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# Worker Misclassification and Wage Theft in Rhode Island


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## EXECUTIVE SUMMARY

This report offers a quantitative analysis on the extent and economic costs of payroll fraud in Rhode Island, with a particular focus on the misclassification of workers as independent contractors. This study reviews data provided by the Rhode Island Department of Labor and Training (DLT) on (a) aggregate results of DLT employee misclassification investigations, (b) the issuances of Stop Work Orders, and (c) the results of employer payroll audits conducted in accordance with the state's unemployment insurance system. The authors then use these data to make projections about the number of workers misclassified statewide and the costs to workers and taxpayers. Based primarily on the results of over 3,000 UI audits of randomly-selected Rhode Island employers completed between 2016 and 2021, the principal findings in this report are:

- 9.3% of Rhode Island employers are illegally misclassifying workers as independent contractors, a substantial increase from a similar review of UI audits in 2008. This suggests that misclassification is a growing concern in the state.

- Rhode Island employers misclassified 4.4% of the state's workforce, amounting to an estimated 19,359 workers in 2019. Workers misclassified as independent contractors are denied their legal rights to overtime pay, social insurance, and health and safety protections on the job site.

- 20.3% of employers fail to fully report their workers' wages and salaries to the DLT. Misclassifying workers and underreporting wages and salaries allows employers to evade required taxes and contributions to social insurance programs.

- An estimated $185.3 million in workers' wages and salaries was unreported to the DLT in 2019, attributable to both worker misclassification and the failure of firms to fully report the earnings of correctly-classified employees.

- Worker misclassification occurs in every industry, but is especially rampant in the construction sector. UI audits reflect that 11.7% of construction employers are misclassifying workers, affecting 8.4% of the industry workforce.

- Residential builders and janitorial firms are among the worst violators, as over 30% of their respective industries' workforces are comprised of misclassified independent contractors. Among subindustries with a sufficient number of audits, others with high rates include landscapers, general freight trucking, and building finishing contractors.

- UI audits undercount the full extent of worker misclassification due to the difficulty in proving off-the-books payments to workers and the presence of employers who operate outside of the UI system (e.g., labor brokers). As such, the estimates offered in this report are only lower-bound projections of misclassification and the true values are likely much higher, especially in industries with larger underground economies (e.g., construction).

- Separate from UI audits, an investigative team within Wage and Hour Division of the DLT charged 180 companies with misclassifying workers between 2019 and 2021. This led to $1.2 million in assessed payments for back wages, fines and penalties. The construction industry accounted for roughly 70% of these cases.

- The Workers' Compensation Division of the DLT issued 589 Stop Work Orders between 2016 and 2020, reflecting that workers' compensation insurance fraud is a substantial issue in Rhode Island. Between the DLT and the Workers' Compensation Court, violating firms were assessed $754,561 in penalties for the lack of coverage.

- Payroll fraud is estimated to have cost Rhode Island taxpayers between $25.1 million and $54.4 million in 2019 when applying a series of different assumptions about the full extent of misclassification and off-the-books employment in the state. Cost estimates feature an unavoidable margin of error due to uncertainty about the amount of cash transactions in the underground labor market.

- Payroll fraud denied Rhode Island workers at least $5 million in overtime pay in 2019. Further, employers offloaded tens of millions of dollars in Social Security tax obligations (i.e., the "employer" share of FICA) onto the backs of workers that year by misclassifying them as independent contractors and not as employees.

Based on the authors' research, potential changes in state labor law offer considerable promise in restoring worker rights and ensuring greater justice in Rhode Island's workplaces. The first is to make wage theft a felony. While it is difficult to measure wage theft directly in Rhode Island, increases in worker misclassification and off-the-books employment have created a "hot house" for wage theft across the state. Under current state law, wage theft is a misdemeanor no matter the dollar amount. This limits prosecutors' ability to impanel a grand jury, all but eliminating the Attorney General's subpoena power to compel testimony and authority to request extradition of out-of-state violators. Considering that many employers see the fines and penalties associated with the crime—if they are ever caught in the first place—as simply "the cost of doing business," it seems unlikely that any meaningful change in labor practices will occur without upgrading wage theft to a felony.

This study and others across the country have made clear that the current regulatory structure does not provide sufficient penalties to employers who engage in intentional, egregious, and repeated misclassification of workers. In addition to establishing greater disincentive for workers' direct employers, policymakers should also consider the establishment of joint liability for wage and hour violations. The extraordinary rise in subcontracting—from construction sites to cleaning companies—has given rise to an employment structure in which principals, developers and general contractors knowingly hire subcontractors whose business models are predicated on low costs generated by misclassifying workers and wage theft. Until these larger firms are held responsible for the behavior of their subcontractors, payroll fraud will continue to be standard practice in many industries.

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## INTRODUCTION

Our work defines who we are, how we earn a living, and how we contribute to our community. The basic blocks of employment law are the right to be paid for the work we do in a timely fashion, to have our health and safety protected on the job, and to be eligible for social safety net programs such as workers' compensation, Social Security, and unemployment insurance when we need them.

Across Rhode Island, however, far too many employers are not playing by the rules, denying workers these basic rights. This is primarily the result of employers illegally misclassifying their workers as independent contractors. This allows them to save approximately one-third of their labor costs by not paying their taxes, not paying into Social Security and unemployment insurance, and not paying legally-required workers' compensation insurance coverage. While this results in higher profits for these employers, these actions have real consequences: their workers–now considered independent contractors–are denied their legal rights as employees and are left without the most fundamental protections on the job.

In far too many instances, these independent contractors are also the victims of wage theft. Sometimes workers are paid late. Sometimes workers are only paid for a fraction of their hours worked. And sometimes, workers are not paid at all. Wage theft puts workers and their families in the untenable position of being unable to pay rent on time, buy groceries, or afford child care. With many affected workers already struggling to make ends meet, wage theft can push families' already precarious financial situations over the edge.

While workers bear the primary burden of misclassification and wage theft, the ramifications of these illegal labor practices ripple throughout Rhode Island society. Employers who misclassify and refuse to pay their workers are able to lower their labor costs, thereby making it much harder for legitimate employers who play by the rules to compete. And Rhode Island taxpayers are often left holding the bill. They have to cover revenue shortfalls because these employers evade required taxes and associated costs. And taxpayers have to pay increased social insurance expenses to support the victims of misclassification and wage theft. In sum, these employers are cheating workers, cheating legitimate employers who play by the rules, and cheating Rhode Island taxpayers.

*What is Worker Misclassification?*

The concept of worker misclassification sounds like a benign technical issue. But as the National Employment Labor Project suggests, "'Independent contractor' and 'employee' are not just labels; the designation has concrete and long-term implications for workers, law-abiding employers, and the public."[1] Our entire worker protection system is based on individuals classified as employees of a firm. Once workers are no longer considered employees but independent contractors, they are cut loose from virtually all those protections.

It is important to note that there have always been legitimate independent contractors. This is the case for many small businesses. They have a particular expertise, bring their employees to a job, and supervise the workers. The presence of legitimate independent contractor firms is not the problem in the state. The problem is unscrupulous employers who continue to have employees but illegally misclassify them as independent contractors to improve their bottom line.

The state of Rhode Island has made it very clear who is and who is not an employee in the state. According to the Joint Task Force on the Underground Economy and Employee Misclassification, an employee is "Anyone performing services for an employer who controls **what** will be done and **how** it will be done by the worker. What is important is whether or not the employer has the right to control the details of the services being done." They continue, "Independent contractors have an independent trade, business or profession. Their services are offered to the public. Independent contractors have the right to control the menus and methods of how the work is performed."[2]

*Wage Theft and Worker Misclassification in Rhode Island*

There have been a number of high-profile cases of misclassification in Rhode Island, including one at the Commons at Providence Station. Almost in the shadow of the Rhode Island State House, the Commons was a $54.1 million project of Tocci Building Construction. The project received nearly $10 million in state and city tax credit, including $5.5 million in Rebuild Rhone Island tax credits.[3] Yet, in 2018, the Rhode Island Department of Labor and Training (DLT) determined that JS Interior Construction–one of the subcontractors Tocci hired for the job–illegally misclassified their drywall workers as independent contractors and paid them far below industry wages. Most of its workers were immigrants already struggling to make ends meet and this loss of wages had a significant impact on them and their families. This should not be the case on such a high-profile construction project underwritten by such massive state and city tax breaks.

