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PACIFIC RESOURCE PARTNERSHIP

# INSIGHTS

HAWAII'S UNDERGROUND ECONOMY



INSIDE:

ROLLING THE DICE ON A  
CHEAP CONTRACTOR

# GAMING the System

Non-compliance with Hawaii's labor and employment laws is a big problem that gets very little attention. It's not just a union labor issue – it affects businesses in all industries, every taxpayer and the entire state economy. But unless you interact directly with a non-compliant contractor, you might not know the extent of the problem.

**SAVVY DEVELOPERS** look beyond the bottom-line cost of a bid to understand the total value that a respected and trustworthy general contractor brings to the development team.

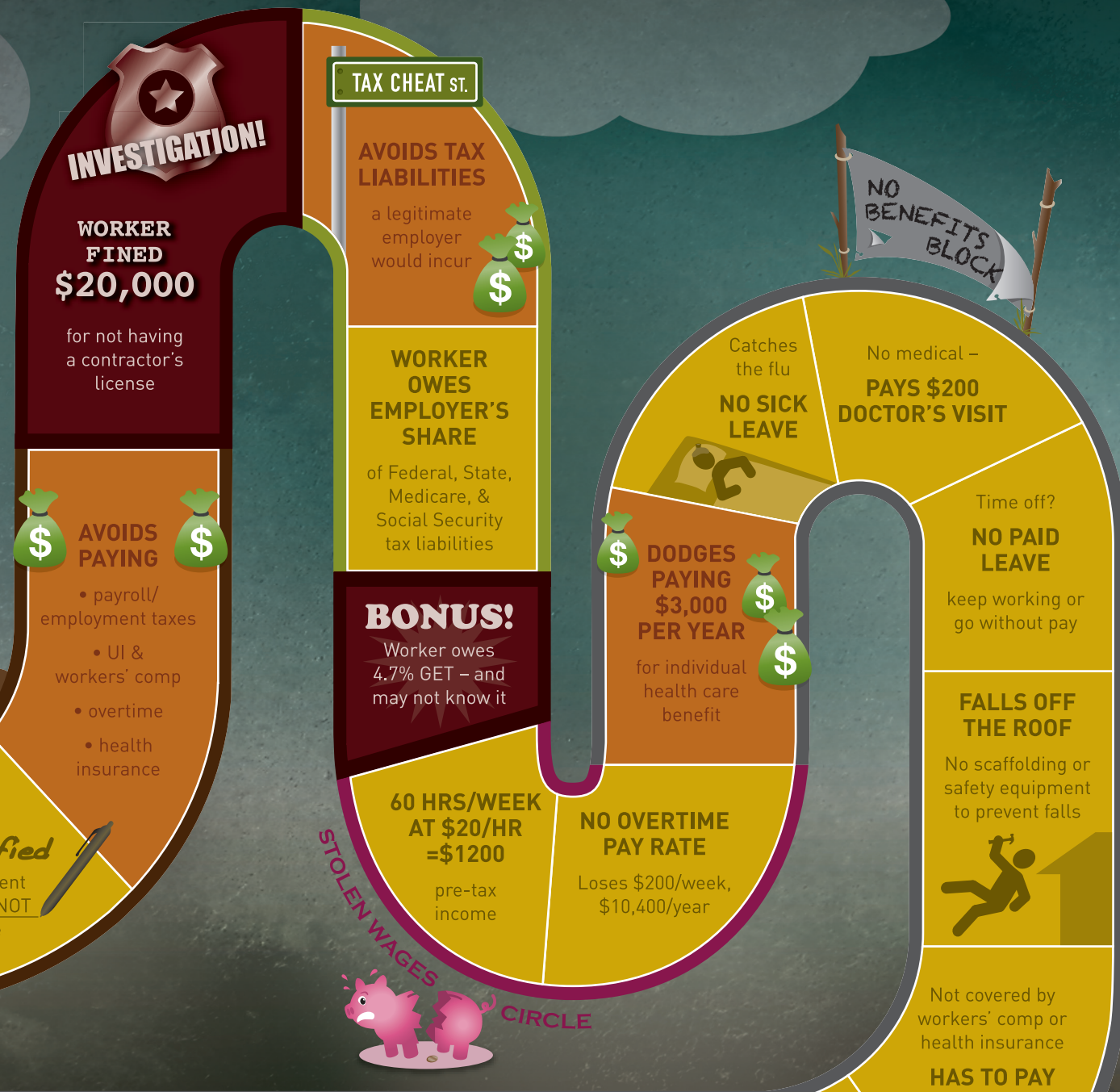
*Here's one scenario to illustrate how the game is rigged.*

