

### **Criminal Investigations**

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### **What is the Employment Development Department's role on the Revenue Recovery and Collaborative Enforcement Team? In what ways will this new revenue-based focus differ from previous similar efforts in which EDD has been involved? What factors do you believe will determine the team's success?**

The EDD is charged with ensuring that workers receive the benefit coverage they are entitled to and that all employers comply with the payroll reporting and tax payment requirements under the CUIC. To protect the integrity of its programs, the EDD enforces provisions of the CUIC. Doing so assures the integrity of all EDD programs and protects the interests of employers, claimants, and taxpayers. The EDD takes a comprehensive approach to fraud prevention, detection, and deterrence. This approach involves EDD programs, EDD oversight entities, and business partners including federal, state, and local law enforcement agencies, and prosecutors.

The EDD's Investigation Division actively investigates allegations and suspected violations of the CUIC, and other laws and regulations pertaining to fraud or misconduct; and pursues criminal enforcement action against violators to protect the integrity of the EDD's programs and resources. The Investigation Division conducts criminal investigations and seeks prosecution of employers committing payroll tax fraud against the EDD. In addition, the Investigation Division identifies, investigates, and prosecutes disability and unemployment insurance benefit fraud. The EDD Investigation Division partners with other law enforcement agencies and is a member of several task forces for the purpose of sharing information on criminal activity and to conduct investigations more effectively and efficiently.

The Revenue Recovery and Collaborative Enforcement Team (RRACE) was created when Assembly Bill 576 was enacted. This bill was enacted to enhance collaboration in combating criminal tax evasion associated with the underground economy by, among other activities, developing a plan for a central intake process and organizational structure to document, review, and evaluate data and complaints. The RRACE's partnership includes many of the labor and tax agencies currently participating in the JESF and the LETF. The RRACE focuses on similar efforts as do the JESF and LETF; however, it has more of emphasis on violations that will result in criminal prosecution rather than administrative penalties.

The RRACE is in its infancy, and the roles are still being defined. At this point, the RRACE will be investigating violations brought forward from the partnering agencies, which will include investigations involving sales and use tax, piracy, and human trafficking violations. As the roles of the enforcement partners are further

defined, we will be able to determine the impact on the employment payroll tax program and the potential for generating revenue for General Fund and Special Fund programs. Depending on the outcome, this may allow the EDD to criminally prosecute employers we might not otherwise due to the cost effectiveness of consolidated enforcement efforts.

Past experience shows that when multiple enforcement agencies work together and file multiple charges, there is more leverage for the prosecuting authority to levy fines and penalties. While it is presumed that there would be some revenue gained through the collaborative efforts of the RRACE, it is difficult to assess how much this might be at this point. The overall impact of the pilot program could help create a more level playing field for California businesses by penalizing those that seek to criminally defraud the State. It may also maximize State investigative resources and recover a significant amount of taxes through increasing the number of criminal cases investigated and prosecuted. With each of the successful criminal prosecutions, the State should also experience an increase in the number of employers who comply with labor and tax laws.

Developing new ways to better detect and combat the underground economy is imperative. Technical advancements have contributed greatly to the means in which violators perpetrate tax evasion and fraud. A factor that may determine the team's success is the timely detection of emerging fraud trends. Working collaboratively with other state partners should enable us to use the full array of investigative techniques to find and stop criminals before the criminal activity takes place, rather than after the damage has been done.

**What hurdles do EDD's investigator's experience? Are there regulatory or organizational barriers that obstruct enforcement efforts?**

The EDD Criminal Investigators operate as sworn peace officers in California, but are not authorized to carry firearms (Section 830.3[q] of the Penal Code). As a result, the EDD Investigation Division must contract with the California Highway Patrol and work with other law enforcement agencies who are authorized to carry firearms when issuing search warrants and arresting individuals who are being charged with a crime. This type of arrangement requires additional coordination among several State agencies that may delay serving a search warrant or arresting suspected criminals. It also complicates these actions since the participating partner officers must monitor the safety of the EDD Criminal Investigators while conducting the search or arresting the suspected criminals.

