

Washington State Unregistered Business Study

Presented by Lorrie Jo Brown, Ph.D.,
Senior Forecast Analyst,
Washington State Office of Financial Management
FTA Estimating Conference, Sept 15th, 2008

1

Washington State Unregistered Business Study

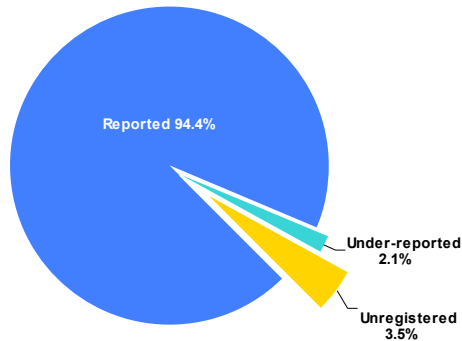
Objectives

- Measure non-Compliance by unregistered businesses in order to better focus compliance efforts
 - Dollar amounts and number of businesses
 - By Industry and geographic location
 - Set a Baseline

2

Estimated Taxes Owed by Unregistered Businesses as a Percentage of Total Tax Revenues

Percentages of Total Tax Owed by Businesses



Data Notes: DOR Compliance Study 2006; DOR Unregistered Business Study 2007; Joint DOR, ESD and LNI Study November, 2007

Definition:

- Unregistered Businesses— Businesses that do not report to one or more Washington state taxing agencies.
- This report does not include barter or illegal activities.

Analysis:

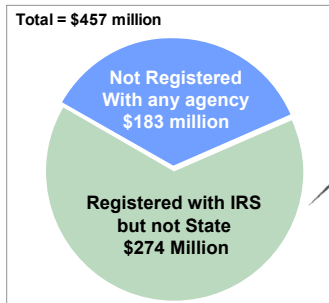
- 5.6 percent of businesses either under-report or are unregistered and do not report.
 - Underreported – 2.1 percent of tax owed
 - Unregistered – 3.5 percent of tax owed
- Failure by some to pay what they owe means that others bear an additional burden (workers' compensation and unemployment insurance rates are driven up by too few businesses paying into the system; lost tax revenues affect essential government services).
- This report addresses the unreported tax by unregistered businesses (unreported tax is addressed in the *Non Compliance Study*).

3

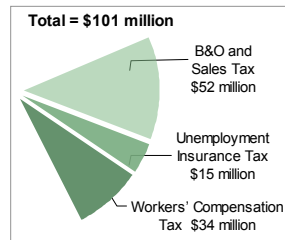
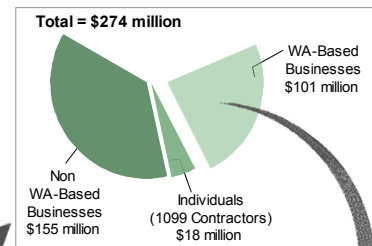
What do we know about unregistered businesses?

Analysis:

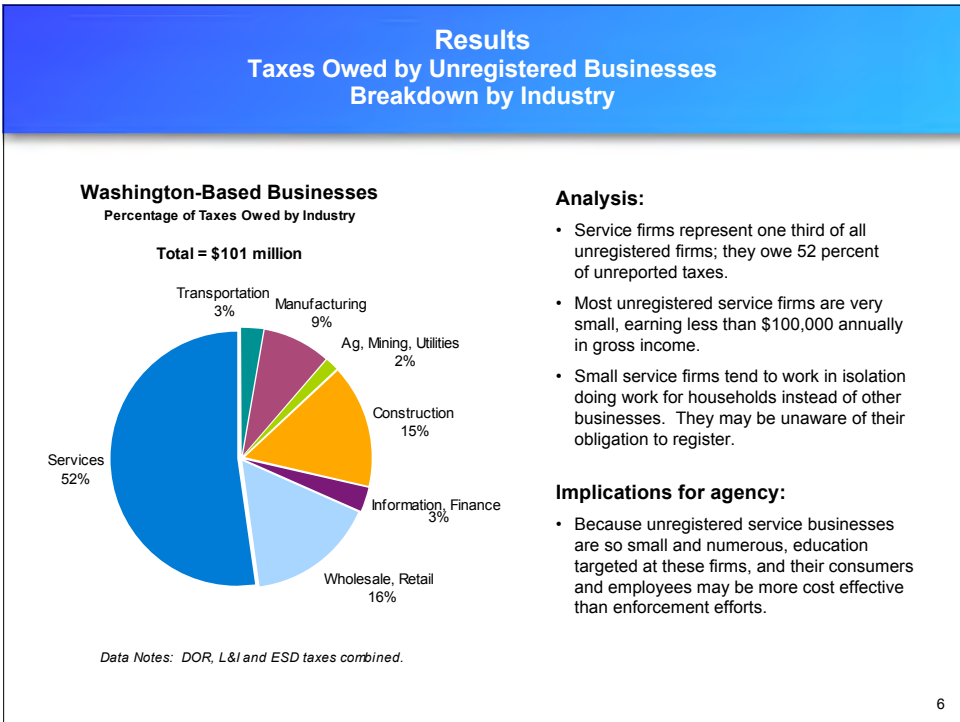
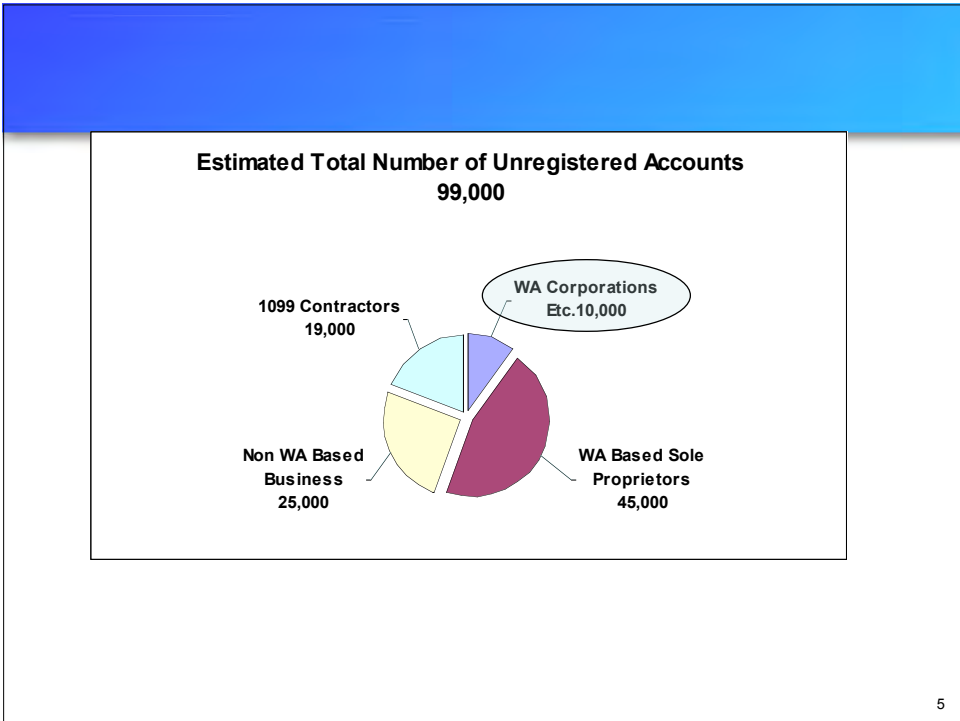
- An estimated \$183 million is lost to Washington annually by businesses not registered with any state or federal agency (based on the IRS Tax Gap Study, 2002). Therefore, there is very little known about this group.
- An estimated \$274 million is lost to businesses registered with IRS but not with DOR, L&I, and ESD.
- Of the \$274 million, an estimated \$155 million is due from businesses based out-of-state but with taxable presence in Washington. An estimated \$101 million is due from Washington-based businesses.
- Of the \$101 million, an estimated \$52 million is due from B&O, sales, and other excise taxes; \$34 million from workers' compensation taxes; and \$15 million from unemployment taxes.



