



*State of New Jersey
Commission of Investigation*

CONTRACT LABOR

The Making of an Underground Economy

SEPTEMBER 1997

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September 1997

Governor Christine Todd Whitman
The President and Members of the Senate
The Speaker and Members of the General Assembly

The State Commission of Investigation herewith formally submits, pursuant to
N.J.S.A. 52:9M, a report and recommendations based on its investigation into matters
involving contract labor.

Respectfully,

Leslie Z. Celentano

M. Karen Thompson

W. Cary Edwards

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Executive Summary

Elements of New Jersey's agricultural and manufacturing industries have been subverted at taxpayer expense by a lucrative underground economy that benefits unscrupulous contractors who trade in cheap, and sometimes illegal, immigrant labor. Millions of dollars in income taxes and other levies go unpaid each year as a result of this enterprise, which also has diverted money from trust funds established to provide Social Security, Medicare, unemployment and temporary disability insurance for law-abiding citizens. The Commission's investigation, which focused primarily but not exclusively on the state's shellfish and poultry processing industries, also revealed evidence indicating Social Security and welfare fraud.

The central figures in this profitable underground economy are contract-labor providers who supply workers to processing and manufacturing plants. These labor providers include individuals known as "crew leaders" as well as the owner/operators of temporary-help service firms. The crew leaders and temporary-help service firms recruit and, in many instances, transport day laborers and are responsible for fulfilling payroll obligations through lump sums of money disbursed to them by the plant owners under various arrangements.

The Commission has determined that in most instances, the contract-labor providers do not supply payroll tax forms to their workers, do not withhold state and federal income taxes, substantially understate federal employment tax liabilities, and fail to remit adequate unemployment and temporary disability insurance taxes to state authorities, as required by law. Evidence indicates that the unremitted taxes are pocketed by labor providers, who then fail to report these illicit profits as income for their own tax purposes. Moreover, the Commission found that it is common practice for workers to be identified in payroll records with false names and bogus Social Security numbers, and that few checks are made to confirm identities. Many of these individuals do not divulge their true identities because they are receiving some form of public assistance, wish to avoid payment of income taxes and/or are undocumented aliens. In some instances, the tracking of contract-labor providers themselves proved difficult because they regularly employ tactics useful in cloaking their activity, such as periodically changing the names of firms and transferring ownership to relatives or friends. This “moving target” phenomenon obstructs the ability of regulatory agencies to impose sanctions, including collecting fines and restitution, against providers found to be in violation of various state and federal laws and regulations.

The Commission also found several factors at work, particularly in the shellfish and poultry processing industries, that appear to nourish the contract-labor system and serve to facilitate the resulting underground economy. First, public demand for products that are reasonably priced fuels intense competition within these industries. Processors

constantly look to shave costs, even if it means entering into questionable labor-supply contracts with crew leaders and temporary-help service firms. Second, existing state and federal laws and regulations governing this system are inadequate or are easily circumvented by operators bent on unscrupulous activity. Finally, insufficient resources and attention have been devoted to proper oversight and enforcement at the state level. At the conclusion of this report, the Commission makes a series of recommendations for systemic reforms and improvements.

The System

Underlying the problems and abuses examined in this investigation is a system characterized by an intensive demand for low-cost, unskilled labor by factory management, a ready source of supply for that labor from private contractors and a no-questions-asked relationship between the two.

On the demand side are owners and managers of commercial agricultural processing plants and industrial manufacturing facilities that require a steady stream of workers to perform a variety of menial jobs for which traditional full-time labor or machinery is too expensive, inappropriate or nonexistent. These jobs include such tasks as removing bones from poultry, shelling clams, sorting and packing produce, assembling parts, and readying finished products, materials and goods for shipment to customers.

On the supply side are individuals willing to take such jobs for payment at or below the minimum wage, which in New Jersey is \$5.05 per hour.¹ Increasingly, this labor pool is made up of immigrants, primarily from South and Central America and Southeast Asia, who reside in New York, Philadelphia, Camden, Bridgeton and other urban venues throughout this region. Picked up at street corners and other designated gathering spots, the prospective workers are packed into overcrowded vans and transported to processing and manufacturing plants daily to work various shifts. Plant managers have found immigrant groups to be far more amenable than the established local labor force to the idea of working cheaply under trying conditions with little or no fringe benefits. In fact, in some instances, factory managers told the Commission they have turned to immigrant-labor supply sources over the past 10 to 15 years because they were unable to fill regular, full-time slots with sufficient numbers of employees drawn from the local community. One plant official told the Commission her firm simply would not be able to meet production requirements without resort to outside labor. This official called the system “a necessary evil.”

Serving as a bridge between the demand for and supply of this type of labor are private providers who operate either independently as crew leaders or as representatives of temporary-help service firms. For many years in the agricultural industry, crew leaders have played an integral role in the system through which groups of migrant laborers are provided under contract to farmers at planting and harvest time. Starting in

¹ On September 1, 1997, the federal minimum wage was increased from \$4.75 to \$5.15 per hour.

the 1980s, however, this system began to expand as a source of labor for post-harvest production and processing as well. It has also in recent years gained a significant foothold in the manufacturing sector. Retained by plant management, contract-labor providers are paid lump sums – upwards of \$3 million per year in some instances – in exchange for providing workers daily for various shifts. The suppliers receive an average of between \$6.25 and \$6.75 per hour per worker and are responsible for meeting the payroll for their work crews. The pay is disbursed in cash, typically based on the minimum wage. Workers are required to pay for transportation arranged by the crew leaders, and housing costs are sometimes factored in as well.

Under this system, the contract-labor providers also are responsible for all employment-related paperwork. It falls to them to ensure the workers possess proper identification and legal working credentials. The providers are responsible for supplying all appropriate tax forms; for withholding, reporting and submitting state and federal payroll tax deductions; for submitting employer payroll taxes on their behalf to cover unemployment insurance, temporary disability insurance and related payroll deductions; and for furnishing workers' compensation coverage in the event of job-related injury. In essence, while these laborers work shifts of up to 10 hours per day inside the confines of a plant or factory – receiving work assignments, training, supervision and, occasionally, disciplinary action as well at the behest and expense of plant managers – they are, for all practical purposes, treated as employees of a third party operating from the outside.

The Commission found that it is precisely this detached, yet mutually convenient, relationship between plant management and contract-labor providers that lies at the heart of the systemic abuses uncovered during its investigation. In many instances, for example, there is no explicit written contract between management and labor providers defining respective roles, duties and expectations. Management officials repeatedly testified that they assume labor providers routinely comply with the appropriate identification, payroll and tax requirements but said in most cases they do not regularly raise questions or check to confirm that assumption. Contract labor providers do not volunteer questionable information about their work crews or about their financial practices because it is not in their interest to do so. State and federal regulators, meanwhile, struggle to keep pace. All too often, their efforts are defeated, notwithstanding current laws designed to protect the system from abuse and subversion.

Under federal law² crew leaders are required to register with the federal government, or, as is the practice in New Jersey, with a state agency authorized to issue licenses on behalf of the U.S. Department of Labor. New Jersey's Crew Leader Registration Act³ provides for registration and regulation of farm labor crew leaders. Enforcement responsibilities rest with the New Jersey Department of Labor, Division of Workplace Standards, Office of Wage and Hour Compliance, Agricultural Compliance.

² The Migrant and Seasonal Agricultural Worker Protection Act, 29 U.S.C. §§1801 et seq.

