. **Administrative** – The EDD has administrative methods of enforcing the payroll tax laws, including the following:

- The EDD's Audit Program issues assessments for payroll taxes due and any applicable penalties and interest to employers located in the State and to employers out of state having California workers. When appropriate, penalties for intent to evade and/or fraud may be applied. The EDD performs follow-up audits to confirm continued compliance. The EDD continually works on identifying new and different methods to promote and verify prospective compliance.

- The EDD has the authority to issue assessments that are **immediately** delinquent and collectable if it is determined that the collection of the assessment is jeopardized by the delays that occur with the normal assessment process. The EDD's Tax Program and Legal Office work together to properly establish and collect on these types of assessments.

- The EDD leads the Joint Enforcement Strike Force (JESF) and participates in the Labor Enforcement Task Force (LETF), which are discussed in detail in the next question.

- The EDD Compliance Development Operations (CDO) identifies and makes assessments of Unemployment Insurance (UI) rate differences when reserve accounts are transferred by employers attempting to unlawfully attain lower UI tax rates through rate manipulation schemes.

- The EDD CDO screens and provides lead development for out of state, in-state, industry specific, and other forms of allegations. The EDD CDO also captures allegations of non-compliance submitted through the Underground

Economy Fraud Hotline, correspondence, and electronic mail, which are screened and referred for audit.

- The FedState Partnership is an ongoing alliance between the Franchise Tax Board (FTB), EDD, Board of Equalization (BOE), and Internal Revenue Service (IRS). The mission of the FedState Partnership is to develop and maintain a partnership that increases tax compliance and provides greater convenience to taxpayers. (For reference, please see Appendix 1 for the FedState Partnership Steering Committee Charter.)

  The FedState Partnership goals include:

  - Enhance taxpayer access to information and services.
  - Reduce taxpayers' burden.
  - Increase voluntary compliance.
  - Increase the sharing of taxpayer data among the partner agencies to enhance compliance activities.
  - Enhance communication among the tax partner agencies regarding current and long-range agency specific projects.
  - Identify opportunities to leverage resources among the partner agencies.

  This partnership is an enduring alliance which works towards an increasingly convenient, effective and streamlined tax system that provides user-friendly service to taxpayers and improves tax compliance for the State of California. The FedState Partnership is a virtual "agency consolidation" of purpose and taxpayer service that:

  - Shares data for compliance purposes.
  - Focuses on the taxpayer.
  - Achieves leverage through combined resources.
  - Embodies a solid collaborative partnership.

  The FedState Partnership also has a sub-group, the Joint Agency Data Sharing Team (JADST), which acts as an advisory board to promote and expand the existing cooperative data sharing partnership between California's three main taxing agencies; BOE, EDD, and FTB. The team is an ongoing body that operates under the general direction of and reports to the BOE, EDD, and FTB members of the Federal State Partnership. The team reviews and evaluates technology initiated within the BOE, EDD, and FTB as it relates to data sharing and will make recommendations to the FedState Partnership. The philosophy of the JADST is to promote a coordinated joint effort resulting in equitable, successful, non-duplicative, and economically efficient data sharing efforts. The scope of the JADST is to explore, evaluate, and provide recommendations on various business, technical, and architectural aspects of data sharing. The team also facilitates communication about and further understanding of new and existing data sharing efforts at each agency.

- The Interagency Tax Collection Committee is an alliance with the EDD, FTB, BOE, IRS, Attorney General, State Controller and various county recorders. This Committee provides a forum to share common collection practices in order to increase compliance and resolve collection issues. It is intended to foster communications and allow collection staff to meet their counterparts, establish working relationships, and encourage cooperation on common tax collection issues.

- Data sharing is a key component to successful administration and have enhanced our partnering and compliance efforts. Authorized FTB, EDD, DIR, and BOE staff has online, real-time access to the key automated systems of the respective tax agencies for tax administration and enforcement purposes.

C. **Criminal** – The EDD's Investigation Division has a specialized law enforcement unit that investigates criminal violations of the CUIC, the California Penal Code, and the United States Code for federal prosecution. They work with law enforcement agencies throughout the State and the JESF partner agencies to identify and prosecute employer fraud. They conduct criminal investigations involving employer collusion in the underground economy, employer failure to register and report wages paid to employees, and collaborate on Workers' Compensation Insurance investigations related to state payroll tax violations. They conduct surveillance, perform undercover operations, interview witnesses, initiate search warrants, and submit completed investigations to prosecutors to convict individuals who commit employment tax fraud.