The DLT issued a stop-work order, which shut down construction until the employer secured a valid workers' compensation insurance policy.[4] The DLT later determined that 29 workers had been illegally misclassified as independent contractors, and the company was forced to make compensatory payments to each of their affected employees and pay a fine of $1,500 for each worker.[5] But Scott Duhamel, Secretary-Treasurer of the Rhode Island Building and Construction Trades Council, argues that "One of the things that I know to be true too is that, although they did go down there four times, they didn't catch everybody."[6]

Michael Sabitoni, business manager of Laborers' International Union of North America (LIUNA) Local Union 271, saw this egregious behavior as a direct challenge to the state's authority and a reflection of how emboldened employers have become in Rhode Island in terms of misclassification. "We were literally right next door (to the State House)… we're right here, we're going to cheat anyway, and we're going keep doing it even though you keep sending the Department of Labor here."[7] He continues, "If you go on a mill [renovation] job, I guarantee you that you will find at least half if not more of those projects are riddled with no workers' compensation, people not even on the books [being] paid in cash, people misclassified."[8]

In another high-profile case, the owners of Massachusetts-based Franklin Analytical Services were charged with wage theft after failing to pay $12,000 in prevailing overtime wages to five employees performing asbestos remediation during construction at Barrington Middle School.[9] According to the Attorney General's Office, the owners knowingly did not pay their employees for work performed on the weekends. And since this was a public project—covered by prevailing wage law—the owners are also accused of attempting to cover up their crime by filing false certified payroll records with the government.

It is of no surprise that these cases feature multiple forms of payroll fraud: wage theft is often used in combination with other deceptive practices. As another example from July 2020, the owner of M&M Cleaning—which once provided services to the Community College of Rhode Island—was charged with wage theft after he failed to pay $10,855 to 16 of his former employees.[10] In addition to wage theft, the Attorney General also found that the owner had committed Workers' Compensation Insurance Fraud reporting an income of $10,000 when state tax records revealed an income of $377,311.

In the M&M Cleaning case, the submission of a false insurance form was charged as a felony but refusing to pay workers—which amounts to theft of wages rightfully earned—was only a misdemeanor despite the theft amounting to over $10,000. In Rhode Island, wage theft is always a misdemeanor regardless of the size of the theft. Defining wage theft as a misdemeanor prevents prosecutors from impaneling a grand jury, all but eliminating the Attorney General's subpoena power to compel testimony and ability to extradite out-of-state violators. This lack of strong investigative powers and the inability to impose real penalties has contributed to the pervasiveness of wage theft, as many employers see the fines and penalties associated with wage theft—if they are ever caught in the first place—as simply the "cost of doing business."

### *The Extent and Cost of Payroll Fraud in Rhode Island*

To assess the extent and the costs of payroll fraud in Rhode Island, the authors analyze data provided by the Rhode Island Department of Labor and Training in three areas: (a) aggregate outcomes of DLT employee misclassification investigations, (b) the issuances of Stop Work

Orders, and (c) the results of employer payroll audits—which seek to identify worker misclassification—as conducted in accordance with the state's unemployment insurance system. The authors then use these data to make projections about the number of workers misclassified statewide and the costs to workers and Rhode Island taxpayers.

This report offers extensive analysis of worker misclassification, and records from the DLT provide the best quantitative data available to examine this issue. However, data on wage theft is more elusive. Given that much of this occurs in the underground economy—where workers are paid entirely in cash with no paper trail—the lack of any systematic records on the issue makes it practically impossible to make a viable estimate of the extent of explicit wage theft in Rhode Island.

## DATA ANALYSIS

### *Employee Misclassification Investigations*

The most direct evidence of payroll fraud in Rhode Island comes from investigations by the Wage and Hour Division of the Department of Labor and Training in the pursuit of cases against employers suspected of violating state labor law. Table 1 highlights that between 2019 and 2021, DLT investigators charged 180 companies with engaging in worker misclassification that directly affected 740 workers. A substantial majority of these cases—roughly 70%—were within the construction industry. These investigations—which included nearly 100 cases in 2021 alone—establish that worker misclassification is a significant problem in Rhode Island.

That the construction industry accounts for a disproportionate number of worker misclassification cases in Rhode Island is consistent with trends in other states. Misclassification in construction is problematic for reasons beyond its prevalence and the number of workers affected. Across the country, construction employers found to be violating labor law are notorious for their ability to evade responsibility for their illegal actions. In the face of a significant penalty, it is commonplace in the industry for the principal

**Table 1. Results of Employee Misclassification Investigations, 2019-21**

| Year Investigation Closed | Total Companies in Violation | Construction as % of Total Companies | Total Employees Misclassified | Construction as % of Total Employees |
|---|---|---|---|---|
| 2019 | 37 | 41% | 132 | 58% |
| 2020 | 55 | 76% | 318 | 64% |
| 2021 | 88 | 84% | 290 | 78% |
| Total | 180 | 73% | 740 | 68% |

*Source: Rhode Island Department of Labor and Training*

of a construction employer to close their current business and open a new one with a different name simply to avoid legal action. In many other cases, the violator is an out-of-state contractor who evades responsibility simply by leaving the state or jurisdiction in question (a problem that is especially acute in a small state like Rhode Island). Considering that construction firms are far more likely than those in other industries to be small and mobile (e.g., not bound to a storefront), it allows these businesses greater ability to avoid legal action.

Consistent with this national story, the results of Table 2 reflect construction employers' increased likelihood of evading regulatory action for their illegal labor practices. In Rhode Island, employers who are determined by DLT investigators to be misclassifying are assessed a fine equal to full and complete back pay for workers and a dollar-for-dollar punitive penalty to be collected by the state. The results reflect that the DLT assessed $1.2 million in fines in the 180 cases concluding between 2019 and 2021, with approximately 70% ($832,000) coming from cases from the construction sector. But construction employers found responsible for violating labor law in Rhode Island pay far less of their assessed fines (35%) than employers outside of construction (56%). This nonpayment represents an evasion of justice that has real consequences and real victims: the aggrieved workers who never receive back pay to make them whole after the exploitative and illegal actions of their employer.

**Table 2. Penalties Assessed and Collected through Employee Misclassification Investigations, 2019-21**

| Year Investigation Closed | Penalties Assessed | Penalties Collected | % Penalties Collected |
|---|---|---|---|
| All Industries | | | |
| 2019 | $225,500 | $97,450 | 43% |
| 2020 | $494,500 | $211,750 | 43% |
| 2021 | $475,000 | $186,975 | 39% |
| Total | $1,195,000 | $496,175 | 42% |
| Construction | | | |
| 2019 | $139,500 | $39,250 | 28% |
| 2020 | $320,500 | $106,750 | 33% |
| 2021 | $372,000 | $145,350 | 39% |
| Total | $832,000 | $291,350 | 35% |
| Non-Construction | | | |
| 2019 | $86,000 | $58,200 | 68% |
| 2020 | $174,000 | $105,000 | 60% |
| 2021 | $103,000 | $41,625 | 40% |
| Total | $363,000 | $204,825 | 56% |

*Source: Rhode Island Department of Labor and Training*

*Stop Work Orders*

Employers who misclassify workers are likely to engage in other forms of payroll fraud. This includes the failure to secure a workers' compensation insurance policy, which is required by law of any business with employees. This problem is especially acute in the construction industry, and the failure of contractors to maintain an active workers' compensation insurance policy exposes their workers to significant risk of financial peril—medical costs and a loss of income due to an inability to work—given the high rate of workplace accidents in construction settings.

This risk put upon uninsured workers is a large part of why many states have the ability to issue a Stop Work Order (SWO). This typically prohibits continuance of work at a site until employers have an active workers' compensation insurance policy in compliance with state law. In Rhode Island, this process is overseen by the Workers' Compensation Division of the Department of Labor and Training. As provided in Table 3, the DLT issued 589 SWOs across all industries between 2016 and 2020.[11] While the DLT notes that many employers come into compliance relatively quickly, the Workers' Compensation Division assesses penalties for periods where insurance was required but not in place. Between 2016 and 2020, this amounted to $754,561 assessed by either employer agreements with the DLT or through the Workers' Compensation Court.