³ N.J.S.A. 34:8A-7 et seq.

In addition to the regular obligations of any employer, crew leaders operating in New Jersey must meet these requirements:

- Demonstrate proof of eligibility to work based upon federal Immigration and Naturalization Service regulations;
- Undergo fingerprinting upon registration and every three-year interval thereafter;
- Meet certain requirements as to health licensing, if engaged in the transportation of workers; and
- Provide workers' compensation insurance, along with liability insurance coverage and other requirements for motor vehicle operations, including safety inspections.

Temporary-help service firms are regulated by the New Jersey Department of Law and Public Safety, Division of Consumer Affairs.⁴ In addition to meeting the normal statutory obligations of any employer, these service firms must provide:

- Identifiers as to the firm, principals and business locations; criminal history; and affidavits of compliance;
- Schedule of fees;
- Posting of a bond, if the corporation or entity has a net worth of less than \$100,000; and
- Payment of fees based upon both number and type of business location.

⁴ N.J.S.A. 56:8-1 et seq., and N.J.S.A. 34:8-43 et seq.

The Systemic Abuses

During the course of its investigation, the Commission conducted extensive inquiries into the background and operations of 25 separate contract-labor providers and their relationships with various segments of New Jersey's agricultural and manufacturing sectors. The investigation was based upon a referral to the Commission from the U.S. Department of Labor's Office of Labor Racketeering in Mays Landing. Thousands of documents were subpoenaed and analyzed, numerous individuals were questioned and extensive fieldwork was conducted in an effort to elicit a comprehensive picture of the functioning of this underground economy. Because of the foreign background of many of the individuals involved, the investigation required the use of language interpreters.

The investigation focused on the four-year span between 1993 and 1996. During that period, the 25 labor providers whose operations were examined collected a total of \$44.5 million in gross revenues from 10 businesses in exchange for supplying between 690 and 1,685 workers daily.⁵ The abuses discovered by the Commission were flagrant and consistent across the entire spectrum:

⁵ State records reflect a total of 152 registered crew leaders, 233 temporary-help service firms and 173 consulting firms that provide temporary-help services operating in New Jersey. The Commission's overall findings are based upon investigative analysis of a substantive sample. In every case analyzed, evidence of varying degrees of systemic abuse was detected. While the findings clearly point to broad-based problems, they are not meant to suggest wrongdoing by the agricultural and manufacturing sectors as a whole.

- **Failure to Pay State and Federal Income Taxes**

Millions of dollars in state and federal income taxes have gone unpaid based upon substantial underreporting and non-reporting of gross receipts by contract-labor providers for corporate, business and personal income tax purposes. Thousands of individual workers supplied by the labor providers have failed to pay state and federal income taxes as well.

- **Failure to Pay Federal Payroll Taxes (Social Security/Medicare)**

Nearly \$5 million in federal payroll tax liabilities, excluding interest and penalties, went unpaid by labor providers, all of whom either failed to report or substantially underreported these obligations.

- **Failure to Pay N.J. Unemployment/Temporary Disability Insurance**

Most labor providers underreported to the New Jersey Department of Labor both employee wages and required contributions to the unemployment and temporary disability insurance funds. In other instances, no filings were made at all.

Records reflect that as of June 1997 there were 67 registered crew leaders with outstanding unemployment and disability insurance liabilities of approximately \$1.98 million, including interest and penalties. These liabilities date back as far as 1988. The Commission found that 12 crew leaders – only five of whom were on the Labor Department's delinquency list – and two temporary-help service firms had combined liabilities alone of more than \$1.35 million for the period 1993-96.

This suggests that the actual total amount in unpaid UI/TDI liabilities is far greater than officially known.

- **Improper Use of Employment Classification**

Some contract-labor providers avoided their payroll tax obligations by designating their workers improperly as “independent contractors,” despite operating in a traditional employee/employer relationship.⁶ Treating workers as independent contractors allows an employer to ignore federal and state income tax withholding or payroll responsibilities beyond the mere filing of IRS Form 1099-Misc. One crew leader was found to have issued more than 3,900 Form-1099s for laborers during 1996 alone.

- **Failure to Obtain Employment Verification**

The investigation revealed widespread lack of compliance with federal employment verification requirements mandating the completion of a special form, known as an I-9, for each worker. Of 17 contract-labor providers subpoenaed, only four were able to produce I-9s.

⁶ The courts have set forth factors to be considered in determining if an individual is an independent contractor, rather than an employee of a business. Those factors, no single one of which is necessarily dispositive of the issue, are: (1) the degree to which the business controls the manner in which the work is performed, (2) the individual’s opportunity for profit or loss depending on the managerial skill, (3) the individual’s investment in equipment or materials, or his employment of helpers, (4) the need for the individual to possess a special skill, (5) the degree of permanence of the working relationship, and (6) whether the individual renders a service that is integral to the nature of the business. State and federal statutes establish similar criteria for use in various contexts.

- **Concealment of Worker Identities for Economic Gain**

An examination of 650 randomly sampled Social Security numbers of workers employed by eight of the contract-labor providers revealed that only 15 (two percent) were genuine. The vast majority – 494, or 76 percent – were bogus, and 141 (22 percent) could not be positively identified as having been issued to employees listed in the records. In one instance, a labor provider was found to have altered the numerical order of individual Social Security numbers on more than 100 Form-1099s filed with the IRS. Evidence and testimony demonstrated that workers also sought to conceal their identities to avoid income taxes and/or because they were collecting public assistance in New Jersey or Pennsylvania.

- **Immigration Violations**

The immigration status of numerous workers employed by contract-labor providers is open to question because few checks are conducted to verify compliance. During a road-stop conducted in South Jersey by an intergovernmental task force that included Commission investigators⁷, it was determined that approximately 30 percent of 79 workers interviewed were undocumented aliens.

⁷ Other agencies whose personnel participated in the road-stop include the N.J. State Police, N.J. Department of Labor, N.J. Division of Taxation, U.S. Department of Labor, U.S. Immigration and Naturalization Service, Pennsylvania Office of the Inspector General and Philadelphia Police Department.

- **Inadequate Records**

Payroll, tax and other business records received by the Commission from various contract-labor providers ranged from poor to non-existent. Records that were provided proved to be unreliable. In some instances, this appeared to be part of a deliberate ploy designed to frustrate efforts to obtain an accurate picture of basic items such as gross revenues and the number and identities of workers.

The circumstances and facts presented in the following scenarios serve to illustrate and support the Commission's overall findings.

Scenario #1: Vegetable Processing

Between 1993 and 1996, several New Jersey firms, including a leading processor of fresh vegetables and fruit, paid more than \$18.2 million for contract labor supplied by a succession of individuals who share two key traits: They all are members of the same extended family, and they have used these family ties as one of several devices in a scheme to plunder the tax system. (See chart, p. 15A)

During the four-year period reviewed by the Commission, no federal or state income taxes were withheld from the wages of thousands of individual workers who were supplied to the processors by these labor providers. Further, the providers themselves substantially understated corporate earnings and personal income for federal and state tax purposes. Also, they failed to pay on behalf of the workers approximately \$2.4 million in federal payroll taxes for Social Security and Medicare and more than \$119,000 in state unemployment and disability insurance taxes. Moreover, many of the workers possessed Social Security numbers that were either fabricated or inactive. When asked whether he accepted any responsibility for checking and confirming the workers' identities and Social Security numbers, the labor provider asserted his Fifth Amendment privilege and refused to answer the question.