   A recent partnership that received local media attention is the combined efforts of the EDD and the BOE filing a criminal complaint against a restaurateur and developer who owed the state $5.4 million in payroll and sales taxes. The agencies were represented by the Attorney General's Special Crimes Unit. The responsible individual was arrested and charged with 105 counts. The defendant entered a no contest plea in which he agreed to make specific payments over a four year period. If he fails to make payments per the agreement, he faces over four years in state prison.

What are the Employment Development Department's roles on the Labor Enforcement Task Force and the Joint Enforcement Strike Force? In what ways have these collaborative efforts shown success, and what factors have facilitated these successes? In what ways have the groups experienced difficulty?

In October 1993, Executive Order W-66-93 established the JESF to combat the underground economy by pooling resources and sharing data among the state agencies charged with enforcing licensing, labor, and payroll tax laws. On January 1, 1995, Section 329 was added to the CUIC, which placed the provisions of the Executive Order into law.

The EDD is the lead agency for the JESF. The JESF 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 JESF is empowered and authorized to form joint enforcement teams when appropriate to utilize the collective investigative and enforcement capabilities of the JESF partners. The partners include, but are not limited to, the:

- Employment Development Department (EDD)
- Department of Industrial Relations (DIR)
- Department of Consumer Affairs - Contractors State Licensing Board (CSLB), Bureau of Automotive Repair (BAR), Bureau of Security Investigative Services
- Department of Insurance
- Department of Justice (DOJ)
- Franchise Tax Board (FTB)
- Board of Equalization (BOE)
- Department of Labor (DOL)
- Alcoholic Beverage Control
- Internal Revenue Service
- District Attorneys throughout California
- Local Law Enforcement

The EDD's enforcement efforts undertaken by the JESF to combat the underground economy include:

- Conducting unannounced site inspections to identify employers operating in the underground economy by interviewing owners, managers, and workers. The goal is to identify and bring into compliance individuals and businesses in the underground economy who are in violation of payroll tax, labor, and licensing laws.

- Utilizing various databases, income tax return analysis, along with informant information to conduct in-depth desk investigations of employers suspected of operating in the underground economy. When noncompliance is detected, the case is referred to the EDD's Audit Program.

- Collaborating efforts between the EDD and the Internal Revenue Service (IRS) that allow for an exchange of case information regarding unreported wages and/or misclassified workers. This multiagency compliance approach presents a united effort to taxpayers and their representatives that both the federal and state agencies work together to enforce tax laws.

- Targeting of industries known for high levels of noncompliance with licensing, labor, and payroll tax laws.

- Pursuing administrative actions to address employer noncompliance detected via the JESF efforts, or for cases warranting criminal investigation, the EDD Investigation Division's Criminal Tax Enforcement Program works with law enforcement agencies and the JESF partner agencies to identify and prosecute those responsible for the criminal activities.

The LETF was initially formed in 2005 as the Economic and Employment Enforcement Coalition and began operating as the Labor Enforcement Task Force in January of 2012. The LETF is responsible for ensuring that California workers receive proper payment of wages and are provided a safe work environment; ensure California receives all employment taxes, fees, and penalties due from employers; eliminate unfair business competition by leveling the playing field; make efficient use of state and federal resources in carrying out its mission. The DIR leads this multi-agency coalition. The LETF partners include, but are not limited to, the:

- Department of Industrial Relations (DIR)
- Employment Development Department (EDD)
- Department of Consumer Affairs – Contractors State Licensing Board (CSLB) and Bureau of Automotive Repair (BAR)
- Board of Equalization (BOE)
- California Department of Insurance
- State Attorney General and district attorneys throughout California

The JESF and LETF are similar in mission, vision, and goals, with the focus of JESF primarily on **tax law**, and LETF's focus on **labor law**. However, in late 2013, the JESF and LETF began an administrative collaboration effort called the LETF/JESF Collaborative Enforcement Partnership (CEP). This was done to improve communication and better resource utilization between the two programs by holding joint strategic executive meetings and bi-weekly operational meetings. The JESF and LETF leverage the strengths of each program and deploy the statewide staffing of the combined enforcement teams. The LETF/JESF CEP will be able to target industries with a broader reach throughout California. (For reference, please see Appendix 2 for the memorandum issued to JESF and LETF staff on November 13, 2013, announcing the collaboration effort under CEP.)

A recent success of the LETF/JESF CEP was a joint training that allowed for sharing of best practices and cross-training on skill sets and experience leading to more strategic and effective enforcement against the underground economy. Each partner has different and specialized skill sets and knowledge that is unique to specific areas of labor, licensing, and payroll tax laws, but the collaborative training allowed for greater ability to leverage resources.