*Unemployment Insurance Audits*

The most expansive evidence of payroll fraud in the United States comes from state agencies' audits of employer payroll records. In the operation of state unemployment insurance (UI) programs, the U.S. Department of Labor requires state officials to audit employers' records

**Table 3. Stop Work Orders Issued and Penalties Assessed, 2016-20**

| Year | Stop Work Orders Issued | Total Penalties Assessed | Penalties: Payment Agreement w/DLT | Penalties: Workers' Compensation Court |
|---|---|---|---|---|
| 2016 | 144 | $119,256 | $23,410 | $95,846 |
| 2017 | 148 | $360,176 | $59,802 | $300,373 |
| 2018 | 142 | $119,865 | $25,204 | $94,662 |
| 2019 | 114 | $119,163 | $42,435 | $76,727 |
| 2020 | 41 | $36,102 | $8,554 | $27,548 |
| Total | 589 | $754,561 | $159,405 | $595,156 |

*Source: Rhode Island Department of Labor and Training*

to ensure that workers are correctly classified, that all wages and salaries are reported to the government, and that all relevant taxes are paid by the employer (specifically contributions to state UI programs). In the study of payroll fraud in the U.S., reviews of state UI audits represent the predominant approach in documenting worker misclassification. Studies conducted by academic scholars and state agencies alike have commonly used audit results to document extensive illegality in workplaces across the country.[12]

In Rhode Island, UI audits are conducted by the Department of Labor and Training. For this study, the DLT provided audit results of employer payrolls between 2016 and 2021. The data were anonymized and the authors had no information that allowed them to identify specific employers or workers involved. Across this six-year period, the DLT completed 3,470 UI payroll audits, including 432 on construction employers. Audits typically review four quarters of a business's payroll records, but the time period can be expanded if the audit uncovers an employee that is misclassified; especially egregious cases are shared with the Division of Taxation, and to other divisions within the DLT (e.g., Division of Labor Standards). Most UI audits are conducted on firms selected at random among employers in the state's UI system. However the DLT supplements these with targeted audits on firms where there is evidence that a business may be actively engaged in misclassification.[13]

The overall results of UI audits completed in Rhode Island by the DLT between 2016 and 2021 are presented in Table 4. On random audits—which encompasses the best available cross-section of employers in this study for making statewide projections—approximately one in five employers (20.3%) underreport wages on required payroll forms submitted to the state as a part of its unemployment insurance program. Many instances of underreporting are small as roughly half (48%) of such cases feature less than $10,000 underreported, however approximately 10% of employers who are found to underreport wages do so with at least $100,000 in wages and salaries. Altogether, the results of random audits reflect that Rhode Island employers underreport 0.8% of wages to the DLT, which extrapolates to $185.3 million in unreported wages based on 2019 labor market data.[14,15]

Unsurprisingly, firms who illegally misclassified employees as independent contractors are far more likely to be identified as underreporting significant amounts of wages and salaries in their filings with the government. And the results from Table 4 indicate that employee misclassification is rampant in Rhode Island, with 9.3% of random audits identifying employers who were misclassifying at least one employee. Across all industries, the data reflects that 4.4% of the Rhode Island workforce is misclassified; using 2019 data, this equates to 19,359 workers in the state.[16]

**Table 4. Unemployment Insurance (UI) Payroll Audits, All Industry and Construction Totals, 2016-2021**

| | All Industries | | Construction | |
|---|---|---|---|---|
| | Random Audits | All Audits | Random Audits | All Audits |
| **Audit Results (2016-21)** | | | | |
| Number of Payroll Audits | 3,226 | 3,470 | 384 | 432 |
| % of Employers Misclassifying: Wages *(Employers who underreport total wages)* | 20.3% | 23.2% | 27.3% | 32.9% |
| % of Wages Underreported | 0.8% | 1.3% | 2.4% | 3.8% |
| % of Employers Misclassifying: Employees *(Employers who underreport # of employees)* | 9.3% | 12.2% | 11.7% | 17.1% |
| % of Industry Workforce Misclassified | 4.4% | 7.3% | 8.4% | 16.1% |
| **Statewide Estimates (2019)** | | | | |
| Total Wages Underreported (in $ millions) | $185.3 | $290.2 | $31.1 | $49.6 |
| Total Number of Workers Misclassified | 19,359 | 33,469 | 1,828 | 3,843 |

*Notes: Audit results provided by the Rhode Island Department of Labor and Training; statewide estimates of total number of workers developed using additional data from Quarterly Census of Employment and Wages made available by the DLT: https://dlt.ri.gov/labor-market-information/data-center/employment-wages-industry-qcew.*

There are several reasons to suspect that the totals offered via random audits in Table 4 are substantially undercounting the extent of misclassification in Rhode Island. Employers engaging in illegal labor practices will often go to great lengths to conceal their actions from government regulators and tax agencies.[17] This includes, but limited to, an increased reliance on cash-only employment relationships that have come to define the "underground economy." Construction stakeholders in the state and across the country that have been interviewed by the authors overwhelmingly suggest that the industry is awash in cash-only employment relationships. But this type of employment often lacks any type of paper trail, making it difficult, if not impossible, for even the most-skilled investigators to prove every instance of illegal misclassification; this also makes audits of cash-based businesses (e.g., nail salons, cleaning companies, construction) especially challenging.[18]

The results of random audits are also likely to undercount the degree of payroll fraud in Rhode Island because they are likely to exclude the most prolific violators of labor law. By definition, UI audits are restricted to employers who are registered within the state's unemployment insurance system. However, a recent report in Massachusetts highlighted the emergence and influence of "labor brokers" in the New England construction sector that operate entirely off the books and who pay their workers in cash; none of these employers would appear in the UI database and, accordingly, would never directly be subject to a UI audit.[19]

While imperfect, one commonly-used approach to account for the undercounting of misclassification on random audits is to examine the aggregated results of *all* UI audits, both random and targeted, as the latter is more likely to identify employers engaged in illegal labor practices. This "all audit" total for Rhode Island is provided in the second column of Table 4. The results suggest that 23.2% of employers in this combined sample were found to be misclassifying by underreporting wages amounting to 1.3% of wages and salaries. The results also reflect that 12.2% of employers misclassified workers, representing 7.3% of the state's workforce. Further, the all-audit total suggests that Rhode Island employers may have underreported up to $290.2 million in wages in 2019 and misclassified 33,469 employees as independent contractors (which includes paying workers off-the-books).[20]

Even with omission of labor brokers and some cash-only payments, the last two columns of Table 4 nevertheless highlight that misclassification is rampant in the Rhode Island construction industry as measured via UI audits. Rates of wage underreporting and employee misclassification are far higher in construction than the state average. Using both totals as endpoints, the results of Table 4 reflect that 27.3% (random audits) to 32.9% (all audits) of construction employers underreported wages while between 11.7% and 17.1% of businesses misclassified employees as independent contractors. These actions affect a substantial number of workers, as the results reflect that between 1,828 (8.4% of the industry) and 3,843 (16.1%) construction workers were denied their rights under state labor law due to illegal misclassification. Meanwhile, wage underreporting allowed construction employers to evade required taxes and social contributions on between $31.1 and $49.6 million in wages.

Two perspectives emerge in a comparison of the data provided in Table 4 to other sources. First, worker misclassification has gotten worse in Rhode Island over the last 10-15 years. A 2009 report submitted to the Rhode Island General Assembly suggested that UI audits of the time reflected that 6% of employers were found to misclassify at least one employee; the results above reflect that 9.3% to 12.2% of employers were doing so in 2016-2021.[21] Second, a statistical approach applied by the authors in previous studies suggests that the construction-specific totals expressed in Table 4—even the "all audit" totals—are likely to be undercounting the full extent of payroll fraud in the state's construction industry.[22]

Expanding the analysis, Table 5 presents an industry-by-industry comparison of UI audit results that reflects misclassification to be especially prevalent in a few key sectors of the Rhode Island economy. Three industries appear especially troubling: construction (16.1% of workers misclassified across all audits), administrative and waste management services (21.9%; includes janitorial and landscaping services), and other services (13.1%; includes automotive repair, nail salons, drycleaners, parking garages).[23] While misclassification rates are much lower for these industries when limiting the sample to randomly-selected employers, these three industry categories clearly reflect the highest rates of employee misclassification and wage underreporting. In reviewing the underlying data, the

**Table 5. Misclassification Rates, Major Industry Totals (min. 100 audits), 2016-2021**

| Industry | Number of Audits | % of Employers Under-reporting Wages | % of Industry Wages Under-reported | % of Employers Misclassify Workers | % of Industry Workforce Misclassified |
|---|---|---|---|---|---|
| **ALL AUDITS** | | | | | |
| Administrative & Waste Mgt. Services | 239 | 34.7% | 3.0% | 20.5% | 21.9% |
| Construction | 432 | 32.9% | 3.8% | 17.1% | 16.1% |
| Other Services (except Public Admin.) | 342 | 23.1% | 2.5% | 11.1% | 13.1% |
| Wholesale Trade | 138 | 21.0% | 0.8% | 14.5% | 4.8% |
| Accommodation & Food Service | 453 | 22.1% | 0.8% | 11.9% | 4.6% |
| Manufacturing | 247 | 22.3% | 0.4% | 11.3% | 3.3% |
| Retail Trade | 403 | 18.4% | 1.0% | 7.7% | 2.5% |
| Professional, Scient. & Tech. Services | 387 | 16.8% | 0.6% | 6.2% | 2.5% |
| Health Care & Social Assistance | 365 | 23.0% | 0.6% | 12.1% | 2.2% |
| Total (includes excluded groups) | 3,470 | 23.2% | 1.3% | 12.2% | 7.3% |
| **RANDOM AUDITS ONLY** | | | | | |
| Administrative & Waste Mgt. Services | 216 | 31.5% | 2.7% | 16.7% | 16.4% |
| Construction | 384 | 27.3% | 2.4% | 11.7% | 8.4% |
| Other Services (except Public Admin.) | 318 | 21.1% | 1.7% | 8.8% | 7.7% |
| Wholesale Trade | 132 | 19.7% | 0.9% | 12.9% | 5.1% |
| Manufacturing | 235 | 20.9% | 0.4% | 11.1% | 3.4% |
| Accommodation & Food Service | 402 | 19.9% | 0.5% | 9.0% | 2.4% |
| Health Care & Social Assistance | 351 | 21.1% | 0.5% | 10.3% | 1.9% |
| Retail Trade | 384 | 16.1% | 0.5% | 5.2% | 1.1% |
| Professional, Scient. & Tech. Services | 373 | 14.2% | 0.3% | 3.8% | 0.7% |
| Total (includes excluded groups) | 3,226 | 20.3% | 0.8% | 9.3% | 4.4% |