The family network of labor providers examined by the Commission in this case was founded in the mid-1980s by a Cambodian immigrant who served as a crew leader

supplying workers to plants involved in both poultry and vegetable processing. In 1993, an audit of his books by the New Jersey Department of Labor revealed that he had been underreporting the wages of his workers for the previous five years. At about the same time, the labor provider relinquished control to his wife and several in-laws who ran the operations under their own names until a new corporation eventually was formed. The original owner also allowed his crew leader registration to lapse even though he remained a director of the new corporation. These ploys enabled him to effectively evade efforts by state authorities to collect the unpaid UI/TDI obligations. As a result, the initial judgement against this labor provider, including interest and penalties, has risen to \$615,500. It remains unpaid, even though the family business continues to thrive.

Under its current configuration, the firm provides an average of about 195 workers per day to a plant that processes lettuce and other fresh vegetables into ready-made salads and condiments for fast-food restaurant chains and retail supermarkets. The workers staff an assembly-line operation during 10-hour shifts in an environment that, due to the nature of the product, requires damp conditions and a year-round plant temperature of 33° F. Although the workers are trained and supervised by plant officials, they are paid by the crew leader who receives a lump sum from the plant at a rate of \$6.75 per worker per hour. Individually, the workers receive \$5.05 per hour in cash, disbursed by the crew leader. During the period reviewed by the Commission, 1993-96 – a period in which a gross amount of \$18,262,829 was received by the labor provider from all processing plants – no money was withheld from the workers' pay packets for state

and federal income taxes, and a pattern of failure to deduct payroll taxes has been persistent.

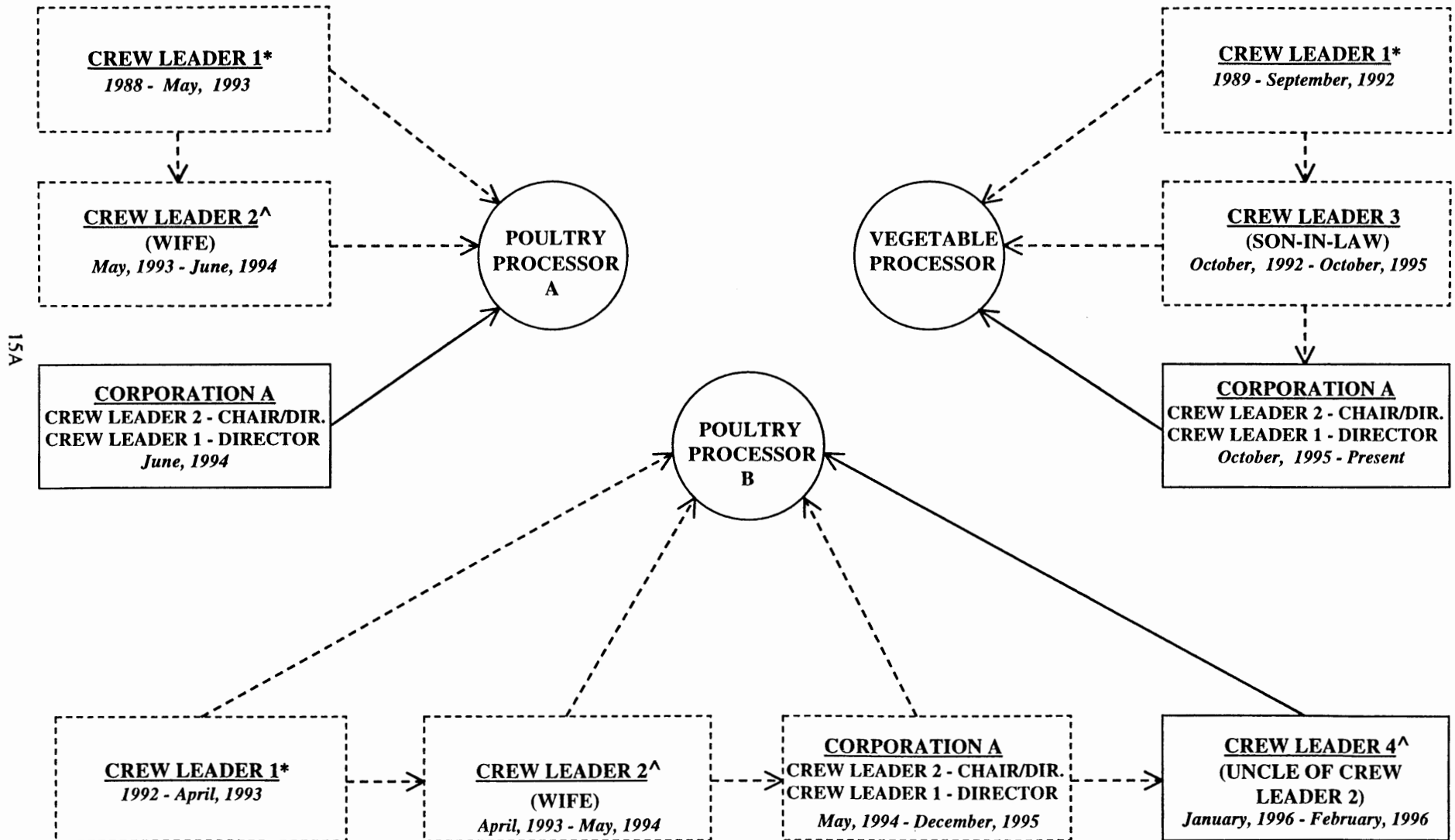
As to the question of responsibility for ensuring proper deducting, withholding and reporting of taxes and other obligations, the labor provider takes the position that the workers are “independent contractors” and, as such, are responsible for compliance on their own. However, a written agreement entered into between plant officials and the labor provider clearly states, for example, that the provider is responsible for deducting “. . . unemployment and workers’ compensation as well as the employees’ share of Social Security.” Officials of the processing plant, meanwhile, regard the workers as direct employees of the labor provider and play no role in oversight of tax compliance involving the workers.

Similarly, no mechanism exists to prevent workers from being identified with fake names, addresses and Social Security numbers, although plant officials told the Commission they have undertaken a program of random checks of worker immigration status when work crews arrive at the plant for each shift.

Plant officials testified that this contract-labor provider has supplied between 100 and 200 workers daily to their operations located in Ohio.

SCENARIO #1

FAMILY RELATIONSHIPS



* OUTSTANDING JUDGEMENTS

^ NOT REGISTERED WITH NJDOL - UI/TDI

Scenario #2: Poultry Processing

The operators of a South Jersey chicken processing plant sought out independent sources of labor several years ago when it became clear that the local pool of prospective full-time employees was insufficient to meet their facility's workload. The result was a loosely structured arrangement with a private labor provider that has enabled the plant to meet its needs – and the labor provider to line its pockets – at the expense of taxpayers.

Between July 1994 and December 1996 – a period in which the provider was paid a gross total of \$5.8 million for supplying workers – approximately \$3.5 million in wages to those workers went unreported for federal and state income tax purposes. (See chart, p. 19A) In addition, the failure to make proper deductions for Social Security and Medicare cost the federal treasury \$536,000 in lost revenues. Further, at least \$154,000 in state unemployment and disability insurance payments went uncollected during that 30-month period examined by the Commission.

