A Shameful Scam that Steals Your Work

by Peter A. Cockshaw

There is an illegal practice that’s plagued construction for years. Today this insidious scam is an epidemic—an epidemic spreading rapidly due to fierce market competition and razor-thin profits.

Key players in this corrupt practice are contractors who undercut their competitors by failing to pay mandated benefits.

These employers’ most common scheme is the illegal classification of tradesmen as “independent contractors.” By giving workers this status, contractors escape payment for Social Security, workers’ compensation and unemployment taxes.

Victims are many. They include employees who don’t have the benefits when needed and citizens whose insurance premiums rise for the uncovered workers’ medical bills.

But the big losers are closed and “merit shop” contractors who pay the legally-required benefits and lose work to cheaters who do not.

The dollar savings to benefit avoiders are substantial. This is indicated by the average national payout assessed employers for the three mandated benefits. These all-trade payroll percentages are as follows:

- Worker’s comp: 10%
- Unemployment taxes: 1.5%
- Social Security: 7.65%

The three assessments total 19.2% of payroll—which is no small change. And, with the exception of Social Security, the percentages can be much steeper depending on the state, craft and employer’s labor costs.

Workers’ comp premiums extract the biggest chunk. Contractors’ costs just for the heavy-highway sector average as high as $65.56 per $100 of payroll (i.e. in Montana).

In many states, workers’ comp outlays for higher-risk crafts—like ironworkers and roofers—are astronomical. Moreover, union contractors must swallow a bigger and more bitter pill because these premiums are based on payroll dollars.

It’s clear, then, that a contractor’s dollar outlay for the three mandated benefits is a hefty burden. It’s also clear that employers who, by whatever guise, escape payment enjoy a sizable cost advantage.

So what is being done to ensnare the cheaters and give all employers a level playing field? The answer: very little.

Contractors who fail to pay mandated benefits are hurting their employees and the industry.

The dollar savings to benefit avoiders are substantial. This is indicated by the average national payout assessed employers for the three mandated benefits. These all-trade payroll percentages are as follows:

- Worker’s comp: 10%
- Unemployment taxes: 1.5%
- Social Security: 7.65%

The three assessments total 19.2% of payroll—which is no small change. And, with the exception of Social Security, the percentages can be much steeper depending on the state, craft and employer’s labor costs.

Workers’ comp premiums extract the biggest chunk. Contractors’ costs just for the heavy-highway sector average as high as $65.56 per $100 of payroll (i.e. in Montana).

In many states, workers’ comp outlays for higher-risk crafts—like ironworkers and roofers—are astronomical. Moreover, union contractors must swallow a bigger and more bitter pill because these premiums are based on payroll dollars.

It’s clear, then, that a contractor’s dollar outlay for the three mandated benefits is a hefty burden. It’s also clear that employers who, by whatever guise, escape payment enjoy a sizable cost advantage.

So what is being done to ensnare the cheaters and give all employers a level playing field? The answer: very little.

Yes, the Internal Revenue Service made a big slash last year by announcing a crackdown on the independent contractor scheme—citing contractors as prime offenders.

Although the IRS has stepped up enforcement, an agency source admitted that “We’re overburdened with many, many other types of tax-dodging. Manpower is stretched so thin it’s very difficult to make much impact on an industry as vast as construction.”

The situation is even bleaker in state enforcement. Few states ever have had the necessary resources for such enforcement, and recent budget cuts have restricted most to bare bones enforcement.

This means that states must rely heavily on “tipsters” to report benefit violations.

A prime source of such tips is the workers themselves. But few illegally classified as independent contractors report such ploys for three main reasons:

1. they are willing participants to the scheme;
2. they are afraid of being fired; or
3. they don’t know—or care—about their employer’s practice.

The end result of lax enforcement: contractors who “play by the rules” are behind the competitive Eight Ball.

Relief Against “Benefit Bandits”

That’s the bad news The good news is that onestate’s construction industry devised a workable strategy to help curb the benefit cheaters. That state is Connecticut.

The steps taken in Connecticut may be a blueprint for action that employ-
ers elsewhere can put to very good use. The strategy to give legitimate contractors recourse against cutthroat competitors was “the brainchild of John Cunningham, Carpenters Local 210’s business manager,” emphasizes AGC of Connecticut’s labor relations director, Bob Fontana.

“The plan Cunningham proposed,” Fontana said, “embraced two prime objectives.

“The first was a law that would act as a deterrent to such illegal activity (i.e. misclassifying tradesmen as independent contractors to avoid payment of legally-required benefits).

“The second was a mechanism to allow recovery of monetary damages from violators. This gives contractors, employer associations and labor unions a private course of legal action.”

Such legislation was desperately needed in Connecticut, Fontana explained, “because illegally paying workers as so-called independent contractors is rampant.”

Fontana also revealed that “the prime violators are non-signatory independents—construction employers not affiliated with any industry association.”

Another informed source (an electrical member of Connecticut’s ABC chapter who requested anonymity) added: “Believe it or not, I’ve discovered that there are many more benefit bandits that are non-union independent specialties than general contractors.”

Whether general or specialty, employers who cheat give their companies a distinct competitive edge. Dramatic evidence of this unfair cost advantage is illustrated from data provided by Jim Lohr, director of Carpentry Industry Partnership, a joint labor-management group.

