
**Interagency
Compliance Network's
Second Report
to the Oregon Legislature**

Employment Department
Department of Consumer and Business Services
Department of Revenue
Department of Justice
Bureau of Labor and Industries
Construction Contractors Board
Landscape Contractors Board

March 2013

www.oregonindependentcontractors.com

Executive summary

The 2009 Legislature created the Interagency Compliance Network (ICN) to improve employers' and workers' compliance with Oregon's tax and employment laws. The ICN is made up of seven state agencies. Its mission is to focus on the classification of workers as independent contractors (ORS 670.700). The group must report its results to the Legislature every two years. This overview of activities from July 2010 to June 2012 is the ICN's second report.

In its early stages, the ICN identified four focus areas:

- Communicating with ICN's broad audience base.
- Sharing and analyzing data among the seven agencies.
- Coordinating compliance enforcement.
- Investigating criminal activities related to worker classification.

With few resources, the communication workgroup created an easy-to-understand website to help employers and workers recognize the difference between an independent contractor and an employee. The site includes links to webcasts, statutes, FAQs, and contacts from each agency. The website's tone is friendly and nonthreatening, even though the topic is serious.

To share information among the participating agencies, the ICN created the High-risk Employers Database (HRED). The database enables ICN auditors to compare employer 1099 data with 1040 individual return data. It also provides industry-specific information.

The ability to share data is the backbone of the ICN. It allows participating agencies to work more efficiently to ensure compliance from all perspectives: worker protection, and law and tax compliance.

To improve compliance among employers, the ICN cross-trained auditors from three agencies in July 2010 so employers would be reviewed by only one auditor instead of three or more. This made audits much less time-intensive, saving the state money and fostering a more positive relationship between the auditor and employers.

As of December 2012, the ICN has referred four cases to the Oregon Department of Justice (DOJ) for investigation. DOJ successfully prosecuted one of these cases in July 2011. As the ICN project moves forward, one of the most important lessons the group has learned is to continually improve auditor "cross training" so they understand other agencies' compliance requirements.

Because sharing tax information among ICN agencies is vital to the network's success, the Employment Department and the Department of Revenue have written a proposal requesting to share data elements of federal tax information.

Participating ICN agencies

Seven state agencies make up the ICN:

- Employment Department.
- Department of Consumer and Business Services.
- Department of Revenue.
- Department of Justice.
- Bureau of Labor and Industries.
- Construction Contractors Board.
- Landscape Contractors Board.

In 2010, the Legislator's Emergency Board released funds to the ICN agencies to fund temporary staff, legal services, and website improvements, based on an action plan developed by the participating agencies.

The action plan is built upon four strategy areas described in this report:

- Outreach and assistance.
- Data sharing and analysis.
- Coordinated enforcement.
- Criminal investigations.

Outreach and assistance

The ICN agencies identified public outreach and assistance as one of the group's four focus areas. The agencies worked cooperatively in public outreach.

In August 2010, the ICN agencies created a communication workgroup and tasked it with "the evaluation and overhaul of tools, strategies, and materials to improve education and outreach to businesses and workers on the issue of proper worker classification."

Under the leadership of the Bureau of Labor and Industries, the workgroup met monthly to share information on continuing projects, and to approve website content and educational materials. The monthly meeting stopped once the materials and website were complete in August 2011. The group now meets ad-hoc.

Two of the communication workgroup's education activities included seminars for employers and workers, and maintaining a website about independent contractors and worker classification. The site is www.oregonindependentcontractors.com.

Objectives and measures

The workgroup's charter identifies the completion of these deliverables:

- Create, update website and communication materials (presentations, brochures, etc.).
- Review proposals for communication tools and methods.
- Create a process that updates information to customers so that information is always current.
- Create a complaint-reporting method so that the public can report suspected violations.
- Provide a process for publicizing effects of noncompliance, using real examples.

Outcomes to date

Website redesign

The ICN's website, www.oregonindependentcontractors.com, is at the heart of ICN's outreach efforts. The website was established in 2005 to help employers and workers understand independent contractor issues.

As a result of HB 2815, the communication workgroup made these website updates:

- Added content about how all ICN agencies apply related laws.
- Updated content that encourages people to contact ICN agencies with questions or complaints.
- Improved usability, including:
 - Removed clutter and unnecessary links from homepage.
 - Rewrote content to meet web and plain language standards.
 - Added a site-specific search capability.
 - Added a series of webcasts on worker classification.