The labor provider in this instance, and the no-questions-asked relationship it has enjoyed with the processing plant, exemplify the elements, the abuses and the lack of accountability inherent in this system. The provider is a small “mom and pop” operation established by a Cambodian couple who immigrated to the U.S. in the mid-70s. During the Commission's investigation, the couple retired and turned the business over to their son, who changed the firm's name and corporate registration. The firm currently supplies

between 110 and 135 workers – primarily Vietnamese and Cambodian immigrants – to the plant for 10-hour shifts four days a week. Members of this work crew, an adjunct to the plant's otherwise unionized employee force, are engaged in the unskilled task of deboning meat from whole cooked chickens. The plant pays the provider \$6.50 per hour per worker. Of that, the workers are supposed to receive \$5.05 per hour – a total of \$41 per day each, less transportation fees. Disbursal of the pay, done strictly on a cash basis, is solely the responsibility of several individuals who serve as drivers for the labor firm. The balance – \$1.45 per hour per worker – is retained as earnings by the labor provider.

A Commission review of payroll records and tax forms revealed that the labor provider, for tax purposes, consistently and substantially underreported the number of workers supplied to the plant. The review also showed that payroll sheets containing worker names for given days were merely photocopied and submitted repeatedly to the processing plant even though different individuals undoubtedly worked the shifts in question. Even in cases where the names on payroll sheets matched those of individuals who actually worked, no money was deducted or withheld from their pay for tax purposes. The labor provider's wife – who supervised and managed the day-to-day operations – told the Commission no taxes were deducted from the cash pay packets because the workers "don't like me to do that." As for the failure to make required payroll deductions for unemployment and disability insurance, the owner's wife complained that the gross amount received from the processing plant – \$6.50 per hour per worker – was insufficient to make such deductions worth the firm's while. Officials at

the plant, meanwhile, told the Commission they never checked to see whether adequate tax withholding and reporting had been conducted. They said it was solely the labor provider's responsibility.

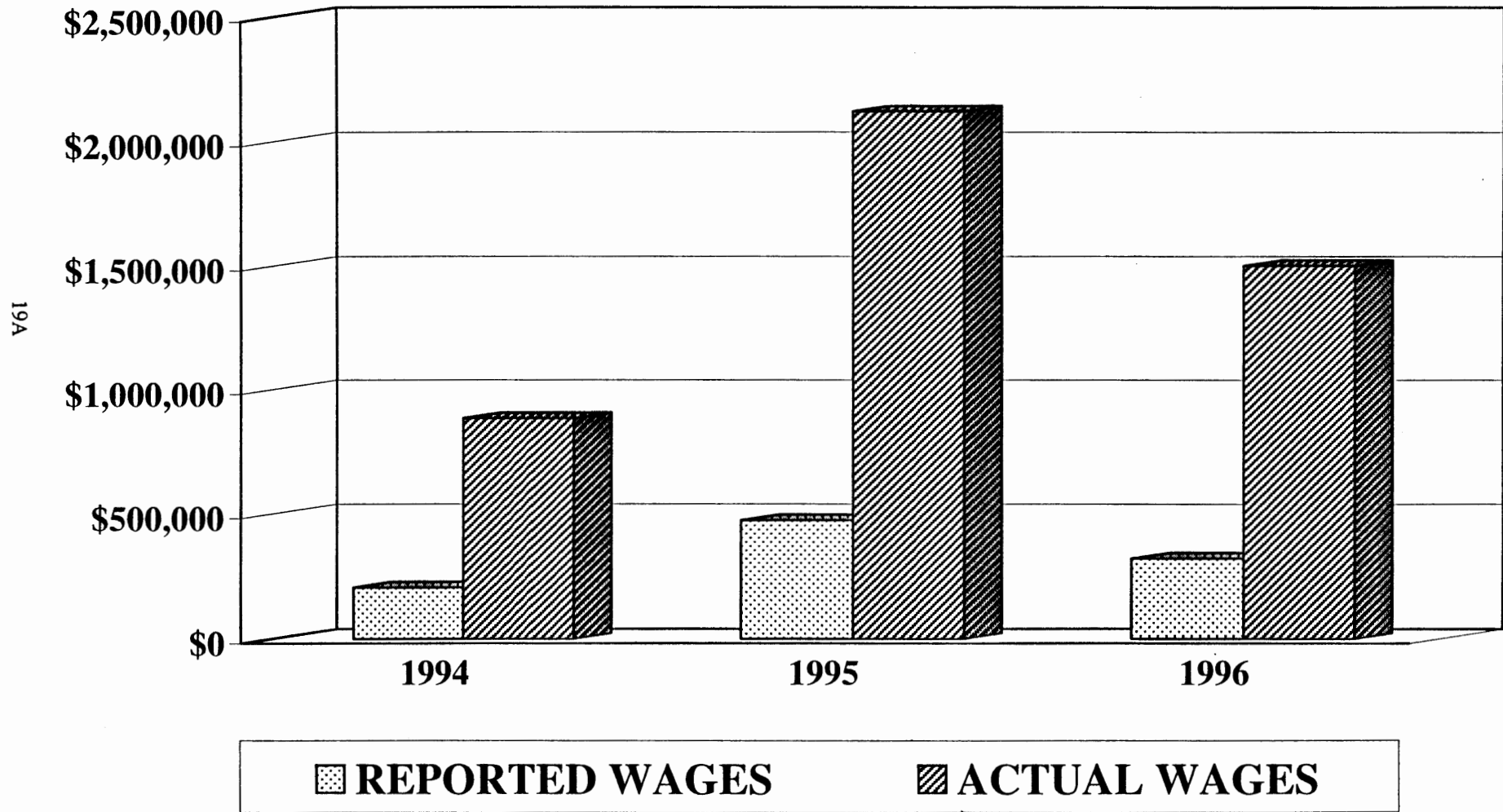
Until the Commission launched its inquiry, no effort was made by either the labor provider or plant officials to confirm the identities, Social Security numbers, immigration status or work eligibility of the workers supplied by the labor provider. The labor firm's owner acknowledged his responsibility to obtain Social Security numbers from the workers but said the task was rarely accomplished because they would leave the crew if pressured. As a result, bogus Social Security numbers routinely were listed on payroll sheets. During the investigation, an official of the processing plant undertook a regimen of random identity checks on workers as they arrived for their shifts. The checks consisted of requesting two forms of identification, but there was no means to determine the authenticity of any documents produced. "Everything I saw looked to be correct," the plant official said. "I wouldn't know bogus or phony."

According to testimony, the main reason for the workers' reluctance to provide real identities is that they are simultaneously collecting some form of public assistance in addition to their jobs at the processing plant. In one instance, welfare fraud investigators in Camden County determined that a worker illegally collected \$16,000 in public assistance while working at the plant. This individual is currently employed full-time at

the plant and has responsibility for taking a daily head count of the workers supplied by the labor firm.

SCENARIO #2

UNDERSTATEMENT OF WAGES REPORTED TO THE STATE OF NEW JERSEY



Scenario #3: Shellfish Processing

An average of approximately 60 Asian laborers per day are supplied to a South Jersey clam cannery by a self-employed crew leader who has profited richly from the unique problems associated with the contract-labor system. An analysis of tax records, payroll forms and other documents showed that more than \$4 million was funneled through this crew leader in exchange for workers between 1993 and 1996, but no state and federal income taxes or payroll taxes were withheld on that amount during the entire four-year period. Moreover, the crew leader grossly understated his own earnings for tax purposes. He also failed to register with the state for unemployment and disability insurance purposes and admitted that he has never paid any UI/TDI taxes on behalf of the workers he supplies. Further, neither the crew leader nor the cannery has undertaken any steps to verify the workers' identities and employment eligibility.