The overall collaborative efforts among the partners have shown success because a business owner can actually see and experience the active partnerships which work together to combat the underground economy. Working together, cross training, sharing resources, keeping open lines of communication, sharing data, and learning as much as possible about our partner agencies facilitates the success of the

program. The joint enforcement efforts have provided significant benefits to the partners, without the added cost of organizational consolidation. Businesses operating in the underground economy constantly develop new schemes to avoid detection of their illegal activities. As these new schemes are identified, information regarding these schemes is shared with member agencies, business associations, and labor organization. The benefits of joint enforcement effort include sending a strong message on the risks of noncompliance, leveraging resources, protecting workers, protecting consumers, promoting fair taxation for all, and leveling the playing field by promoting fair business competition.

As a result of the joint enforcement efforts, in 2012 the EDD CDO participated in 2,599 joint inspections resulting in 1,166 EDD audit referrals. Of those referrals, there were 678 EDD payroll audits conducted resulting in $36,348,078 in EDD payroll tax assessments and bringing 13,226 unreported employees into unemployment and state disability insurance coverage. Please refer to the 2011 JESF Report and the 2012 Annual Fraud Report for a detailed breakdown. The 2012 JSEF Report will be provided once approved for publishing.

What are the ways in which EDD conducts outreach and education to consumers, employers and employees? How does the department manage resources and balance missions in its operation of outreach activities and enforcement efforts?

The EDD has trained staff dedicated specifically to the outreach and education activities and enforcement efforts. The staff from both areas (outreach/education and enforcement) work closely together to establish the needs of the outreach and education activities. The staff dedicated to the outreach and education activities does not generally participate in the enforcement efforts; however, the staff dedicated to the enforcement efforts has a duty to also provide education and assistance in order to promote fair competition, safeguard worker's rights, and maximize voluntary compliance. Outreach and education to consumers, employers, and employees are performed utilizing the following communication vehicles:

- The EDD maintains its website at www.edd.ca.gov which contains information specific to Payroll Taxes and can be viewed in Spanish. The EDD website offers a variety of resources for consumers, employers, and employees. This includes information on when an employer becomes a subject employer, reporting requirements, and proper classification of workers.

- The California Tax Services Center website at www.taxes.ca.gov, which is a one-stop tax resource for individual taxpayers, employers, and businesses. Sponsored by the California FedState Partnership, the tax agencies include Board of Equalization, Employment Development Department, Franchise Tax Board, and Internal Revenue Service. This website provides access to forms, publications, filing due dates, links to filing and paying online, seminars, etc.

- A web page is dedicated to specifically cover the underground economy, Report Fraud – Underground Economy Operations. The page offers information on the underground economy and provides various methods for reporting businesses operating in the underground economy. It covers the impact of the underground economy on businesses, workers, and consumers. The page also covers the general operations of the Joint Enforcement Strike Force and Labor Enforcement Task Force.

- No-fee state Payroll Tax Seminars are offered by the EDD in both classroom style and online training, also available in Spanish. The EDD partners with the IRS and DIR –Division of Labor Standards Enforcement and offers joint presentations. The seminars are designed to help employers comply with the state payroll tax laws. The classroom seminars are offered in a variety of locations throughout California. The EDD receives many requests for seminars outside of what is offered on the website and will accommodate the requests and conduct these in other languages as requested. The EDD may provide industry specific presentations as requested by various worker organizations.

- The EDD website provides a series of Forms and Publications covering payroll tax withholding and reporting requirements, and employment classification issues, some of which are available in Spanish and/or Vietnamese. There are publications specifically geared to the underground economy.

- The public can also obtain information personally by visiting a Walk-In or Self-Service Office. The EDD has 10 Walk-In Offices throughout the State where the public can obtain information and advice on payroll tax responsibilities. In addition, the EDD has Self-Service Offices where the public can obtain tax forms and have access to a free direct-line phone. The listing of office can be found on the EDD website under the Office Locator.

- Education is also provided through audits and site inspections. Auditors and agents provide information and guidance specific to that employer's needs and specific industry to promote long- term compliance.

- Small Business Employer Advisory Committee (SBEAC) is a group of diverse associations representing small business employers throughout California. The SBEAC provides the EDD with recommendations on how to better service California's small businesses and disseminates information to their respective members. The SBEAC provides the small business employer community and the EDD's Tax Branch an avenue to better understand each other's needs by addressing issues of mutual concern.

- In order to reach out to a variety of businesses, the EDD also keeps tax professionals informed of issues and concerns by speaking at various conferences. For example, California Society of Enrolled Agents (CSEA), California Society of Certified Public Accountants, BAR Association.

The EDD is continuously looking for ways to improve and develop the outreach and education provided to the general public, consumers, employers and employees on the consequences associated with the underground economy. All information listed above and clarification can also be obtained by calling the EDD Taxpayer Assistance Center.