- Added translation capability.
- Included a web-based user feedback survey to help the workgroup improve the site.
- Added a complaint form individuals can submit to report suspected violations.
- Included comprehensive legal content.
- Incorporated compliance tools—for example, a chart that presents side-by-side comparisons of employer and worker criteria used by each ICN enforcement agency.
- Revised content to include industry-specific content that lists additional worker classification considerations for 19 industries (e.g., adult foster care, internet-based services, taxicab operators, pharmacists).
- Developed web-based complaint form so people can anonymously report suspected violations. The ICN enforcement team uses this information to pursue leads.

Website analytics show that the site’s traffic increased dramatically since these revisions were made. Unique page views increased from the first quarter of 2010 through the first quarter of 2011 by more than 400 percent.

During the project, the workgroup met at least monthly to approve website updates. Representatives from each ICN agency contributed to website and training materials content. They also made sure that communication proposals were approved by all ICN agencies.

Getting the most out of limited resources

The ICN requested funds to provide ongoing improvements and updates to the website as part of the long-term communication strategy. The workgroup considered using these funds to create a website outside the restrictions of the state’s content management system (TeamSite); however, under the advice of DOR’s website usability expert, the workgroup decided to work within the TeamSite framework because:

- Revising and reorganizing the current site would provide many of the benefits of an independent website but without the complications or costs of hiring a website contractor and third-party website host.
- Content remains within the ICN’s control.

The workgroup also decided which website functionalities to pursue. Although anecdotal evidence indicates a shift in the way people use the internet (i.e., away from search engines, toward social media), there is little traffic on the site’s blog. The workgroup determined that, for now, a more traditional website is most helpful to our customers. Web analytics show searches on relevant terms confirm that ICN-agency websites are successfully directing visitors to the ICN website.

The workgroup created a document that captures key themes, media options, and communication strategies. It’s a framework for future efforts beyond the workgroup’s deliverables and funding.

Funding

A portion of ICN funding was allocated to the Bureau of Labor and Industries to establish a full-time, limited-duration position to develop and maintain the website. The position also served as the workgroup’s project leader.

Because there was no additional funding, the position ended June 30, 2011. As a result, the Employment Department maintains the ICN website but does not receive any dedicated funding for this effort.

Other communication, training

The communication workgroup is the clearinghouse for coordinating educational seminars and vetting media pieces related to worker classification. In 2010, the communication workgroup approved three news releases about worker classification. The releases ran in newspapers statewide. Two more news releases ran in 2011. The group coordinated eight interagency panel presentations around the state in Portland, Salem, Bend, Eugene, Medford, and Corvallis. Nearly 290 people attended the presentations, which targeted constituencies such as the Oregon Employer Council, the Employment Law Conference, SAP Corp, and Oregon State University. The communication workgroup now meets ad-hoc instead of monthly. Educational seminars are conducted upon request.

The outreach continued through 2012 with the Governor’s Marketplace Road Show where many of the participating ICN agencies provided education in understanding tax reporting requirements and worker classification. The Governors Marketplace Road Show included presentations throughout Oregon including Pendleton, Ontario, Hood River, Astoria, and Newport.

Publicizing noncompliance: what are the impacts?

The ICN is considering publicizing the outcomes of ICN audits as a way to encourage noncompliant employers to come into compliance; however, because many audits are nearing completion, the ICN must consider the potential impact of this publicity on all ICN agencies’ compliance rates. The following table shows the results of the ICN’s initial 14 audits.

Underreported tax data from ICN audits

June 2010–June 2012

Misclassified employees	1,265
Underreported payroll	\$62.8 million
Employment tax	\$1.4 million
Withholding tax	\$908,469.58
Transit tax	\$367,095.74
Workers Benefit Fund	\$9,509

In addition to the ICN CS3 program, the member agencies, through the Interagency Compliance Network Enforcement Group (ICNEG), conduct joint audits of employers with independent contractor issues. Through referrals brought to the ICNEG, assigned members for each agency determine whether to assign auditors or investigators from their agency to participate in the joint audits. From January 1, 2011 through June 30, 2012 (Phase II), the statistics from these joint audits are as follows:

Phase II of CS3 program

- Started 12 audits
- Completed 9 audits

Total unreported payroll	\$23,326,920
Total number of misclassified workers	419
Total UI tax assessed	\$455,811
Total W/H tax assessed	\$6,815
Total transit tax assessed	\$141,891
Total number of appeals filed on audits submitted for Phase II	8
Total number of appeal audits settled	2
Total number of appealed audits affirmed at hearing	1
Total number of appealed audits overturned at hearing	1

From April 1, 2011 through June 30, 2012, the OED compliance enforcement officer (CS3) has dedicated 380 hours to case preparation, consultations with OED's authorized representative (who presents the agency's cases at hearing), witness participation, and settlement/audit adjustments in ICN audits that have been appealed to administrative hearing.