On its face, the arrangement between the cannery and the crew leader appears to be a normal, above-board business transaction. Payroll records reflect a payment rate of \$6.70 per hour per worker for a daily crew consisting of anywhere from 47 to 97 workers – clam shuckers, cooks and packagers – depending on demand. During 1993, the cannery paid the crew leader a total of \$1,055,475; in 1994, \$1,031,830; in 1995, \$1,050,886; and in 1996, \$874,373. The payments were made by check, in increments, issued to the crew leader on a weekly basis. The checks were then cashed, and the

workers were paid at a rate of \$5.05 per hour. The difference – \$1.65 per worker per hour – was retained by the crew leader as earnings.

In reality, however, the arrangement proved to be a tax fraud scheme.

The crew leader told Commission staff that he has never withheld state and federal income taxes from the workers because he considers them to be “independent contractors” and, thus, responsible for their own tax obligations. However, the investigation revealed that the laborers, who in most cases were paid regularly for 40-hour work weeks, 52 weeks per year, satisfied none of the criteria commonly used to determine independent-contractor status.

Meanwhile, the true identities and employment eligibility of many of the workers are unknown because no means of verification was implemented. The cannery considers it the crew leader’s job to maintain this information while the crew leader, in turn, says it is the responsibility of several individuals he has hired to provide transportation for the workers. As a result, most of the workers are listed on payroll records with false names and bogus Social Security numbers. The crew leader has been fined repeatedly by the Internal Revenue Service for submitting fake Social Security numbers but has persisted in doing so because he claims the workers would leave if he demanded that they provide their genuine identities.

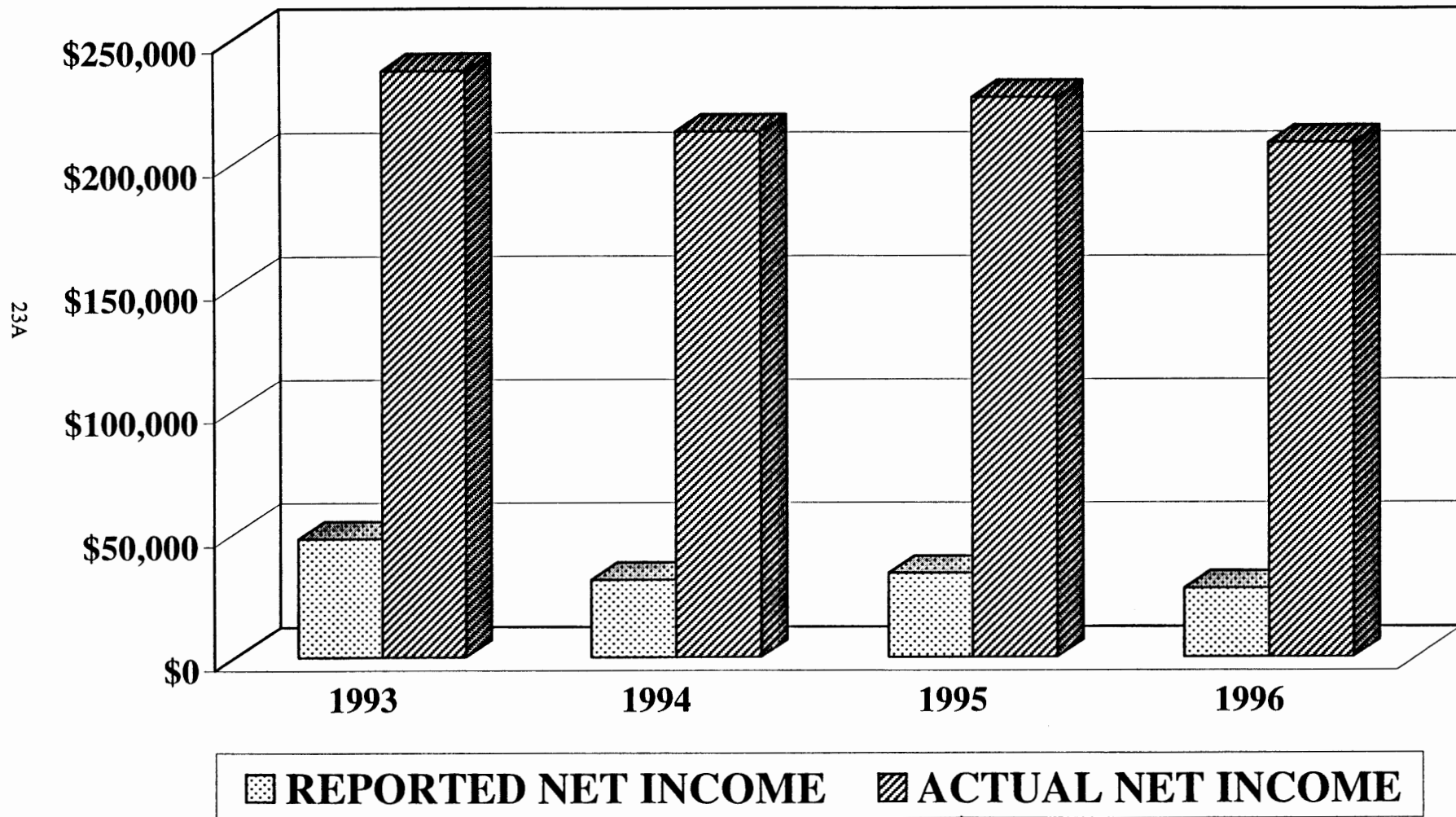
The crew leader also complained that he is not paid a sufficient amount by the cannery to justify any requirement that he submit state and federal payroll taxes on behalf of his workers. His balance of unpaid unemployment and disability taxes to the State of New Jersey totals approximately \$132,800. He owes approximately \$462,000 in unpaid federal payroll taxes for Social Security and Medicare. The Commission found that despite his complaint of insufficient resources, the crew leader has accumulated substantial amounts of income through concealment. Between 1993 and 1996 – a period in which he was paid a gross amount of more than \$4 million by the cannery for providing workers – the crew leader understated his net income for tax purposes by approximately \$743,000. He claimed income of only \$140,000 during the four-year period, but his true income topped \$883,000. (See chart, p. 23A)

One mechanism that helped cloak the crew leader's actual income involved a payment scheme known as "structuring," which is designed to circumvent certain reporting requirements. Under federal laws aimed at detecting large currency transactions indicative of money-laundering and tax evasion, banks are required to file a Currency Transaction Report (CTR) with the U.S. Treasury for every check cashed in an amount above \$10,000. The filing of CTRs can trigger Treasury and Internal Revenue Service inquiries. Examination of checks received by this crew leader from the cannery revealed that he never received a check for more than \$10,000. Invoices subpoenaed from the cannery show that payments to the crew leader routinely were divided and spread out among multiple checks, each issued in an amount less than the reporting

threshold, and nearly all of the checks were cashed. Cannery officials claimed this was done because of their cash flow problems. However, another crew leader who furnished workers to the cannery simultaneously received checks for total invoice amounts – in some instances ranging up to \$20,000.