The following breakdown represents typical hourly labor costs of signatories to Connecticut’s Carpenters Local 210:

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages $17.80</td>
<td></td>
</tr>
<tr>
<td>Fringes $3.00</td>
<td></td>
</tr>
<tr>
<td>Social Security $1.33</td>
<td></td>
</tr>
<tr>
<td>Workers comp $4.57</td>
<td></td>
</tr>
<tr>
<td>Unemployment $1.08</td>
<td></td>
</tr>
<tr>
<td>Total $27.78</td>
<td></td>
</tr>
</tbody>
</table>

Cheaters Reap 25% Cost Advantage

Add up the tab for mandated Social Security, workers’ compensation and unemployment taxes and you’ll see the savings gained by the cheaters.

A Connecticut employer who illegally avoids such costs slashes $6.98 an hour—a whopping 25% from labor costs. Even if your state’s mandated benefit outlays are lower, just a 5-to-10% reduction can make the difference between winning a job or losing it.

New Law to Curb Illegal Practices

Faced with the unpleasant prospects of losing more jobs in a highly competitive market, Connecticut’s construction community geared up for action. The industry launched a campaign in January to enact what was termed an “Unfair Trade Practices Act.”
Key ingredients of the legislation were the two objectives noted earlier. The effort was spearheaded by labor officials led by Carpenters Local 210’s Cunningham and two major contractor associations—the Connecticut Construction Industry Association and AGC of Connecticut.

The joint labor-management Carpentry Industry Partnership played a vital role in coordinating the campaign.

Surprisingly, given the fact that most legislation moves at a snail’s pace, the “Unfair Trade Practices Act” passed and became law within months of initial introduction.

The formal language which amended a previous law describes the measure as “an Act concerning actions for damages resulting from violations of unemployment and workers’ compensation statutes by bidders on construction contracts (i.e. both public and private work).”

Effective October 1, Public Act No. 90-273 will offer legal relief to “any person, firm, association or corporation which suffers damages as a result of a competitive bid for a project involving construction, repair, remodeling, alternation, conversion, modernization, improvement, rehabilitation, replacement or renovation of a building or structure.”

**Injured Parties Can File Suits for Damages**

Any party—employer, contractor, association or tradesman—who suffers from loss of a competitive bid to a violator of the state’s unemployment and workers’ comp statutes “may bring action for damages in superior court.”

A key to successful legal action brought by parties who lose jobs is the definition of “independent contractor.” Under the Act, the determination of whether contractors have misclassified an employee as such will rely on provision in the U.S. Internal Revenue Code.

An IRS source said that for construction, “There are two prime factors used in determining independent contractor status. One is the actual provider of material and workplace. The other is whether there is a formal contract to perform services.” Another of the 20 factors relied on is whether a contractor has the right to discharge an employee. “This factor,” the IRS official stressed, “indicates an employer-employee relationship—not an independent contractor arrangement.”

To characterize Connecticut’s construction industry as “overjoyed” by passage of the new law is putting it mildly. As AGC’s Bob Fontana, a 20-year labor relations veteran, puts it:

“We finally have a true deterrent to curb the benefit thievery that has greatly accelerated. Certainly, the real possibility of facing a private cause of action and damages awards will have a very chilling effect on potential cheaters.

“Moreover, by creating a private cause of action, the law adds a third class of parties with legal standing to sue—-and punish—violators.”

**Mechanicals To Pursue Violators**
It appears that the “third class of parties.” Fontana cites are ready to capitalize on the new law.

Notes Art Piviotto, President of the Mechanical Contractors of Southwestern Connecticut (MCSWC):

“The Carpenters and their contractors have performed a great industry service. We’re going to take advantage of these reforms by actively pursuing litigation against offending contractors.

“Benefit cheats now have a legal Sword of Damocles hanging over their heads!”

Adds MCSWC contractor member Ricci Otto: “This is a law you only have to use once. Once we are successful in getting a judgment against just one offending contractor, the word will get around--and fast.

“Obtaining court-ordered monetary damages will put other violators on notice that such anti-competitive practices no longer will go unpunished.”

Connecticut’s “Unfair Trade Practices Act” is most justified. *Legitimate* contractors already face too much risk for too slim profits.

Companies compounding this problem by engaging in cutthroat competition via non-payment of benefits have no place in construction. They richly deserve to be put out of business.

Victims of this insidious scam--in whatever state they operate--are advised to take a long hard look at Connecticut’s reform measure.

The new law exemplifies the kind of corrective action that’s long overdue.

The above analysis was reprinted with permission from the August 1990 edition of Cockshaw’s *Construction Labor News+Opinion*. Publisher of this authoritative industry advisory is Peter A. Cockshaw, construction’s leading expert on labor-related issues.

Readers can obtain a free sample issue of Cockshaw’s current newsletter at no obligation. Contact Cockshaw Publications, P.O. Box 427, Newton Square, PA 19073.

**About the Author**

Peter A. Cockshaw is a nationally respected authority on construction labor related issues. He is also editor and publisher of construction’s most widely read labor and employee relations advisory service. A former special assistant for the U.S. Congress, Cockshaw is a member of the exclusive “Republican Senatorial Inner Circle.” A popular speaker, Cockshaw has addressed over 550 industry meetings since 1965. His books include *A Bargaining Guide for Contractors, Profit-Oriented Employee Relations Techniques*, and *How Contractors Can Improve Jobsite Productivity and Profits*. 