Joint audits conducted by OED and DOR employer tax auditors (CS2s):

Number of joint audits started during Phase II	15
Number of joint audits completed in Phase II	9
Total payroll audited	\$74,207,515
Total unreported payroll generated from joint audits	\$7,403,159
Number of misclassified workers found	2,332
Total OED tax assessed	\$168,613
Number of OED assessments from joint audits appealed	4
Number of those affirmed at hearing	2
Preparation & participation time spent for appealed cases	8 hours

Summary

While lack of dedicated funding limits the workgroup's efforts, the outcomes reflect each ICN agency's commitment to leveling the business playing field through proper worker classification.

Through the communication workgroup, the ICN:

- Creates new communication tools (e.g., website, presentations, webcasts).
- Provides employers with information on employee and worker classification criteria.
- Assists workers and employers to avoid worker misclassification by providing information and resources (e.g. complaint form, web content, ICN agency contact information).

Each outcome is a strong deterrent to misclassifying workers and provides a straighter path to correcting misclassifications.

Data sharing and analysis

The ICN created a database housed at DOR of leads identified as having potential compliance issues. One agency flags these leads so other ICN agencies can audit the ones that are most relevant to the agency. DOR developed two other tools to identify businesses that may misclassify their workers.

The ICN can efficiently generate a list of probable audit leads by using the data provided in the two tools described above. This also enables the ICN to evaluate leads based on set criteria: location, payroll size, number of employees, Employment Department claim data, previous DOR audits or investigations, etc.

High-risk Employer Database

The High-risk Employers Database (HRED) is a catalog of employers that filed federal tax returns, meet certain criteria, and have more than two employees. It compares data from their tax form 1099 with data from individuals' form 1040 tax filings to identify individuals who reported all of their annual income on one 1099 form. These individuals may be misclassified as independent contractors.

This analysis uses a 1989 Government Accountability Office study¹ methodology with currently available Oregon data. We expanded this analysis to look at the data by specific industry.

Data tool

Another ICN data tool helps identify employers that report significant decreases in the number of workers who filed W-2 forms while showing a simultaneous increase in the number of workers who filed 1099-MISC. The data tool also identifies employers who paid fewer wages (as reported on W-2 forms) from one year to the next while paying more 1099-MISC income.

The initial database included 16,867 businesses. From this, we identified 118 businesses to evaluate further. This methodology is similar to analyses that California's Compliance Development Operations group conducts.

Performance measures

Auditors completed audits for businesses suspected of misclassifying employees.

The new joint audit process helped the ICN meet these objectives:

- Establish consistency in agency determinations relating to the classification of workers.
- Gather and share information relating to employers who pay workers in cash and who do not comply with laws relating to taxation or employment.
- Gather and share information relating to the misclassification of workers.
- Develop investigative methods for auditing employers who pay workers in cash, misclassify workers, and don't comply with laws relating to taxation and employment.

¹US GAO. 1989. Tax Administration: Information returns can be used to identify employers who misclassify workers, <http://archive.gao.gov/d26t7/139838.pdf>.

- Identify opportunities for and obstacles to improving compliance with laws relating to worker classification, taxation, or employment.
- Create an efficient, coordinated enforcement process of worker classification laws that is both fair and effective.
- Conduct audits on businesses suspected of misclassifying employees.
- Identify and mitigate obstacles that prevent or impede information sharing among ICN agencies regarding independent contractors and joint audits.

Performance measures initially identified include:

- Assessments issued per program.
- Misclassified employees identified.
- Under-reported payroll numbers.
- Dollars collected per program.
- Number of businesses contacted.
- Cost per contact.
- Percentage of increased productive leads.
- Agency referrals.
- Audit time.

Underreported payroll is directly related to underpayments in unemployment, workers' compensation insurance premiums and transit taxes.

The next table illustrates that employers who misclassify employees as independent contractors save nearly \$5 per \$100 of payroll. This creates an uneven playing field compared to employers who properly classify their employees.