SCENARIO #3

UNDERSTATEMENT OF NET INCOME REPORTED TO THE INTERNAL REVENUE SERVICE



Scenario #4: Manufacturing

The contract-labor system has expanded nationally well beyond agriculture and food processing in recent years as hard-goods manufacturers have come to recognize the value and flexibility of hiring temporary workers to perform unskilled, minimum-wage jobs. One such New Jersey company, a maker of household mops, brooms, brushes and dust pans, secured the services of an unregistered temporary-help service firm in 1991. Close scrutiny of this arrangement showed that, in typical fashion, it worked to the benefit of everyone involved – except the taxpayers.

During a four-year period (1993-96) examined by the Commission, the labor provider billed and was paid a total of \$9,425,504 for supplying workers to the manufacturer's two New Jersey factories. Of that amount, \$8.5 million was paid in wages to the workers, but not a single dollar was withheld from their pay packets for state and federal income taxes. The labor firm's owner, meanwhile, understated his personal income for federal and state income tax purposes by more than \$539,000. During the same period, nearly \$1.1 million in federal payroll taxes for Social Security and Medicare went unpaid, as did more than \$128,000 in unemployment and disability insurance payments to the State of New Jersey. (See charts, pp. 26A and 26B)

The workers supplied by this labor provider consist primarily of Vietnamese and Cambodian immigrants recruited from the Camden, Pennsauken and Philadelphia areas.

The firm's owner receives between \$6.25 and \$6.45 per hour per worker, depending on the shift. The workers typically are paid \$5.05 per hour, although some receive up to \$5.50 based on performance. They are paid in cash by the owner or by several individuals employed by the labor firm as drivers.

Records furnished by the labor provider pursuant to Commission subpoenas were found to be inadequate and replete with errors and misstatements. The documents were such that it was impossible to determine the total number of individual workers the firm provided during the period under review. No records were available that could be used to verify accumulated worker earnings, such as payroll books and canceled checks.

Moreover, forms submitted to tax authorities contained data that was patently false. For example, despite a high turnover rate among the members of his work crews, the labor provider listed the same 47 names in consecutive order on state reports of wages paid for the fourth quarters of both 1995 and 1996. But while the names were identical, the Social Security numbers attached to them in each of the quarters were different.

It would appear that the firm's records were kept in this fashion as part of a deliberate effort to disguise a routine practice of understating, for tax purposes, the numbers of workers supplied. According to the labor provider, he supplied between four and 100 workers daily to one of the manufacturer's two plants and between 30 and 60 to the other. Officials at the manufacturer, however, estimated that the labor firm supplies approximately 200 workers per day. The best indicators of the true number of daily

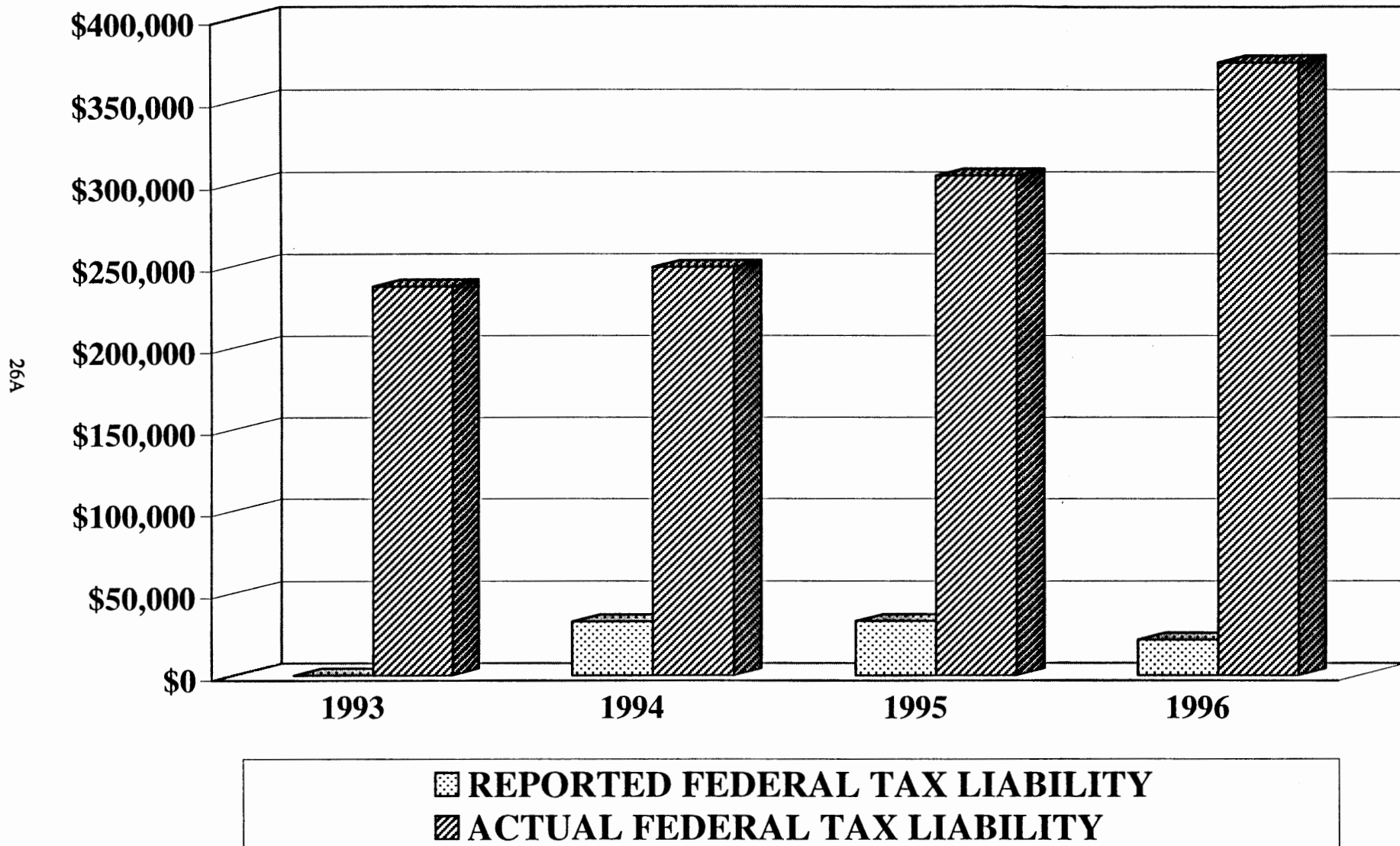
workers supplied are time sheets furnished by the provider and verified by the manufacturer. These records show that for normal workdays during the years 1993-96, the labor provider supplied as few as 76 workers per day and as many as 316. The time sheets indicate that, during the period reviewed, the number of workers per day grew annually and that the average number in 1996 was well in excess of 200. When confronted with this information, the labor provider acknowledged its accuracy.

No one in this instance has taken responsibility to determine and verify the actual identities, work and immigration status, Social Security numbers or addresses of the individual workers. The labor provider said he does not routinely obtain Social Security numbers, and officials of the manufacturer told the Commission they had never received any records that would verify the worker's identities. Similarly, the manufacturer has never taken steps to ensure that proper withholding, reporting and submitting of payroll taxes and deductions has been undertaken on behalf of its contracted workers.

Beyond New Jersey, this manufacturer operates a third plant located in Texas. In an interview with Commission staff, the New Jersey operations manager stated that the Texas plant also utilizes a contract-labor provider who supplies between 200 and 260 Mexican workers daily for their labor force.