FedState Partnership Steering Committee

CHARTER

FedState Partnership
Steering Committee Charter

This Charter describes the structure, purpose, goals and objectives, roles and responsibilities, rotation of chair and recorder, decision making process, and assumptions and constraints of the FedState Partnership Steering Committee. The General Operating Procedures of the FedState Steering Committee are contained in Attachment I.

I. Structure

The Steering Committee is sponsored by the Executive Committee and operates within the approved formal FedState Partnership structure which includes:

- Executive Committee, composed of the Executive Director or the Deputy Director from each tax partner agency;
- Steering Committee, composed of three managers from state tax partner agencies and six members from the IRS, who have the authority to commit resources and make decisions on behalf of their appointing agency;
- FedState Coordinators, composed of one staff member from each tax partner agency;
- Information sharing committees and project teams.

For a list of current members, see Attachment II.

II. Purpose

The FedState Steering Committee, working with the Coordinators, will act as an intermediary and facilitator between the Executive Committee and the information sharing committees and project teams. The Steering Committee will:

1. Act as a high-level oversight committee to provide continuous guidance and monitor information sharing committees' and project teams' activities and make adjustments/modifications when necessary.
2. Ensure all Partnership efforts are coordinated and progressing appropriately.
3. Obtain resources needed and re-allocate resources as committees and projects evolve to ensure adequate and appropriate staff resources are dedicated.
4. Remove barriers by providing the mechanism to identify and resolve one-time and recurring issues or escalate them to the Executive Committee, as needed.
5. Approve potential projects that meet Partnership Goals.

III. Goals

The Steering Committee adheres to the FedState Partnership goals, which are:

- Enhance taxpayer access to information and services
- Reduce taxpayers' burden
- Increase voluntary compliance
- Increase the sharing of taxpayer data among the partner agencies to enhance compliance activities
- Enhance communication among the tax partner agencies regarding current and long-range agency specific projects.
- Identify opportunities to leverage resources among the partner agencies.

IV. Member Roles and Responsibilities

The FedState Steering Committee member represents his/her appointing agency. The member provides guidance and direction to information sharing committees project teams; raises and addresses issues between information sharing committees and project teams and his/her agency; and acts as a communications channel between information sharing committees and project teams, the Steering Committee, and his/her agency. Other responsibilities include:

1. Ensure that the Executive and Steering Committee modifications/adjustments to the information sharing committees' and project teams' activities are implemented (for the activities their agency has the lead.)
2. Recommend, obtain, and re-allocate resources from their agency.
3. Determine whether their agency wants to participate in a new project or activity.
4. Bring information sharing committees' and project teams' issues to the Steering Committee.
5. Report their agency's key initiatives and issues.
6. Inform and consult with the Executive Committee member from his/her agency.

V. Rotation of Chair and Recorder

The term of office for both chair and recorder shall be one calendar year and shall be rotated as follows:

2006	EDD, Chair; FTB, Recorder
2007	FTB, Chair; IRS, Recorder
2008	IRS, Chair; BOE, Recorder
2009	BOE, Chair; EDD, Recorder

VI. Decision Process

1. Decisions, appropriate to the jurisdiction of the Steering Committee, will be reached by consensus of members present. Consensus is defined as reaching a decision that everyone can live with after a complete airing of differing viewpoints. Consensus is achieved through discussion, not voting. If the group cannot reach consensus, the Chair will present the issue to the Executive Committee.
2. Approved joint projects may not require staff participation by each tax partner agency.

VII. Assumptions and Constraints

- Each appointed Steering Committee member has the authority to commit resources and make decisions on behalf of their appointing agency.
- The making of decisions will not be postponed or nullified due to the absence of a member of the affected organization.
- The Steering Committee has the authority to establish, modify, and terminate information sharing committees and project teams as deemed necessary.
- Information sharing committees and project teams will employ standard project management methodologies (defined by this committee) for all projects in order to ensure projects are completed on time, within budget, and meet business needs.
- Information sharing committees and project teams will also implement security policies and standards to protect systems, networks, resources and data from loss and unauthorized access, use, modification, destruction, and disclosure.
- The role of the FedState Coordinators is to coordinate the work of this Steering Committee and the information sharing committees and project teams by acting as a clearinghouse for joint projects. They should insure communications with affected parties and work to avoid duplication of effort among the partner agencies. They also will serve as a liaison between the Steering Committee and the other partnership committees to ensure clear communications, project guidance, and provide an annual review of committee and project activities.
- The successful completion of FedState projects is dependent upon the active participation and resource availability of participating agencies.