The EDD Criminal Investigators are dependent on partner agencies to assist in performing their high-risk investigative activities and responsibilities. Increased efficiency and effectiveness could be realized if the same statutory authority and resources were extended to each enforcement agency. A consistent classification and authority would also promote the state's retention of a skilled investigative workforce comprised of peace officers that are equally equipped and trained to perform the duties in their respective positions.

Based on limited resources in relation to the vast number of employers, not every employer who breaks the law can be prosecuted criminally. Criminal investigations for payroll tax evasion are technical, complex, and time consuming. Due to the limited number of investigators and resources, case selection is assigned based on investigator availability and current caseloads. Consideration is also given to investigating cases when the potential amount taxes owed can be estimated in order to make the best cost-benefit decision. Cases that cannot be investigated or prosecuted criminally are referred for administrative remedies. Having dedicated staff assigned to the EDD's Investigation Division for the purpose of investigating criminal cases, such as forensic auditors and information technology personnel, could increase internal efficiencies and streamline investigations that are delayed because of conflicting priorities.

In 2012, the EDD's Investigation Division conducted tax enforcement activities, which included:

- Investigating 184 ongoing and new payroll tax evasion fraud cases with a potential tax liability of \$53.8 million.
- Filing 17 criminal complaints representing a potential tax liability of \$4.9 million.
- Completing 21 criminal prosecutions with a potential tax liability of \$8.8 million.
- Referring seven conviction cases with tax liabilities in the amount of \$546,999 to EDD's Collection Division for recovery.

Refer to the [2012 Annual Fraud Report](#).

**What insights could you offer regarding two avenues to improvement: shutting down major violators through enforcement and increasing voluntary compliance through education?**

The EDD has benefitted from participating on joint enforcement efforts where there is direct involvement of a dedicated prosecutor, or team of prosecutors, familiar with the violations of each agency. This allows the prosecutor(s) to be involved in the investigation at an early stage that will result in obtaining the greatest amount of restitution and penalty. An example of such partnership is the EDD's successful collaboration and participation in the statewide District Attorneys' Workers' Compensation Program whose efforts are funded by the Department of Insurance grants. The partnerships within the program complement each other's investigative casework and show that there are significant benefits of having a prosecutor involved in criminal investigations. It would therefore be beneficial if prosecutors were available throughout the State to take part in the existing enforcement programs.

When multiple enforcement agencies work together and file multiple charges, there is more leverage for the prosecuting authority to levy fines and penalties. For example, the felony conviction and prison sentence of a business owner in Orange

County had the effect of shutting down several companies owned by this individual. Knowing that this business owner is no longer operating illegally means future contracts can be awarded to legitimate businesses. This is just one example how the District Attorneys' Workers' Compensation Program and support from the dedicated prosecutor at the very beginning of the investigation worked to shut down a major violator. Increasing grant opportunities may be a consideration for expanding the District Attorneys' Workers' Compensation Program or replicating it for other enforcement activities.

The EDD strives to promote and maximize voluntary compliance through education and outreach. However, employers operate businesses in the underground economy because they believe that nothing will happen to them if they are caught. State enforcement agencies could emphasize the results of prosecuted cases by publicizing them in forums of general public interest. Once employers realize that they can be ordered to pay back taxes and penalties and serve jail time, the employers may be more hesitant to operate in the underground economy. One consideration is to implement a state-level website of "Top Underground Economy Offenders" that publishes convicted criminal violators of the underground economy. This website can serve as a deterrent and also as a tool to serve the public who are seeking services from legitimate businesses.

As a result of the press releases from the Orange County Premium Fraud Task Force there have been instances where the District Attorney will see an influx of leads and employers' wanting to come into compliance after a press release is issued. Orange County Deputy District Attorney Debbie Jackson who leads the Premium Fraud Task Force verified her office received an increase in calls after press releases, and cited the Petronella Roofing Case as an example.