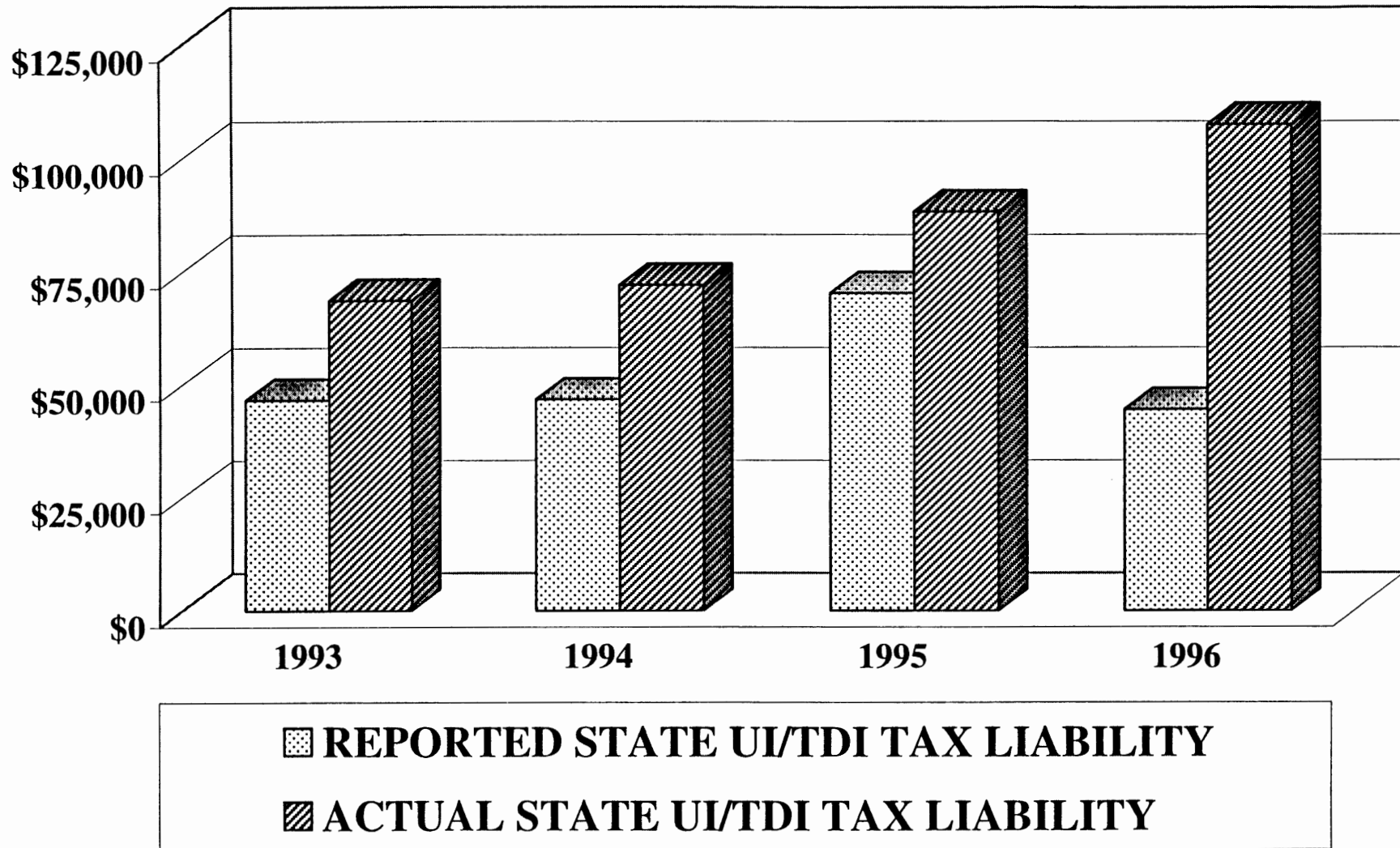
SCENARIO #4

UNDERSTATEMENT OF FEDERAL TAX LIABILITY



SCENARIO #4

UNDERSTATEMENT OF STATE EMPLOYMENT LIABILITY



REFERRALS AND RECOMMENDATIONS

The Commission refers the results of its investigation to the following agencies of government for review and whatever action is deemed appropriate:

- Office of the United States Attorney
- Internal Revenue Service
- Social Security Administration
- United States Department of Labor
- United States Immigration and Naturalization Service
- Office of the Attorney General
- New Jersey Department of Human Services
- New Jersey Department of Labor
- New Jersey Department of Law & Public Safety, Division of Consumer Affairs and Division of Criminal Justice
- New Jersey Department of Treasury, Division of Taxation
- Ohio Bureau of Employment Services
- Pennsylvania Office of the Inspector General
- Texas Workforce Commission

The Commission makes recommendations in the following key areas:

1. Recognition of Joint-Employer Status

A contract-labor provider and the processor or manufacturer using a provider's services should be recognized as joint employers of workers for all federal or state tax and other reporting requirements. In addition, the New Jersey Department of Labor (NJDOL) should be given the authority to hold contract-labor providers and the individuals or entities for whom they provide workers jointly and severally liable for the proper withholding and submitting of state income and employment taxes. Under current state and federal laws, processors or manufacturers, as detailed in this investigation, may be viewed as employers of those workers supplied by labor-contractors. To avoid any ambiguity or uncertainty on this question, legislation should be enacted to recognize and clearly define the joint-employer status.

In addition, any business or industry utilizing contract-labor providers should be required to have a written contract with its labor provider detailing their respective responsibilities for the proper withholding and the remittance of tax liabilities. Both parties to the contract should be required to make it available to state and federal authorities upon request.

2. Consolidate Contract Labor-Providers Under One Regulatory Scheme/ Limit Crew Leader Designation

The investigation revealed that various contract-labor providers, while providing essentially the same type of service, may be operating as crew leaders, temporary-help service firms or completely outside any regulatory system. All contract-labor providers as illustrated in this report should be consolidated into a single legislative scheme under the NJDOL. Adequate resources should be made available to regulate this significant segment of the state's underground economy. The artificial designation "crew leader" or "temporary-help service firm" should not result in a different regulatory scheme for entities providing similar labor forces. As part of a new single regulatory scheme, a complete review should be undertaken of both crew leader and temporary-help service firm requirements and regulations.

The designation of crew leader under the Crew Leader Registration Act should be limited to those labor providers who supply seasonal, migrant farm workers to farms for initial-stage, on-site agricultural processing. This unique labor field should continue to be handled by Agricultural Compliance, a specialized regulatory section within the NJDOL.

3. Transfer Collection Functions

All UI/TDI collection functions should be brought under the Department of Treasury, Division of Revenue, to coordinate and facilitate the collection of payroll taxes. The Division of Revenue has the most up-to-date technology for the processing and collection of such payments which should result in significant cost savings. Overall compliance should be increased with integration of such functions in one office. In addition, UI/TDI registration forms should be included in the New Jersey Tax Registration Packet (REG-P) which contains forms needed to register a business with the New Jersey Division of Taxation.

4. Automatic Notification to State Authorities

Any business registration or license issued in the state should be forwarded automatically to the NJDOL Division of UI/DI Financing and the Divisions of Revenue and Taxation. The Commission found instances where contract-labor providers registered with the NJDOL Agricultural Compliance section for crew leader licensing purposes were not registered with the NJDOL for UI/TDI purposes.

5. Expand NJDOL's Statutory Authority

Changes to the Unemployment Compensation Law,⁸ should be enacted to give the NJDOL expanded authority as described below.