There are too many variables to accurately correlate underreported payroll—based on misclassified employees—to an actual amount of state income tax due. A misclassified employee could report and pay their state income tax correctly (as an employee) or they could take advantage of deductions available to independent contractors. The amount of tax they pay based on how they file is affected by many other factors

Direct assessments for each \$100 of underreported payroll.

Unemployment insurance (statewide average)	\$3.08
Workers' compensation (statewide average)	\$1.69
Transit taxes	\$0.007
Total	\$4.78

Employment and transit taxes are affected immediately by misclassification of workers because those taxes are based on a percentage of wages paid to employees.

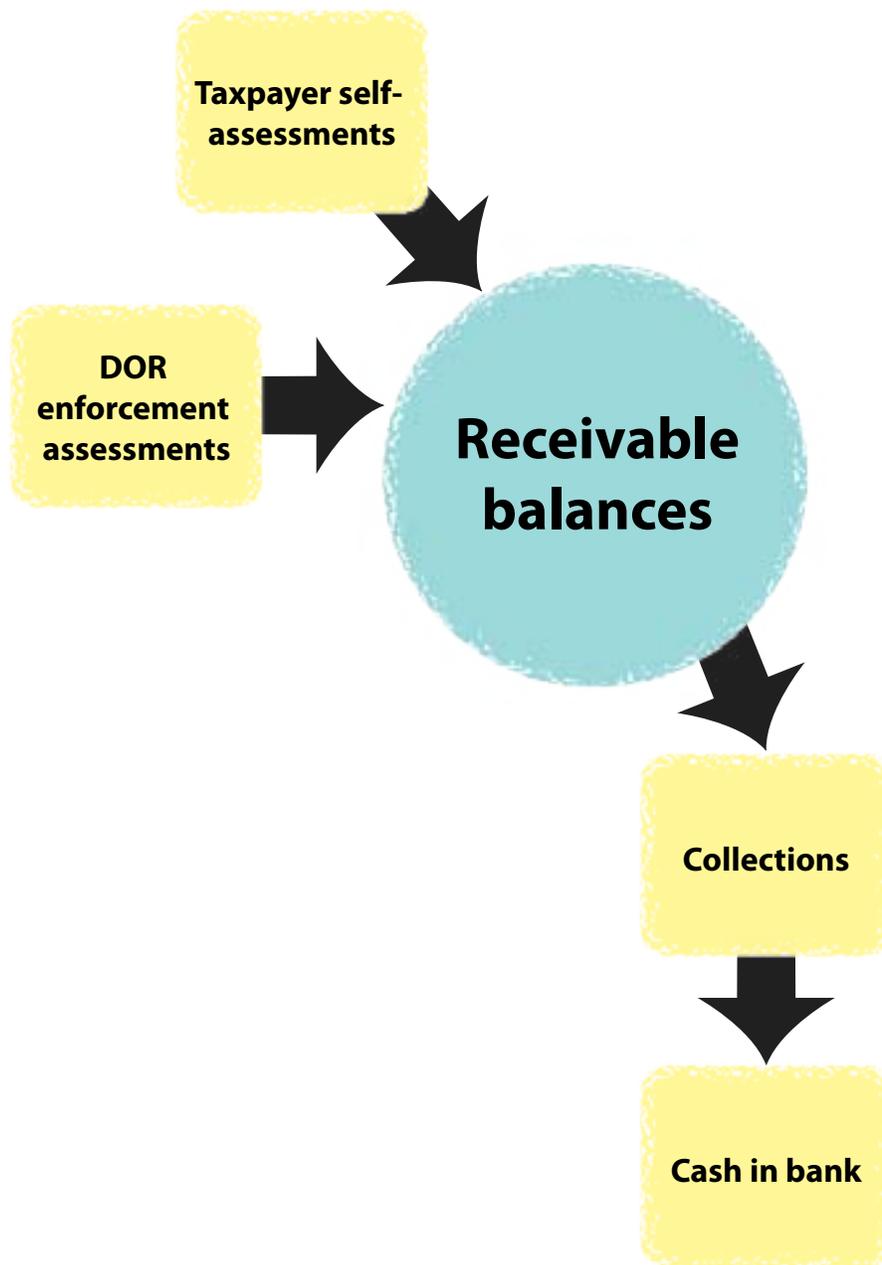
If a misclassified worker files and pays their state income tax as an independent contractor, their state income tax is calculated on net business income (gross receipts less expenses). Many expenses that independent contractors may claim are not allowable deductions for employees

(vehicle expenses, meals and entertainment, etc.). So although individuals may pay their state income taxes even when they have been misclassified as independent contractors, they may take expenses that should not be permitted, resulting in them paying less than their full fair share of taxes.