The increase in calls ranged from people wanting to report allegations, additional witnesses, to contractors and employers who wanted to get in compliance with the law. This type of publicity results in more leads to investigate and also serves to improve voluntary compliance of tax laws.

## **EDD considerations/recommendations to combat the underground economy**

**Are there ways that you would suggest the state change or expand its approaches to combating the underground economy? Are there recommendations that you would suggest the Little Hoover Commission consider?**

### Data Sharing

Federal restrictions on sharing key Internal Revenue Service data is one barrier to conducting joint investigations. Enforcement agencies should work collectively to seek changes at the federal level to remove the restrictions to data sharing, thereby giving all agencies access to data that can be used to combat underground economy activities and enforce labor and tax laws.

### Enhanced Penalties

Heighten the level of risk and the penalties associated to individuals participating in the underground economy, whether it is businesses purposely avoiding their responsibilities or individuals who choose to work underground (i.e., cash-pay). Strengthen the enforcement, and, at the state level, publicize the enforcement actions taken. The loss of employers' licensing could also be imposed for egregious underground economy violators, especially since these violators often operate businesses that have unsafe working conditions, and fail to contribute to worker protection programs.

### Increase Staffing Resources

If current public policy is to more aggressively combat and decrease the underground economy, then adding staffing resources specifically to address the underground economy is an option. While this would be true of any of the State government enforcement agencies, specific to the EDD, this would include additional staff that have a direct role, such as lead developers, auditors, collectors, programmers, investigators, and attorneys that work specifically on combating the underground economy.

### Evaluate Employee Classifications

From a human resources perspective, the classifications should be evaluated for consistency for the same level of work, including the investigation, tax audit and compliance, and management series. A consistent classification and authority would promote the state's retention of skilled workforce, and ensure staff that are equally equipped and trained to perform the duties in their respective positions in any enforcement program.

Implement Common Employer Identifiers

The different employer identifiers used by the various State agencies make data exchange complex. Multiple studies have been conducted over the years looking at the feasibility of having agencies use one common identifier to ease the exchange of information. While prior studies evaluated a single sign-on as a common identifier, the findings suggest that, due to the different systems used by the agencies, this could be very costly and complex without understanding the benefits derived. However, as the legacy systems are replaced within each agency, looking strategically, the new technology should move in the direction with one common identifier or technology broad-banded to ease the exchange of information.



## Memorandum

**To:** All LETF and JESF Team Members

**From:** Christine Baker, DIR Director and Sharon Hilliard, Chief Deputy Director

**Date:** November 19, 2013

**Re: LETF JESF Collaborative Enforcement Partnership**

Dear JESF and LETF Team-Members,

As part of the State's efforts to help combat underground economy and protect worker's rights, the Department of Industrial Relations (DIR) and the Employment Development Department (EDD) have two successful enforcement programs, the Labor Enforcement Task Force (LETF) and the Joint Enforcement Strike Force (JESF). There are opportunities for us to collaborate further and optimize the State's enforcement programs.

We recognize both the JESF and LETF teams have special focus, talent, and strength. To leverage the many attributes of both enforcement programs, we will focus on training, administration of operations, and strategic planning. The LETF and JESF will remain under the guidance of their respective programs, while taking advantage of opportunities to more effectively streamline operations, leverage resources and mitigate overlap and increase overall coordination. This will result in broader statewide operations, stronger communications, and provide knowledgeable, cross-trained staff. Our teams will work in partnership and take next steps to leverage the strengths of both programs for operational efficiency. Renée Bacchini, Special Assistant to the Director of DIR, and Mike Lee, Chief of the Compliance Development Operations for EDD, are leading this effort, and as the specific details are identified, additional information will be forthcoming.

By joining efforts, our enforcement team becomes a stronger strategic force against the underground economy. These are exciting times for our Departments, and we look forward to working together to make our enforcement programs even stronger for the people of California.

Sincerely,

Christine Baker  
Director  
Department of Industrial Relations

Sharon Hilliard  
Chief Deputy Director  
Employment Development Department