❖ Authorize the Commissioner of Labor to require the posting of adequate security by contract-labor providers to guarantee the payment of state income and employment taxes. The security should be in the form of cash, indemnity bond, letter of credit or other form of security and/or collateral deemed appropriate by the Commissioner of Labor. Authority should be given to the Commissioner of Labor to promulgate regulations concerning the amount and manner of the posting of the security which should be substantial and scaled to the dollar amount of the contract-labor provider's payroll.

❖ If an employer has no assets in New Jersey, or if it appears that it is not possible to find in this State assets of the employer sufficient to pay the entire balance of contributions or other amount owed, the NJDOL should be granted the authority to issue, collect or enforce a certificate of debt.

The NJDOL should be granted the authority to designate agents or retain counsel for the purpose of collecting, outside the State of New Jersey, any unpaid

⁸ N.J.S.A. 43:21 et seq.

contributions, assessments, interest or penalty which may have been assessed under this act against an employer who has assets outside of this State.

The NJDOL should be authorized to request that the Attorney General bring suit in any other state to collect any contributions, assessments, interest or penalty legally due under this act.

❖ The maximum penalty for criminal violations of the act should be increased from a \$1,000 fine and/or imprisonment for 90 days to a fine of \$5,000 and/or imprisonment for one year.

❖ The NJDOL should be authorized to serve writs of execution in order to avoid the need to rely upon county sheriffs to do so.

❖ The NJDOL should be granted the authority to garnish the wages of an individual or officer of a corporation for unpaid contributions, assessments, interest or penalty owed by the corporation.

6. Comprehensive Audits

NJDOL should conduct more comprehensive state employment tax audits relative to contract-labor providers. The Commission recommends that the records of both contract-labor providers and those processors or manufacturers utilizing their services be

reviewed simultaneously to verify the accuracy of the wage reports submitted by contract-labor providers

7. Expand Employee Verification Programs

The Commission recommends that a new federal employee verification program known as the Basic Pilot program be expanded and made available to New Jersey employers. Basic Pilot, an electronic on-line system, will verify the employment and immigration status of all newly hired employees. It will permit employers on a voluntary basis to obtain free information concerning the employment eligibility of new hires through both the Social Security Administration and the Immigration and Naturalization Service. Basic Pilot is presently slated for implementation in five states: California, Florida, Illinois, New York and Texas. The Commission recommends that the Basic Pilot program be expanded to include New Jersey employers because non-citizen prospective employees currently can avoid scrutiny of their employment status simply by indicating they are citizens on Form I-9.

In addition, the Commission urges that the NJDOL monitor the success of this program, advocate its implementation in New Jersey, and consider mandating its use by all contract-labor providers. Finally, given the magnitude of lost revenues under the present system, the Commission suggests that the Department of Treasury evaluate a program of financial incentives for participating employers.

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The Commission appreciates the assistance provided by the New Jersey Department of Labor during the course of this investigation. Additional assistance was provided by the following agencies, to which the Commission expresses its appreciation: United States Department of Labor, United States Immigration and Naturalization Service, New Jersey Department of the Treasury, New Jersey State Police, Pennsylvania Office of the Inspector General, and the Philadelphia Police Department.

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The SCI's investigative team was directed by Counsel Charlotte K. Gaal and the investigation was conducted by Assistant Director Helen K. Gardiner, Chief Accountant Joseph A. Becht, Investigative Accountants Christine F. Klagholz and Jeanne M. Jackson, Special Agents Patricia England and William Sweerus and former Special Agent Kurt S. Schmid.

APPENDIX

The chart on the following pages presents a comprehensive and categorical picture of tax-related, regulatory and statutory deficiencies in the operations of 19 selected contract-labor providers investigated by the Commission. The compliance status beneath each column heading is delineated by either Y (Yes), N (No) or N/A (Not Available or Not Applicable).

DEFICIENCIES CHECKLIST OF SELECTED LABOR PROVIDERS

Contract-Labor Provider	Registered with N.J. DOL UI/TDI	WR 30's Filed ¹	UC 27's Filed ²	W-2's Issued	I-9's Maintained ³	Bogus SSN's	Federal Tax Returns Received	Understating Federal Income	Understate Federal Employment Tax Liability	State Tax Returns Received	Understating Income to State	Adequacy of Records
Contractor 1	N	N	N	N	N	N/A ⁴	N	N/A ⁴	N/A ⁴	N	Y	N
Contractor 2	Y	N	N	N	N	N/A ⁴	N	N/A ⁴	Y	N	Y	N
Contractor 3	Y	N	Y	N	Y	48%	Y	N/A ⁴	Y	N	Y	N
Contractor 4	Y	N	Y	* ⁵	Y	66%	Y	Y	Y	N	Y	N
Contractor 5	Y	Y	Y	* ⁵	Y	73%	Y	N/A ⁴	Y	N	Y	N
Contractor 6	N	N	Y	N	N/A ⁴	83%	Y	Y	Y	N	Y	N
Contractor 7	N	N	N	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴
Contractor 8	Y	* ⁵	N	N	N	N/A ⁴	N	Y	Y	N	Y	N
Contractor 9	Y	N	N	N	N	N/A ⁴	Y	N/A ⁴	Y	Y	N/A ⁴	N
Contractor 10	Y	* ⁵	N	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴

¹New Jersey Quarterly Employee Report of Wages Paid. Contributes to the process of determining eligibility for New Jersey unemployment and temporary disability benefits.

²Quarterly Contributions Report. Reports employer tax liability after the close of each calendar quarter.

³Federal Employment Eligibility Verification Form. Establishes identity and employment eligibility of workers.

⁴Not Available or Not Applicable

⁵Limited Filing.

DEFICIENCIES CHECKLIST OF SELECTED LABOR PROVIDERS

Contract-Labor Provider	Registered with N.J. DOL UI/TDI	WR 30's Filed ¹	UC 27's Filed ²	W-2's Issued	I-9's Maintained ³	Bogus SSN's	Federal Tax Returns Received	Under-stating Federal Income	Understate Federal Employment Tax Liability	State Tax Returns Received	Under-stating Income to State	Adequacy of Records
Contractor 11	Y	N	N	N	N	N/A ⁴	N	N/A ⁴	N/A ⁴	N	N/A ⁴	N
Contractor 12	Y	* ⁵	Y	N	N	N/A ⁴	N	N	Y	N	N	N
Contractor 13	Y	N	Y	* ⁵	N	90%	N	Y	Y	N	Y	N
Contractor 14	Y	Y	N	* ⁵	N	N/A ⁴	N	Y	Y	N	Y	N
Contractor 15	N	N	N	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴
Contractor 16	Y	N	N	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴	N/A ⁴
Contractor 17	N	N	Y	N	N	83% ⁶	N	Y	Y	N	Y	N
Contractor 18	Y	* ⁵	* ⁵	N	N	83% ⁶	Y	Y	Y	N	Y	N
Contractor 19	Y	N	Y	* ⁵	N	77%	Y	Y	Y	N	Y	N

¹New Jersey Quarterly Employee Report of Wages Paid. Contributes to the process of determining eligibility for New Jersey unemployment and temporary disability benefits.

²Quarterly Contributions Report. Reports employer tax liability after the close of each calendar quarter.

³Federal Employment Eligibility Verification Form. Establishes identity and employment eligibility of workers.

⁴Not Available or Not Applicable

⁵Limited Filing.

⁶Combined totals for Contractors 17 & 18.