Data Notes: Unregistered Business Study 2007

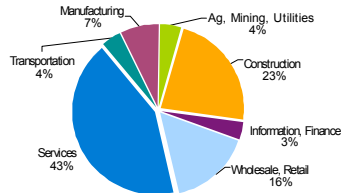


4



Taxes Owed by Unregistered Businesses Breakdown by Industry and Agency

Unemployment Insurance Taxes – \$15 million



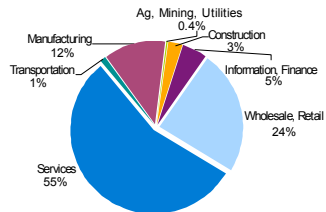
Analysis:

- Unregistered construction businesses appear to be more of a problem for ESD and L&I than for DOR.
- ESD and L&I construction rates are high due to high injuries and the seasonality of employment. DOR tax rates are lower for construction because sales taxes, for the most part, are borne by the final consumer.
- The unregistered construction firm owes an average of \$6,000 in taxes – twice as high as the average for other businesses. High taxes can lead to evasion and give the competitive edge to the unregistered firm.

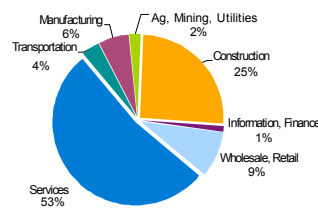
Implications for agencies:

- Evasion in an industry calls for joint agency investigation such as data sharing and data matching. Fraud detection and anti-fraud campaigns can be appropriate.
- Registering firms that can be identified deters those businesses that can't be identified. By examining records of unregistered businesses, agencies can identify their unregistered suppliers and purchasers.

B&O and Sales Taxes – \$52 million



Workers' Compensation Taxes – \$34 million



Note: Includes only Washington-based businesses with industry code on IRS return.

7

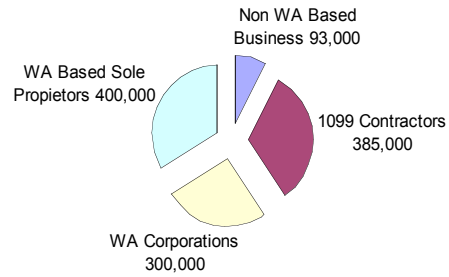
Methodology Source Data: Data Warehouse

- What is it?
 - IRS
 - ESD
 - DOR
- How are the files related?
 - We use Identity Systems to create Match Tables (Score)

8

IRS Files in Data Warehouse

Base Data In DW
out of a total of 9.5 Million Records



Note: overlapping data not removed

9

Unregistered Washington Based Sole Proprietors

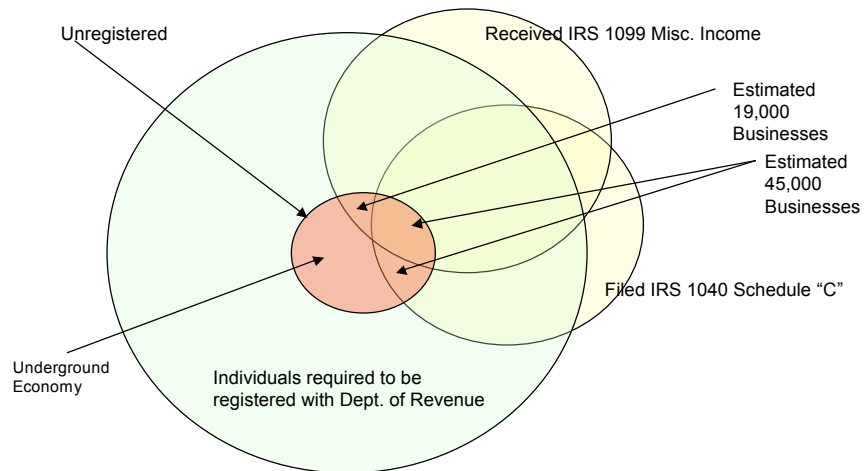


Diagram not to scale

10

Process

- Queried Data Warehouse
- Applied confidence level
 - Stratify Accounts by Type and Amount
 - Hand check accounts to determine and apply confidence level
- Applied Tax Rate
 - Stratified Accounts by Type using NAICS
 - Applied Effective Tax Rate