The state’s income tax rates range from 5 percent to 11 percent.

Diagram 1 illustrates the relationship between audit-generated assessments and accounts receivable collections, resulting in the state’s “cash in bank.”

Diagram 1. Enforcement activities revenue cycle.



Coordinated enforcement

Action plan

One of the ICN's coordinated efforts is enforcing the appropriate classification of workers.

HB 2815's objective is for state agencies to share information so that more employers and workers comply with tax and employment laws. To do this, the ICN created a process in which one ICN auditor, instead of different auditors from three or more agencies, examines business records for the Department of Revenue, Employment Department, and Department of Consumer and Business Services. In addition, that auditor refers pertinent information extracted from those business records to BOLI, the Construction Contracting Board, and Landscape Contractors Board for their follow-up.

The ICN enables state agencies to maintain consistency in determinations and investigative methods. It also has streamlined many of the agencies' duplicate processes.

Implementing agreements

The seven ICN agencies entered into a basic agreement to coordinate their efforts. It provides the overarching purpose of the ICN and allows for the coordination of efforts based on HB 2815 and ORS 670.700.

In addition to the basic agreement, ICN agencies entered into an implementation agreement in September 2010. It supplements the basic agreement with more detail that includes the exchange of information, joint investigations, confidentiality, and sharing leads among participating agencies.

Coordinated enforcement staffing

The Department of Revenue, Employment Department, and the Department of Consumer and Business Services hired three limited-duration compliance specialists to perform audits during the second half of 2010 through the first six months of 2011. A limited-duration operations and policy analyst position was created to improve data analysis and compliance strategies. Today, there are two full-time equivalent positions providing this function, one at the Employment Department and one in the Department of Revenue.

This coordinated enforcement staffing makes sharing pertinent information among the ICN agencies more transparent and efficient.

Criminal investigations

In 2011 and 2012, ICN agencies referred four cases to the Department of Justice for criminal investigation.

Hillsboro corporation and its owner plead guilty to criminal antitrust and racketeering charges

July 29, 2011

Antitrust charges against S&S Drywall and its owner, Steve Nagy, stem from rigging the bid process on a \$24 million condominium project in Portland's Pearl District

Attorney General John Kroger today announced the guilty plea and sentencing of a Hillsboro contractor and his corporation, S&S Drywall Assemblies, Inc., on antitrust and racketeering charges. This case is the first state criminal prosecution for antitrust violations in the history of Oregon.

Stephen Gregory Nagy (DOB: 08/24/61) pleaded guilty this morning in Washington County Circuit Court to Criminal Antitrust, Racketeering and Felon in Possession of a Firearm charges. He was sentenced to 30 days in jail and five years of supervised probation. S&S Drywall Assemblies was ordered dissolved.

The Oregon Department of Justice worked closely with the Worker's Compensation Division of the Department of Consumer and Business Services on the 18-month investigation leading up to today's sentencing. The Division is responsible for ensuring that Oregon employers comply with wage and hour laws as they apply to worker's compensation.

"The Department of Justice is committed to investigating and prosecuting complex racketeering and antitrust schemes that disrupt fair competition in Oregon's marketplace and rip off state agencies," said Attorney General Kroger. "I would like to thank the Department of Consumer and Business Services and the Hillsboro Police Department for their valuable contributions to this case."

As part of his sentence Nagy will forfeit more than \$50,000 in cash and more than \$250,000 worth of assets to the state. He will be stripped of his license with the Oregon Construction Contractors Board and is not permitted to reapply for 20 years.

In addition, Nagy is prohibited from working for any "family operated" business within the next 20 years and may not seek employment in the construction industry unless he discloses these convictions to future employers. Nagy must also repay state agencies defrauded by his illegal activity, including the Employment Department, to which he currently owes in excess of \$100,000. That figure is expected to rise.

The antitrust charges against Nagy derive from rigging the bid process that awarded S&S Drywall a \$1.2 million project associated with the development of a \$24,000,000 condominium structure in Portland's Pearl District. Nagy also engaged in a pattern of racketeering activity in which he bilked the state of hundreds of thousands of dollars. In particular, the charges focus on a scheme to fraudulently induce the Oregon Employment Department to issue unemployment benefits to S&S Drywall employees and forcing workers on prevailing wage jobs to return large percentages of their paychecks to him.