*Notes: Industries based on two-digit industry codes in the North American Industry Classification System (NAICS). Totals only presented for industries with at least 100 audits completed between 2016 and 2021. Audit results provided by the Rhode Island Department of Labor and Training.*

construction industry and the administrative and waste management services industries are especially concerning in that they feature both (a) the highest proportions of employers engaged in any form of misclassification and (b) the highest rates of employers who engaged in *extensive* misclassification (i.e., those with more misclassified workers than regular employees).[24]

To this point, a focus of this report has been examining conditions within broad industry totals. But the use of *overall* industry totals may conceal as much as they reveal. For example, the construction industry is comprised of markedly different subsectors based on trade and building type. Conditions in each subsector vary markedly on the basis of occupational licensing and worker skill requirements, union involvement, wage and benefit levels, and most important to this study, the extent of worker misclassification, wage theft, and other forms of payroll fraud. Therefore, any policy action designed to reduce illegal labor practices in the construction sector must first recognize the specific subsectors where misclassification is most prevalent.

To those ends, Table 6 provides a summary look at audit results within the four largest subsectors of the Rhode Island construction sector (as defined by a four-digit industry code). The results reflect that the extent of misclassification is distinctly different *within* various subsectors of the Rhode Island construction industry. Most glaringly, illegal labor practices appear particularly rampant among residential builders, a result consistent with prior research on the New England construction industry.[25] Combining the values from the random and all-audit totals, the results of UI audits reflect that one in three residential builders underreports wages to the DLT, aggregating to approximately 7%-13% of all industry wages and salaries. This is the second-highest wage underreporting rate of any subindustry in Rhode Island (min. 20 audits), just slightly behind general freight trucking. The results also reflect that residential builders misclassify 31%-48% of their employees. While this may include a lot of short-term workers, it represents the second-worst rate of

**Table 6. Results of UI Employer Payroll Audits, Subsectors of Construction Industry (min. 60 audits), 2016-2021**

| | Residential Building (NAICS=2361) | Foundation, Structure & Exterior (NAICS=2381) | Building Equipment (NAICS=2382) | Building Finishing (NAICS=2383) |
|---|---|---|---|---|
| **ALL AUDITS** | | | | |
| Number of Payroll Audits | 87 | 62 | 118 | 83 |
| % of Employers Underreporting Wages | 36.8% | 32.3% | 23.7% | 41.0% |
| % of Wages Underreported | 12.7% | 3.1% | 2.3% | 7.9% |
| % of Employers Misclassifying Workers | 23.0% | 8.1% | 13.6% | 26.5% |
| % of Industry Workforce Misclassified | 47.5% | 3.9% | 8.3% | 24.2% |
| **RANDOM AUDITS** | | | | |
| Number of Payroll Audits | 75 | 56 | 110 | 67 |
| % of Employers Underreporting Wages | 29.3% | 28.6% | 20.0% | 34.3% |
| % of Wages Underreported | 7.1% | 2.9% | 1.3% | 5.1% |
| % of Employers Misclassifying Workers | 14.7% | 3.6% | 10.9% | 17.9% |
| % of Industry Workforce Misclassified | 31.3% | 1.8% | 4.7% | 12.4% |

*Notes: First number represents the outcome of random audits; the second number includes the results of both random and targeted audits. Industries selected featured the results of at least 60 total audits between 2016 and 2021. The results exclude the "Other Specialty Trades" category (NAICS=2389) given the diverse nature of "other" categories. Audit results provided by the Rhode Island Department of Labor and Training.*

any subsector in Rhode Island behind general freight trucking (all audits) and services to buildings and dwellings (random audits), which includes janitorial and landscaping.

Among the remaining three categories of specialty trades contractors, misclassification also appears quite prevalent among the building finishing trades which include drywall, painting, flooring, and finish carpentry. More than one-third of these contractors underreport wages to the DLT, amounting to 5%-8% of all wages and salaries in the category; this is the fourth-worst rate of any subsector in Rhode Island that featured at least 20 audits. Further, the audits reflect that 12%-24% of the subsector's workforce is misclassified as independent contractors or paid off-the-books, which is approximately three times the statewide average across all industries.

As evidence that labor conditions vary distinctly *within* the Rhode Island construction industry, the other two subsectors of construction summarized in Table 6 feature much lower rates of worker misclassification. Among foundation, structure and building finishing contractors (which includes masons, structural steel, concrete foundations, framing and roofing), wage and worker misclassification rates as reflected in UI audits were far below the overall state average. For building equipment contractors (electrical, plumbing, HVAC), the results were close to state averages but far below rates in other subsectors of the state's construction industry. It is telling that this pattern of misclassification—egregiously high among residential builders and building finishing contractors but much lower in the other two categories—is consistent with a similar review of UI audits in Massachusetts between 2017 and 2019.[26]

There is value examining the results in specific trades. However, this is problematic given that there are not a sufficient number of UI audits in many narrowly-defined industry categories to draw justifiable conclusions. But among those narrower classifications (five-digit industry codes) with at least 20 UI audits completed by the DLT, the results presented in Table 7 offer some powerful perspectives. First, residential builders exhibit the highest employee misclassification rate (47.5%) in the all-audit total and the second-highest rate (31.3%) among firms that are audited at random. Second, painting contractors and finish carpentry contractors—each included in the "building finishing" category in the earlier analysis—each reflect worker misclassification rates in the all-audit total that places them in the top five in the state; neither had the minimum of 20 random audits to quality for the bottom half of the panel.

Beyond the construction industry, the results of Table 7 reflect that two types of businesses—janitorial and landscaping—exhibit misclassification rates that far exceed anywhere else in the non-construction economy. Even among randomly-selected (i.e., non-targeted) firms that provide janitorial services, greater than 40% of employees are deemed by the DLT to be misclassified. Landscapers also reflect substantial rates of misclassification with roughly one-third of workers not correctly identified as employees. Given that both business types are included in the "administrative and waste management services" industry that was prominent in earlier tables, it is clear that these two business types are largely

**Table 7. Highest Worker Misclassification Rates, Five-Digit NAICS Industry Totals (min. 20 audits), 2016-2021**

| Industry | Number of Audits | % of Employers Underreport Wages | % of Employers Misclassify Workers | % of Workers Misclassified |
|---|---|---|---|---|
| **ALL AUDITS (31 industries)** | | | | |
| Residential Building Construction | 87 | 36.8% | 23.0% | 47.5% |
| Janitorial Services | 36 | 55.6% | 38.9% | 45.8% |
| Painting & Wall Covering Contractors | 20 | 40.0% | 25.0% | 35.7% |
| Landscaping Services | 118 | 33.9% | 22.9% | 33.8% |
| Finish Carpentry Contractors | 21 | 38.1% | 23.8% | 26.8% |
| **RANDOM AUDITS ONLY (26 industries)** | | | | |
| Janitorial Services | 29 | 51.7% | 31.0% | 42.2% |
| Residential Building Construction | 75 | 29.3% | 14.7% | 31.3% |
| Landscaping Services | 111 | 31.5% | 19.8% | 28.9% |
| Wholesale Trade Agents/Brokers | 20 | 30.0% | 15.0% | 20.9% |
| Offices of Real Estate Agents/Brokers | 33 | 15.2% | 6.1% | 15.0% |

*Notes: Industries based on five-digit NAICS codes. Totals only included for industries with at least 20 audits completed between 2016 and 2021. Audit results provided by the Rhode Island Department of Labor and Training.*

responsible for the elevated rates within that sector.