**LESS DISCERNING DEVELOPERS** only care about building as cheaply as possible, and will choose the lowest bid, not suspecting (or not caring) that a crooked contractor may be cheating by misclassifying his employees as independent contractors.

**GROUND-AND-LAW-BREAKING**



**WRONGED WAY**



## UNFAIR ADVANTAGE

Contractors who don't play by the rules steal work from honest, law-abiding contractors because they can offer to do the same project more cheaply. Here's a comparison that shows the amount of legally required payroll costs a dishonest contractor can avoid by misclassifying employees in the State of Hawaii:

### STATE-MANDATED EMPLOYER PAYROLL EXPENSES, BASED ON \$1 MILLION PAYROLL

W-2 EMPLOYEE	MISCLASSIFIED EMPLOYEE
Social Security: \$62,000	Social Security: \$0*
Medicare: \$14,500	Medicare: \$0*
Federal Unemployment Tax: \$462.00	Federal Unemployment Tax: \$0*
State Unemployment Insurance: \$11,605	State Unemployment Insurance: \$0*
Medical: \$155,844	Medical: \$0
Workers Comp/General Liability: \$108,000	Workers Comp/General Liability: \$0
TDI: \$3,900	TDI: \$0

### MANDATED EMPLOYER WITHHOLDINGS

Federal: \$112,684	Federal: \$0*
State: \$64,361	State: \$0*
Social Security: \$62,000	Social Security: \$0*
Medicare: \$14,500	Medicare: \$0*

**TOTAL SAVED BY MISCLASSIFYING: \$609,856**

\*AMOUNT NOT COLLECTED BY GOVERNMENT AGENCIES: \$342,112

In the underground economy, the worker always loses and the crooked contractor always wins. And that's just two players out of many more who are negatively impacted. Crooked contractors also:

- Lower standard area living wage and take work from upstanding contractors
- Threaten public safety with shoddy work
- Depress the local economy
- Damage the integrity of the industry
- Swindle taxpayers
- Fray the social safety net



Expert Q&A

## LINDA CHU TAKAYAMA

HAWAII DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS



Linda Chu Takayama  
DLIR Director

*Linda Chu Takayama is the Director of the Hawaii Department of Labor and Industrial Relations, which enforces regulations pertaining to a wide array of business and industry activities. She shared her insights on the state's efforts to enforce laws and regulations and halt underground economic activity.*

### \* TO CHECK ON CONTRACTORS BEFORE YOU HIRE THEM

Visit DCCA's website:  
[http://cca.hawaii.gov/rico/business\\_online/](http://cca.hawaii.gov/rico/business_online/)

Or call (808) 587-4272

### Q: WHAT IS THE STATE DOING TO COMBAT THE UNDERGROUND ECONOMY?

**LCT:** Several state agencies, including the Department of Taxation (DoTAX) and the Department of Commerce & Consumer Affairs (DCCA), which regulates business registration and licensure, are working with the Department of Labor and Industrial Relations (DLIR), which enforces workers' compensation, temporary disability insurance, prepaid health care, workplace safety, unemployment insurance, and wage and hour laws.

### Q: WHAT DOES THE STATE NEED TO PREVENT UNDERGROUND ECONOMIC ACTIVITY?

**LCT:** Gov. Ige has tasked the departments to look at ways to break down bureaucratic "silos" to improve communication and coordination between agencies. Last fall's multi-agency operation at the Ewa Wing of the Ala Moana Center was a highly successful example of collaboration between departments. It netted several dozen violators and led to the landlord adopting lease terms that now emphasize tenant responsibilities to uphold state laws.