The weapons charges against Nagy stem from a raid on his residence, during which agents seized more than 20 powerful, high-end firearms. As a convicted felon, he is prohibited from possessing or controlling even one firearm. The Hillsboro Police Department provided important assistance on the day the search warrants were executed.

Senior Assistant Attorney General Andrew Campbell prosecuted the case for the Oregon Department of Justice. Agents Steve Armbruster and Jodi Shimaneck conducted the investigation.

Attorney General John Kroger leads the Oregon Department of Justice. The Department's mission is to fight crime and fraud, protect the environment, improve child welfare, promote a positive business climate, and defend the rights of all Oregonians.

Lessons learned

General

- Team flexibility encouraged agency representatives to:
 - Communicate openly.
 - Report noncompliance leads in a timely manner.
 - Build strong relationships with other team members.
- Leads provided by DOR tools show high rates of noncompliance among certain employers.
 - Each focused lead isolated an instance of noncompliance or misclassification.
- To understand customers better and improve efficiencies, auditors surveyed businesses to collect data on how businesses prefer being audited.
 - Businesses strongly favor one audit by one auditor rather than three audits by three auditors from different agencies.
- Federal tax information restrictions do not allow DOR to grant complete system access to Employment Department and DCBS auditors.
 - This hindered the other auditors' abilities to efficiently work independently.
- The time and resources involved in the litigation process for both the Employment Department (through administrative hearings) and the Department of Revenue (in the Oregon Tax Court) has greatly increased with these ICN audits. In addition, more time during the ICN audit is being spent in discussions and negotiating for information and compliance with the employer's legal representatives than was originally expected. In-person administrative hearings have lasted 3-5 days in duration. These new challenges affect the audit time available for the compliance specialists.
- Audit workbook program was inadequate for scale of ICN audits. Entering payroll and disbursement data, scanning documents, and making audit adjustments was cumbersome and very labor intensive.

Auditor training

- Auditors assigned to ICN were experienced in their native tax programs, so they received training from the other agencies.
 - Training sessions should have been longer and more focused on how different agencies address misclassification.
 - Training time did successfully prepare auditors to use ICN systems.
- To “cross train,” auditors created a reference guide of all applicable laws, common wage issues, and wage taxability.
- Training time was too short.
 - “Teaching audits” took a lot of time as the businesses chosen had large payrolls.

- The teaching audits did not close until June 2011. There is not a sufficient amount of data from the impact of the audits to include in this report.
- Future auditor training sessions will be longer.
- Initial auditor training was open to auditors and to other representatives from ICN agencies.
 - This diverse audience was not conducive to the high-level training auditors needed.
 - Future training will be focused exclusively on auditors.
- Because training was open to ICN agencies, they understand each other's barriers.
 - This understanding has improved communication and cooperation among agencies.
 - It will eventually improve public perception of the agencies' audit processes and create public awareness of the ICN.

Next steps

The steering committee will continue to meet quarterly to monitor expectations and provide guidance to each aspect of the ICN. The Employment Department and DOR will continue to fund a full-time compliance specialist to audit accounts for both agencies.

The other agencies outlined in HB 2815 will participate in the ICN taskforce, a sub-committee of the ICN. The taskforce meets monthly to share leads, identify problematic industries, and discuss and plan audits. Agencies also continue to share leads on the depository database that is hosted by DOR.

The ICN taskforce plans to develop additional lead-identifying tools determined by DOR. These will allow for continued audit leads. These tools include:

- Matching Internal Revenue Service (IRS) form W-2 filing data with Oregon withholding data to identify businesses registered with the IRS as doing business in Oregon, but not registered with the state.
 - This analysis is similar to Washington state’s study that estimated the revenue impact to that state in 2009.
- Comparing W-2 and 1099-MISC forms filing data to look at workers who switched from W-2 to 1099-MISC filing over time.
- Proposing that the IRS allow participating agencies to share federal tax information. The IRS restricts what federal information can be shared. DOR and the Employment Department are writing a proposal for the IRS that, if accepted, will allow all federal information to be shared among agencies, creating additional audit leads.
- Developing a training plan for auditors participating in cross-agency audits. So far, the group has established detailed standards and expectations for each of the compliance specialist 3s.
- Granting system access to auditors so they may work independently.
 - Disclosure training has been arranged for all ICN participants.

Agency key contacts

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