*Direct Costs of Misclassification*

The intentional misclassification of employees as independent contractors—or paying workers entirely off-the-books—is typically rooted in the desire by employers to avoid paying taxes and required social contributions as a means of improving their own profits. These illegal and unethical labor practices come at an enormous cost to workers and their families, law-abiding employers, and Rhode Island taxpayers.[27] Most directly, workers who are misclassified as independent contractors are denied their legal rights to overtime pay, unemployment insurance benefits, investments into their Social Security accounts, certain OSHA protections, workers' compensation insurance benefits, and protection under the Family and Medical Leave Act and other laws that only provide rights and benefits to employees. This puts Rhode Island workers in a highly precarious position, exposing them to both physical and financial risk on a daily basis. As a result, it is far too common to hear stories of construction workers left in physical ruin while dealing with soul-crushing medical bills after a workplace injury made possible by their employer's indifference to safety and failure to provide worker's compensation insurance benefits.[28]

While misclassified workers often bear the largest burden of employers' illegal labor practices, other parts of Rhode Island society must also absorb the effects of this corrosive behavior. Law-abiding businesses have difficulty competing with companies that illegally reduce labor costs far beyond what the legitimate market would support, resulting in a "race to the bottom" in heavily affected sectors such as residential construction. Rhode Island taxpayers are also affected. Most directly, millions of dollars in payroll are never reported to the state government, resulting in substantial income tax losses. The state's unemployment insurance, temporary disability insurance, and job development funds all experience a revenue shortfall as employers evade required payments in the system. At the federal level, Social Security exhibits a substantial revenue shortfall due to persistent misclassification.[29] And with employers either bypassing workers' compensation insurance or doing so fraudulently, this raises insurance premiums on law-abiding businesses.

Estimating the cost of worker misclassification on taxpayers is complicated by the fact that the highest-quality data on the problem—UI audits—undercount the volume of wages paid off-the-books and the number of workers affected. Nevertheless, cost projections using this data represent an important lower-bound of the direct costs of misclassification on Rhode Island taxpayers. Using the estimated amount of wage underreporting in the state economy in 2019 (identified earlier in this report), the results in Table 8 suggest that worker misclassification allowed Rhode Island businesses to illegally reduce their labor costs between $27.0 million and $41.9 million. Most directly to workers, estimates in Table 9 reflect the workers lost $2.1 million and $3.2 million in overtime pay (i.e., the "half" in time-and-a-half), projections that are likely to undercount the true costs to workers by a substantial margin due to methodological reasons.[30]

Beyond the direct impacts to workers, the totals suggest that Rhode Island taxpayers were directly affected, as the loss to state revenue was between $11.6 million and $21.3 million. Of this total, $7.0 million to $10.5 million were revenue shortfalls from the Rhode Island unemployment insurance program, $1.4 million to $2.1 million lost from the temporary disability insurance fund, and around half a million dollars in uncollected money for the job development fund.[31] At the federal level, Rhode Island employers offloaded between $14.2 million and $22.2 million in required Social Security payments onto the backs of workers. In effect, being treated as independent contractors instead of employees means that workers must pay *both* the employee and employer share of Social Security. Finally, misclassification led to between $1.4 million and $2.1 million in unpaid workers' compensation insurance premiums, another value that is likely to substantially understate the extent of the problem due to limitations with the data.[32]

**Table 8. Estimated Costs of Worker Misclassification, All Industries, Based on Estimated Proportion of Wage Underreporting on UI Audits, 2019**

| | | All Industries | |
|---|---|---|---|
| | | Random Audits | All Audits |
| **Statewide Estimates** | | | |
| Total Wages Misclassified | | $185,270,354 | $290,164,438 |
| **Cost of Payroll Fraud** | | | |
| Unemployment Insurance Fund Shortfall | | $6,984,392 | $10,546,719 |
| Temporary Disability Insurance Fund Shortfall | | $2,037,974 | $3,191,809 |
| Job Development Fund Shortfall | | $389,068 | $609,345 |
| Unpaid Workers' Comp. Insurance Premiums | | $1,352,474 | $2,118,200 |
| Employer Share of FICA Offloaded onto Workers | | $14,173,182 | $22,197,580 |
| Overtime and Premium Pay Not Received | | $2,056,927 | $3,221,493 |
| Total Reduced Employer Cost | | $26,994,017 | $41,885,146 |
| **Tax Revenue** | | | |
| State Income Tax Shortfall | Low | $2,223,244 | $3,481,973 |
| | High | $4,446,488 | $6,963,947 |
| Total State Revenue Lost | Low | $11,634,678 | $17,829,846 |
| *(UI + TDI + JDF + State Income Tax)* | High | $13,857,923 | $21,311,820 |

*Notes:* Unemployment insurance fund shortfall estimated using ratio of total underreported wages to UI contribution underpayments in each cell of the table as provided by the Rhode Island Department of Labor and Training. Unpaid temporary disability and job development fund contributions estimated by multiplying 2019 tax rate by wages underreported. Unpaid workers' compensation insurance premiums estimated using loss cost rates of Rhode Island employers provided by the National Council on Compensation Insurance (NCCI). Overtime and premium pay estimated using data from the Bureau of Labor Statistics' Employer Costs for Employee Compensation (ECEC) program. State income tax rate identified at the Tax Foundation; study assumes that between 32% (low) and 64% (high) of misclassified wages are not reported by workers on state income tax forms per the findings of Juravich, Ormiston and Belman (2021) and Ormiston, Belman and Erlich (2020).

Worker misclassification also affects state income tax revenues, albeit in an indirect way. For regular employees who receive a W-2, employers are legally required to report their payroll totals to tax agencies and deduct state income taxes from workers' paychecks. But for independent contractors, the responsibility of reporting and paying taxes on that income falls entirely on the shoulders of the workers themselves. While estimates vary, research has predictably demonstrated that a substantial proportion of income earned outside of a formal employment relationship is not reported on tax forms. Combining a low and a high estimated rate of income underreporting with the lowest marginal tax rate in Rhode Island (3.75% in 2019), Table 8 presents projections suggesting that worker misclassification in the state led to a revenue shortfall between $2.2 million and $7.0 million.[33,34]

It is reminded that the projections in Table 8 represent a lower-bound estimate of the cost impact of worker misclassification on Rhode Island taxpayers as these are based on the hard evidence made available in UI audits about the amount of wages unreported to the DLT. But, as discussed earlier, UI audits do not represent a complete census of misclassification and many instances are either undetectable on audits, nearly impossible to prove, or are occurring through unregistered or out-of-state employers. As a result, any attempt to estimate the costs associated with the full extent of worker misclassification must rely on assumptions about the number of workers and volume of wages involved in these illegal labor practices. The use of assumptions to project economic costs is standard practice among researchers when faced with incomplete information, however doing so injects an unavoidable degree of margin of error into the estimates. The approach used in this report has been used often on similar studies in other states and is nearly identical to the method used by research staff at the Rhode Island Workers' Compensation Court in an analysis included in a 2009 report to the General Assembly.[35]

To offer an estimate of the potential cost effect of worker misclassification in Rhode Island, the analysis requires two key assumptions. First, as a means of building a conservative projection in the face of incomplete information, the authors assume that UI audits represent an accurate count of the number of workers affected by misclassification (19,359 via random audits; 33,469 via all audits). Second, the authors assume that each of these workers earned $27,400 in 2019. This represents the median annual income of self-employed, unincorporated Rhode Island workers in the 2019 American Community Survey (the closest category to misclassified workers in the survey), and the use of this assumed value is consistent with occupational earnings data available from the Bureau of Labor Statistics.[36]

Table 9 presents the projected costs of worker misclassification using these assumptions. Predictably, the presumption that misclassified workers earn more money than is identified on UI audits leads to much larger estimates of the economic costs associated with employee misclassification. The topline numbers of this assumption-based approach suggests that employers were able to shave between $69.1 million and $119.4 million in labor costs by misclassifying workers in 2019, headlined by the fact that workers directly lose an estimated $5.9 million to $10.2 million in legally-earned overtime pay. With regard to lost state tax revenue, the model projects that worker misclassification cost Rhode Island taxpayers between $25.1 million and $54.4 million in 2019, with at least $11 million coming from losses from the state's UI fund.[37]

**Table 9. Estimated Costs of Worker Misclassification, All Industries, Based on Assumptions of the Number of Workers and Wages Misclassified, 2019**

| | | All Industries | |
|---|---|---|---|
| | | Random Audits | All Audits |
| **Starting Assumptions** | | | |
| Number of Workers Affected (from UI audits) | | 19,359 | 33,469 |
| Annual Earnings (from American Community Survey) | | $27,400 | $27,400 |
| Total Wages Misclassified | | $530,431,779 | $917,062,634 |
| **Cost of Payroll Fraud** | | | |
| Unemployment Insurance Fund Shortfall | | $11,904,709 | $20,582,032 |
| Temporary Disability Insurance Fund Shortfall | | $5,834,750 | $10,087,689 |
| Job Development Fund Shortfall | | $1,000,077 | $1,729,031 |
| Unpaid Workers' Comp. Insurance Premiums | | $3,872,152 | $6,694,557 |
| Employer Share of FICA Offloaded onto Workers | | $40,578,031 | $70,155,292 |
| Overtime and Premium Pay Not Received | | $5,889,013 | $10,181,504 |
| Total Reduced Employer Cost | | $69,078,731 | $119,430,105 |
| **Tax Revenue** | | | |
| State Income Tax Shortfall | Low | $6,365,181 | $11,004,752 |
| | High | $12,730,363 | $22,009,503 |
| Total State Revenue Lost | Low | $25,104,717 | $43,403,503 |
| *(UI + TDI + JDF + State Income Tax)* | High | $31,469,898 | $54,408,255 |