The ongoing efforts of the governor and DoTAX to modernize the tax system will also play an important role in improving the state's ability to prevent fraud and preserve the integrity of the tax collection system.

Although DLIR's enforcement capacity does not have the staff or resources to investigate workplaces for non-compliance on a regular basis, the Unemployment Insurance Division does undertake random field audits. Other divisions do desk audits and all respond to specific complaints. It is hoped that the community and the legislators would support the state's requests for additional resources when the legislature convenes in January.

### Q: WHAT SHOULD DEVELOPERS OR OWNERS DO BEFORE HIRING A CONTRACTOR?

**LCT:** Developers or owners can ascertain if a contractor is playing fair in paying all taxes, providing statutory benefits and maintaining licensure. DCCA's website offers a number of online resources to check on companies, individuals or licensed professionals that you intend to hire or do business with. DCCA also provides this service by phone at (808) 587-4272. Additional information includes business complaint history, business name search, professional and vocational license search, licensee complaint history and general excise tax license search.

### Q: WHAT ARE THE FINANCIAL IMPACTS OF THE UNDERGROUND ECONOMY TO THE STATE AND TO TAXPAYERS?

**LCT:** Although un-reporting and misclassification of employees as independent contractors are serious issues harming workers, taxpayers, and businesses, the full extent of the financial impacts of the underground economy to the state and taxpayers is unknown. However, a U.S. Department of Labor-commissioned study in 2000 estimated that 10-30 percent of employers misclassify employees, based on audited firms in nine states. That study estimated that if only one percent of employees were misclassified nationally, the loss in unemployment insurance revenue would be nearly \$200 million annually.

The harm caused by misclassification of workers is not limited to workers and taxpayers, who must shoulder the additional costs of unpaid wages, taxes and social insurance programs that independent contractors do not pay into. Misclassification also harms businesses that are forced into a "race to the bottom" in terms of wages, working conditions and profitability.

Therefore, it is imperative for DLIR and our partners in the community to vigorously and strategically enforce employment laws to correct against the short-term incentives toward misclassification, un-reporting and abuse of workers in the underground economy.



Integrated Communities

## HOW WE BUILD IS AS IMPORTANT AS WHAT WE BUILD



The essence of a community is not just the physical space it occupies. It's also an ideal that we all cherish, especially living in an island state like Hawaii. Elevating the communal over the individual is perhaps Hawaii's defining social value – within our sense of community are wrapped up the Native Hawaiian concepts of aloha, kuleana and ohana that have been adopted and adapted by wave upon wave of immigrants that make up our diverse population, many of them bringing on their own traditions that put the group or family over the self.

And because a community is more than an area or a development, how we build

our communities matters just as much as what we build. We can build gleaming shopping centers and refurbished hotels, but if we do so on the backs of underpaid workers slaving away for the enrichment of tax-dodging developers and crooked contractors, we risk losing something invaluable along the way. We risk our integrity.

Building our communities with integrity means playing by the rules and following laws and regulations. It means paying a living wage and benefits, so that the workers laboring to bring a community to life have a chance at a decent life of their own. It means contributing to civic life, both by

participating in shared communal events but also, more basically, by fulfilling your obligations to pay taxes and support the social safety net.

We envision integrated communities that live up to our highest ideals for convenience, ease of transportation, social connectedness and opportunity. To live up to those ideals, they must start from their very foundations to be built with integrity. ●



*Contractor Profile*

## BRETT K. HILL

BRETT HILL CONSTRUCTION, INC.

**COMPANY:**  
Brett Hill Construction, Inc.

**GENERAL CONTRACTOR:**  
Commercial, Retail, Restaurant,  
Health, Education and Residential

**WEBSITE:**  
www.brethillcompanies.com

**CONTACT:**  
Brett K. Hill

**TITLE:**  
President and CEO

**PHONE:**  
(808) 593-1500

**EMAIL:**  
brett@brethillcompanies.com

*President and CEO of the firm that bears his name, Brett Hill has developed a multi-disciplined firm to provide a full scope of services to manage, construct, furnish and maintain projects. Known in the business as a high-integrity leader, he shared his insights about the value of doing things the right way.*

For Brett Hill, treating workers fairly is a source of pride. "As a union contractor, we are proud to pay our employees a wage they can not only make a living on, but provide for their families."