*Notes:* Unemployment insurance fund, temporary disability insurance, and job development fund shortfalls estimated by multiplying worker earnings by the standard tax rates for 2019. Unpaid workers' compensation insurance premiums estimated using loss cost rates of Rhode Island employers provided by the National Council on Compensation Insurance (NCCI). Overtime and premium pay estimated using data from the Bureau of Labor Statistics' Employer Costs for Employee Compensation (ECEC) program. State income tax rate identified at the Tax Foundation; study assumes that between 32% (low) and 64% (high) of misclassified wages are not reported by workers on state income tax forms per the findings of Juravich, Ormiston and Belman (2021) and Ormiston, Belman and Erlich (2020).

The topline state revenue numbers in the "all audit" total in Table 9 ($43.4-$54.4 million) are consistent with similar findings by the Workers' Compensation Court which, in 2009, used a similar assumption-based approach to suggest that misclassification cost the state $49.9 million in uncollected taxes and contributions.[38] However, had the authors in the current study used the less conservative assumptions applied by the Workers' Compensation Court in 2009—that misclassified workers earn state-average wages—the results of the analysis in Table 9 would have reflected lost tax revenues totaling between $66.4 million and $89.3 million in 2019.[39]

While Tables 8 and 9 represent efforts to measure the direct costs to Rhode Island taxpayers that result from misclassification, it is important to highlight that these estimates reflect only a small portion of the costs borne by the state. In addition to these direct costs, there are countless indirect costs that are exacerbated by the precarious employment situations of affected workers. This includes an increased need for income-supporting social programs, greater reliance on the government-funded health insurance, greater psychological strain on workers and their families, higher workers' compensation insurance premiums for law-abiding firms, and a host of other concerns.

Finally, it is recognized that these projections ignore a particularly damaging form of payroll fraud: explicit wage theft. There are countless examples of employers simply refusing to pay workers what they are owed, from recent court cases in Rhode Island to numerous studies documenting its presence in the New England construction industry.[40] However, there are no quantitative records on wage theft that are sufficient for the authors to project its extent or costs to workers on an aggregate basis in the state of Rhode Island.

## CONCLUSION

This report provides clear evidence that payroll fraud is rampant in Rhode Island. Data provided by the Department of Labor and Training are unequivocal in identifying that worker misclassification exists in every corner of the state economy. Records from UI audits reflect that misclassification is especially prevalent in residential construction, certain types of specialty trades contractors, janitorial services and landscaping. And this is just the tip of the iceberg given the difficulty of proving under-the-table, cash payments to workers and the presence of unregistered employers such as "labor brokers" in construction. Consequently, the results of UI audits represent a lower-bound estimate of the full extent of illegal labor practices in Rhode Island.

Payroll fraud is typically rooted in an employer's desire to reduce labor costs to improve their own bottom line. But these actions have real consequences for Rhode Island society. Workers who are misclassified as independent contractors are denied their legal rights to overtime pay, social insurance (e.g., workers' comp, UI), OSHA protections, and other benefits afforded to employees, thereby exacerbating the precariousness of workers' physical and financial well-being. The competitive position of law-abiding employers is also undermined by firms engaged in misclassification. This compels some fair-minded business owners to either take part in these actions or exit the industry altogether, resulting in a "race to the bottom" in their respective industries. Finally, misclassification amounts to a form of tax evasion that leads to tens of millions of dollars in revenue shortfalls for critical state programs and overall revenues in Rhode Island on an annual basis.

The prevalence of worker misclassification in Rhode Island should come as no surprise. A 2009 report submitted to the General Assembly featured considerable testimony and statistical evidence highlighting its presence. The Rhode Island Underground Economy and Employee Misclassification Task Force was created in 2015 with annual reports documenting important cases and summarizing the volume of activity surrounding enforcement efforts. Reports from other states—such as an in-depth 2021 report on conditions in the Massachusetts construction industry—also highlight just how deep-rooted illegal labor practices are within some industries in New England and across the United States.[41]

In Rhode Island, illegal misclassification appears to be getting worse. A review of UI audits from 2008 discovered 6% of employers misclassifying at least one worker. In comparison, UI audits summarized in this report document that 9.3% to 12.2% of employers were engaged in similar conduct between 2016 and 2021. This is a substantial increase.

Furthermore, the authors' interviews with construction stakeholders in Rhode Island, Massachusetts, and other parts of the country suggest a growing consensus that misclassification in the industry has increasingly gone underground over the past two decades. This means that misclassification has morphed away from a more easily-detectable way of established businesses issuing 1099-MISCs instead of W-2s. Instead, there has been a sharp increase in off-the-books payments and a reliance on unregistered labor brokers operating entirely in the shadows of the construction industry and paying workers primarily in cash. The lack of a paper trail makes this form of misclassification extraordinarily difficult to prove, suggesting that the statistical evidence on misclassification offered in this report—particularly in the construction sector—is likely undercounting the full extent of the problem.

*Policy Recommendations*

Based on the authors' research, multiple policy options hold considerable promise in restoring worker rights and ensuring greater justice in Rhode Island's workplaces. The first would be to make wage theft a felony. While other forms of stealing—embezzlement ($100 or more) and grand larceny ($1,500 or more)—are treated as felonies in Rhode Island, wage theft is only a misdemeanor no matter the dollar amount. It is clear that many employers simply see the fines and penalties associated with a misdemeanor for wage theft—if they are ever caught in the first place—as simply the "cost of doing business." Until employers' calculus around this issue is changed, it is difficult to see how Rhode Island can counter this race to the bottom.

This issue is not restricted to Rhode Island. But legislators in other states have started to awaken to the recognition that wage theft will continue unabated without upgrading the penalties associated with the crime. As an example, Minnesota made wage theft a felony in 2019 for any employer convicted of stealing at least $500 from employees.[42] In 2020, Colorado enacted a law passed the previous year that made wage theft a felony for unpaid wages in excess of $2,000.[43] In 2021, California approved a new law that upgraded wage theft from a misdemeanor to a felony for cases involving at least $950 from one employee or $2,350 from multiple employees over a 12-month period.[44] Enacting a similar law in Rhode Island would offer more significant deterrence against wage theft and provide prosecutors with the necessary tools—specifically, the impaneling of grand juries—to more effectively pursue these cases.

This study has demonstrated that worker misclassification is rampant in Rhode Island, a finding that is consistent with reports from other states. And there are signs that the situation has only been getting worse, both locally and nationally. It is clear that the current regulatory structure does not offer sufficient penalties to employers who engage in intentional, egregious, and repeated misclassification of workers. It is therefore vital that policy efforts to reduce misclassification focus on measures that would more fully disincentive employers that engage in willful, flagrant and repeated violation of state labor laws.

Another important policy recommendation to curb many forms of payroll fraud would be to establish joint liability for wage and hour violations. There has been an extraordinary increase in subcontracting over the past few decades, from construction job sites to cleaning services. This has given rise to an employment structure where large companies, developers, and general contractors knowingly hire subcontractors whose business model is predicated on low costs generated by engaging in wage theft and worker misclassification.[45] Under current statute in Rhode Island, developers and general contractors are absolved of any legal liability when it comes to subcontractors' violations of state and federal labor law. Until principals are held responsible for the behavior of the subcontractors they employ, no meaningful and systematic change in employment practices is fully possible.

Similar to new laws governing wage theft, other states have already established legislative precedent in establishing joint liability either narrowly in the construction industry or more broadly through the entire economy. For instance, California passed legislation that established joint liability for wage and hour violations—with exceptions for small businesses—across all industries that took effect in 2015.[46] More recently, New York approved Senate Bill S2766C in 2021, which established joint liability for wage and hour violations in the state's construction industry.[47]

Finally, the authors' interviews and prior research make clear that wage theft disproportionately targets immigrant and undocumented workers. Employers effectively prey on these workers' reluctance to report wage theft to government regulators, thereby allowing it to continue unnoticed and unabated. Unscrupulous employers will continue to use workers' immigration status against them when deciding whether to pay them on time and in full until there is real immigrant reform at the national level and a pathway to citizenship for the immigrant workers that make up so much of the workforce.

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## SUPPORTING ORGANIZATIONS

*Institute for Construction Economic Research (ICERES)*
http://iceres.org/

The construction industry and its stakeholders face pressing long term issues regarding workforce sustainability, safety, productivity and integration of technology. The Institute for Construction Economic Research (ICERES) supports high quality research with the goal of finding and disseminating pragmatic solutions to these and other construction issues. The Institute for Construction Economic Research undertakes non-partisan research on issues facing the industry, collaborating with existing construction researchers and attracting new investigators into the field of construction research. The Institute also works to develop a network of researchers with ongoing programs on construction issues. In addition to its work in supporting research, the Institute disseminates this research with a working paper series, a web presence, and conferences.

*University of Massachusetts Amherst Labor Center*
https://www.umass.edu/lrrc/

For over fifty years, the University of Massachusetts Amherst Labor Center has been one of the premiere graduate programs in Labor Studies in the United States with over 1,000 graduates in key position in the Commonwealth and nationwide. In addition to our innovative graduate programs, the UMass Amherst Labor Center has an extensive program of applied and policy research. This has includes studies of: wage theft; asbestos monitoring; temporary staffing agencies and labor law; and the state of labor and employment in Massachusetts. Most recently the Center launched a Covid-19 Workplace Project.

## NOTES

[1] Rebecca Smith, "Public Task Forces Take on Employee Misclassification: Best Practices," National Employment Law Project Policy Brief, August 2020: 2.
[2] "What Rhode Island Business Should Know About Worker Misclassification," https://dlt.ri.gov/regulation-and-safety/worker-misclassification.
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[4] https://upriseri.com/wp-content/uploads/2018/07/2018-05-03-RIDLT-v-JS-Interior-Construction-Stop-Work-Order.pdf.
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[6] Scott Duhamel, interview by authors, November 23, 2021, 22.
[7] Michael Sabitoni, Interview by authors, November 23, 2021, 12.
[8] Michael Sabitoni, Interview by authors, November 23, 2021, 5.
[9] "Massachusetts Contractors Arraigned on Wage Theft Charges Stemming from Barrington Middle School Construction Work," https://riag.ri.gov/press-releases/massachusetts-contractors-arraigned-wage-theft-charges-stemming-barrington-middle.
[10] "Owner of Cleaning Company Charged with Wage Theft Provided Services to CCRI," WPRI, July 9, https://www.wpri.com/news/crime/owner-of-cleaning-company-charged-with-wage-theft-provided-services-to-ccri/
[11] The Division of Labor and Training attributes the large decline in SWOs in 2020 to a policy change. Prior to 2020, a Stop Work Order issued a notice of a hearing at the DLT. Starting in 2020, however, the issuance of a SWO effectively shut down the business without a hearing and required them to remain closed until they obtain workers' compensation insurance coverage in compliance with the law or until they appealed the SWO with the Workers' Compensation Court.
[12] The most recent study of worker misclassification published in 2021 featured a review of Massachusetts state UI audits; for more, see: Juravich, Ormiston and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper.* For a review of the additional eight state-specific studies that were published prior to that (MA, ME, IL, NY, MN, MI, IN, VA), see: Ormiston, Belman and Erlich (2020). "An Empirical Methodology to Estimate the Incidence and Costs of Payroll Fraud in the Construction Industry," *Institute for Construction Economics Research Working Paper*, http://iceres.org/wp-content/uploads/2020/06/ICERES-Methodology-for-Wage-and-Tax-Fraud.pdf.
[13] A targeted audit is pursued as the result of information coming from a variety of sources. Most directly, current or former employees of a business—or any other interested party (e.g., relatives, business competitors)--may file a complaint with the DLT alleging misclassification. In addition to tips, UI audits may result from a referral made by another state agency or after an employee attempts to claim UI benefits despite the fact that the employer does not report any wages to the state. To assist reporting of employee misclassification, the DLT has published a public form that can trigger an audit or investigation: https://dlt.ri.gov/sites/g/files/xkgbur571/files/documents/pdf/MisclassForm.pdf.
[14] Statewide employment and wage estimates were generated by extrapolating the results of UI audits to the private-sector employment (424,358 employees) and wage and salary ($22.46 billion) totals for the state in 2019 according to the Rhode Island Office of Labor Market Information. As an example, UI audit results reflected a ratio of $121 in legal wages and salaries for every $1 underreported to the DLT; applying this ratio to the $22.46 billion in legal wages results in an estimate of $185.3 million in underreported wages and salaries. While the industry composition of random UI audits are not an exact match to the industrial composition of all employers in Rhode Island, a comparison of two-digit industry codes (North American Industrial Classification System) between the two sources did not reveal substantial differences that would negate the use of this economy-wide average; further, stratifying the sample by two-digit codes would encounter substantial risks of sampling error given the small number of audits in the least-populated industries in the state. As a result, statewide averages in this study rely on the application of the overall rates determined by UI audits. For statewide data used in this report, see: https://dlt.ri.gov/labor-market-information/data-center/employment-wages-industry-qcew.

[15] Estimates were calculated for 2019 given the pandemic-fueled irregularities in the 2020 labor market and the fact that 2021 data on the broader labor market had yet to have been published by either the Bureau of Labor Statistics or the Rhode Island LMI by the time of the writing of this report in January 2022.

[16] There are many reasons to believe that the estimated number of misclassified workers in the state represents an underestimate of the true total, some of which are outlined later in the study. However, there is one reason why this might also overstate the problem: given that many (but not all) misclassified workers are short-term employees, it is possible that they are bouncing from employer to employer and would thus be double-counted if detected and deemed to be misclassified in multiple locations in the same time period.

[17] As examples of the extremes that New England construction employers will engage to avoid detection, consider Chapter 1 of: Juravich, Ormiston and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper.*

[18] Author's e-mail exchange with a DLT official, January 24, 2022.

[19] For more, see: Juravich, Ormiston and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper.*

[20] The simple addition of firms subject to targeted audits would result in an overestimation of misclassification if random audits reflected a sample of firms consistent with the underlying population of firms and audits captured the full extent of illegal labor practices in Rhode Island. However, given the difficulties in capturing cash-only payments and the presence of unregistered employers (e.g., construction labor brokers), there are reasons to suspect that the "all audit" total may possibly—if not likely—still represent an undercount of the full extent of illegal employment practices in the state. As evidence of this likelihood, the authors used data from the U.S. Census and Bureau of Labor Statistics to indirectly estimate the number of misclassified construction workers in Massachusetts; this number far surpassed what was identified in the "all audit" total on UI audits. For more, see Appendix A of: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts: Appendices," *University of Massachusetts Labor Center Working Paper,* https://www.umass.edu/lrrc/sites/default/files/Appendix%20-%20Massachusetts%20Construction%20Report.pdf.

[21] The 2009 report does differentiate as to whether the results were for random audits only or represented the "all audits" total, clouding any direct comparison. Further, the 2009 report also lists that 4.3% of Rhode Island employees were affected by misclassification by misclassification, compared to 4.4%-7.3% in this study. However, a direct comparison to this work is complicated by the fact that many similar studies at the time calculated the proportion of the workforce affected by simply dividing the number of misclassified workers by the number of legal employees. In contrast, this study divides the number of misclassified workers by the sum of legal employment and misclassified workers, which is a more accurate depiction of the proportion of the workforce affected. For more, see: Special Joint Commission to Study the Underground Economy and Employee Misclassification (June, 2009). *Findings and Recommendations to the Rhode Island General Assembly*.

[22] An evolving statistical approach involves comparing the number of self-identifying construction workers on Census surveys of American households with official payroll records submitted by employers that are aggregated by the Bureau of Labor Statistics; it is presumed that a significant portion of the difference between the number of workers in the industry and the number of legitimate employees claimed by construction business represents a viable proxy for the number of misclassified and off-the-books workers in the industry. In engaging this approach for the Rhode Island construction sector using data from the American Community Survey (ACS) and the Quarterly Census for Employment and Wages (QCEW), the authors found there to be a substantial gap between *total* industry employment as identified by workers and *legal* employment as documented by employers in the state at a number that far surpassed the estimates provided in Table 4. However, estimates of construction employment in Rhode Island taken from the ACS feature a substantial margin of error (presumably due to the small size of the state), undermining the authors' confidence in providing a specific estimate of the number of misclassified construction workers in the state using this statistical approach. For a full discussion of the complications comparing the ACS to the QCEW to estimate the level of payroll fraud in the construction industry, see Appendix A of: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts: Appendices," *University of Massachusetts Labor Center Working Paper.* See also: Ormiston, Belman and Erlich (2020). "An Empirical Methodology to Estimate the Incidence

and Costs of Payroll Fraud in the Construction Industry," *Institute for Construction Economics Research Working Paper*.