Unfortunately, general contractors like Brett Hill Construction (BHCI) can lose projects to competitors who have no such scruples. "We are seeing contractors pay substandard wages or even misclassify their workers as independent contractors, thus treating their employees as sub-contractors." That's not just a technicality on paperwork – it has real consequences that hurt workers and, ultimately, the economy.

"By doing this, bad contractors save money by pushing the burden of cost and liability onto the individual worker." If the worker can't bear those burdens – for instance, if they're injured on the job and don't have proper health coverage – they put a strain on the safety net that law-abiding contractors are paying into. Bad contractors cut costs, dodge taxes and get ahead while reputable firms that play by the rules lose out – at least in the short term.

But ultimately, the tenant or building owner may suffer the consequences if substandard work falls apart, there's an injury or a building code violation. "People often say that when something is

too good to be true, then it probably is," says Brett. "You might be able to make a quick buck here or there, but for true lasting power, I wholeheartedly believe that you have to do right by the community that you live in. To us, this means paying good wages and benefits to our workers and delivering timely and quality projects to our clients. Work that we can be proud of and feel good about."

BHCI recently completed Penhaligon, a retail store at International Market Place in Waikiki. "Every time I go by the International Market Place, I will feel pride in our work, knowing that my team built that store. But if I knew I'd done a shoddy job cutting corners, or built it on the backs of workers who were being exploited, I wouldn't be able to live with myself."

To uphold that level of integrity and still maintain their ability to compete with cost-cutting contractors, BHCI has relied on programs from Pacific Resource Partnership and the Hawaii Regional Council of Carpenters (HRCC). "Programs like PRP's Tenant Construction Program and the competitive package through the Hawaii Regional Council of Carpenters have been great tools in allowing us to level the playing field between us and the bad contractors while not compromising our morals or quality of work." ●

## Afterword

JOHN WHITE  
EXECUTIVE DIRECTOR, PRP



## STANDING UP FOR INTEGRITY

Focusing on the bottom line when you hire a contractor may be tempting (see sidebar, page 3). But lower costs may just be concealing bad practices. Often, hidden in the lowest bids are devastating costs for taxpayers.

The biggest cost is shoddy or unsafe construction. If a contractor is skipping out on some obligations, who knows what corners they are cutting behind the façade or drywall? Building failures are common around the world in places that don't have the protections we enjoy in the United States. That becomes especially apparent when they are subjected to natural disasters like hurricanes, tsunamis and earthquakes that also threaten Hawaii. If our state doesn't enforce its standards and close loopholes, it could be at risk for catastrophic structural failures and the enormous consequences to the finances and human health of our communities. Ultimately, taxpayers will bear the burden of emergency responders', relief, clean-up and rebuilding efforts that may be required in the event of a building failure.

Taxpayers also have to foot the bill when workers are injured and they're not covered by workers' compensation and are forced onto the safety net of public services. Of course contractors who aren't paying into workers' compensation are likely also shirking their other taxes, so they're both increasing the risk of burden on the safety net and avoiding their duty to pay into it.

That's why we're aligning with partners within and outside of our industry who have had enough of the underground economy that takes advantage of taxpayers. We're standing up to make sure honest, law-abiding contractors aren't suffering for their integrity. We're putting a stop to interlopers who come to Hawaii to steal work from local businesses and cheat local workers. We're increasing our vigilance and supporting efforts to increase fines and punish wrongdoers.

Now is the time to take a stand to protect the public against non-compliant actors. I hope you'll join us and stand up for integrity in our industry.



### *Learn more about Industry Integrity*

PRP is committing our time and resources to promote integrity in our industry and raise awareness about the widespread, costly impacts of non-compliant contractors. To learn more, please visit [www.prp-hawaii.com/industryintegrity](http://www.prp-hawaii.com/industryintegrity).



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