[23] Among industries that featured between 50 and 100 audits, it is important to highlight that rates of employee misclassification in two other industries were quite high: transportation and warehousing (71 audits) and real estate and rental leasing (90 audits). In the former, 18.3% of the industry workforce was estimated to be misclassified on all audits (but just 7.5% on random audits); in the latter, it was 20.1% on all audits and 15.5% on random audits.

[24] Across all audits (both random and targeted), the authors identify that 5.2% of employers throughout the Rhode Island economy were found to have more misclassified workers than regular employees. Within the administrative and waste management services industry, the audits reflected a rate of 10.0%; construction was not far behind at 9.3%. No other industry featured a rate above the state average. While numbers were lower when restricting the sample to random audits (3.2%), these two industries still far outpaced every other industry (administrative and waste management services=8.3%; construction=4.7%). Similar trends emerged when looking at extensive wage underreporting (more than $100,000) and those that both misclassified a large number of workers and underreported a significant amount of money.

[25] For more, see: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*; Juravich (2020). "Wage Theft at the North Square Apartments," *University of Massachusetts Labor Center Working* Paper; and Juravich, Ablavsky, and Williams (2015). "The Epidemic of Wage Theft in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*.

[26] For more, see: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*.

[27] For a comprehensive perspective on the public costs of worker misclassification, see: National Employment Law Project (2020). "Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries," accessed at: https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-workers-federal-state-treasuries-update-october-2020/.

[28] For more, see: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*.

[29] Among many studies that have addressed this issue, see as an example: Ohio Attorney General (2009). "Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local Governments in Ohio," accessed at: https://iiiffc.org/images/pdf/employee_classification/OH%20AG%20Rpt%20on%20Misclass.Workers.2009.pdf

[30] The estimate of overtime and premium pay lost is derived using the National Compensation Survey produced by the Bureau of Labor Statistics. In 2019, the average worker earned $25.22 per hour with an additional $0.28 in overtime and premium pay; this ratio was used to assess lost overtime pay amongst Rhode Island workers. But these national averages go across all industries, including those predominantly featuring workers "exempt" from receiving overtime via the Fair Labor Standards Act. But many misclassified workers are located in industries largely populated by "non-exempt" workers, meaning that their rate of overtime-to-regular pay is likely much higher. For data on the NCS, see: https://www.bls.gov/web/ecec/ececqrtn.pdf.

[31] Estimated losses for the state UI program are estimated by using the ratio of UI contributions required to be repaid by misclassifying employers to the total volume of wages underreported on UI audit data.

[32] Projections for unpaid workers' compensation insurance premiums are derived from the state-average "loss costs" on workers' compensation policies in Rhode Island, a value graciously provided to the authors by a representative at the National Council on Compensation Insurance. Loss costs, however, represent only the costs necessary for insurance companies to cover claims and do not equate to the actual cost of a premium paid by employers (which would also include an additional markup by insurance companies). Further, the overall state average loss costs includes many "white collar" occupations that are relatively safe and feature far lower rates of worker misclassification; in contrast, many of the industries with the highest rates of misclassification (construction, landscaping) are also likely to feature higher-priced workers' compensation coverage. This would suggest that the overall state average is likely a substantial underestimate of the true price of coverage foregone by employers engaged in misclassification.

[33] A 2021 study by Juravich, Ormiston, and Belman reviewed 1099-MISCs issued by Massachusetts contractors to state residents. Many of these were issued to Social Security numbers that did not appear in state income tax records for the year, meaning that a substantial portion (32%) of the dollars paid in 1099-MISCs were not reported. In contrast, a 2016 report published by the Internal Revenue Service estimated that the net misreporting percentage on nonfarm proprietor's income to be 64%, a number that included a mix of unreported income from 1099-MISC forms and income earned entirely off-the-books. Since the authors have no evidence suggesting that underreported wages to the Rhode Island DLT are the result of solely 1099-MISCs or also includes discovered off-the-books payments, the results are presented with both assumptions. For more, see: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*; Internal Revenue Service. 2016. "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008-2010." IRS Publication 1415.
[34] A lack of information on the demographics and income situation of workers complicates the ability to estimate projected tax losses. UI audit reflect that the average instance of worker misclassification—represented by the simple average of wages underreported divided by the number of workers misclassified—would be nearly equal to the standard deduction for single people on Rhode Island's income tax forms in 2019 ($8,772 vs. $8,750). But it is unrealistic to think that this is workers' only source of income, suggesting that some portion—if not all of it—would be subject to income tax; incorporating the number of exemptions is also a complicating factor. As a result, the analysis simply applies the marginal tax rate (3.75%) on every dollar given the tax bracket for those earning between $0 and $64,000 to each dollar estimated to be underreported (Source: Loughead, Katherine (2021). "State Individual Income Tax Rates and Brackets for 2021," *Tax Foundation*; accessed at: https://taxfoundation.org/publications/state-individual-income-tax-rates-and-brackets/.
[35] For the cost estimates of misclassification in the 2009 report submitted to the Rhode Island General Assembly, see pages 46 and 47 of: Special Joint Commission to Study the Underground Economy and Employee Misclassification (June, 2009). *Findings and Recommendations to the Rhode Island General Assembly*. For prior studies using this statistical approach, see Ormiston, Belman and Erlich (2020). "An Empirical Methodology to Estimate the Incidence and Costs of Payroll Fraud in the Construction Industry," *Institute for Construction Economics Research Working Paper*; Duncan, Waddoups and Ormiston (2021). "Payroll Fraud in Nevada's Construction Industry: Extent and Fiscal Impact," *Institute for Construction Economics Research Working Paper*; Ormiston, Erlich and Belman (2021). "Payroll Fraud in New York's Construction Industry: Estimating its Prevalence, Severity and Economic Costs," *Institute for Construction Economics Research Worker Paper;* Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper.*
[36] The Bureau of Labor Statistics Occupational Employment Statistics series puts $27,400 between the 10th and 25th percentile of Rhode Island workers' annual wages in 2019. This value is also between the 25th percentile and the median of what housekeepers and janitors earn in the legitimate Rhode Island economy. While many misclassified workers may be paid less than this amount, there is a counterbalance in that some misclassified construction workers can make much more than this value. For instance, $27,400 is far below the 10th percentile of earnings of legitimate carpenters in Rhode Island, and roughly equates to the 10th percentile of contraction laborers who receive W-2s. For more, see: www.bls.gov/oes. Data from the American Community Survey comes from IPUMS USA, University of Minnesota, ipums.org.
[37] To calculate uncollected income tax, the authors multiplied the missing earnings by the marginal tax rate for lower-income workers (3.75%) in 2019. A more complex approach—which would have subtracted workers' standard deduction and exemptions—was scrapped when data from the American Community Survey revealed that most self-employed workers in unincorporated businesses (which best categorize misclassified workers as a whole) have other sources of income (spousal, other work, investments) that would more than offset the standard deduction and exemptions.
[38] See page 46 of: Special Joint Commission to Study the Underground Economy and Employee Misclassification (June, 2009). *Findings and Recommendations to the Rhode Island General Assembly*.
[39] The 2009 report to the General Assembly assumed that misclassified workers earned the state-average income; in 2019, the Bureau of Labor Statistics Occupational Employment Statistics (www.bls.gov/oes) series denoted this to be $57,220. Further, it appears that the Workers' Compensation Court was using the all-audit total of employment which, at the time, was 6.1% of employment. For more, see: Special Joint Commission to

Study the Underground Economy and Employee Misclassification (June, 2009). *Findings and Recommendations to the Rhode Island General Assembly*.
[40] For more, see: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*; Juravich (2020). "Wage Theft at the North Square Apartments," *University of Massachusetts Labor Center Working* Paper; and Juravich, Ablavsky, and Williams (2015). "The Epidemic of Wage Theft in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*.
[41] See: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*.
[42] For more, see: Minnesota Department of Labor and Industry. "Summary of Minnesota's New Wage Theft Law." Accessed at: https://www.dli.mn.gov/sites/default/files/pdf/wage_theft_law_summary.pdf.
[43] For more, see a summary of Colorado HB19-1267 here: https://leg.colorado.gov/bills/hb19-1267.
[44] For more, see California Assembly Bill No. 1003 here: https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220AB1003.
[45] For more, see: Juravich, Ormiston, and Belman (2021). "The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*; Juravich (2020). "Wage Theft at the North Square Apartments," *University of Massachusetts Labor Center Working* Paper; and Juravich, Ablavsky, and Williams (2015). "The Epidemic of Wage Theft in Residential Construction in Massachusetts," *University of Massachusetts Labor Center Working Paper*.
[46] See: https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=LAB&sectionNum=2810.3.
[47] See: https://legislation.nysenate.gov/pdf/bills/2021/A3350A.