How Tax Cheating Contractors Affect Construction Bids

In the construction industry, where it is often the lowest bid that gets a construction award, cheating on taxes can give an unethical and illegal competitive advantage to bogus contractors. Since government operations depend on revenues generated from taxes, schools and municipalities often think they are getting great deals with low bid contractors, when in fact they are the big losers because of the overall loss of tax revenue. Having a responsible contracting policy in place enables schools and municipalities to tell the difference between law-abiding contractors and tax cheats prohibiting them from unwittingly contributing to their own demise (see below).

Calculations listed below were provided by the Michigan Chapter of the National Electrical Contractors Association.

The following background data is used in determining the Skilled Trades computations.

- The skilled trades construction worker has a base rate of $28.00 per hour;
- The skilled trades construction worker would work 1800 hours a year;
- The skilled trades construction worker would spend $1200 a month in purchases subject to a 6% sales tax;
- The skilled trades worker is paying $2500 a year in property taxes

Taxes paid into local, county, state and federal units of government on one hour of electrical work – the following are based on a $28.00/hour base rate:

Income Taxes			
Federal	25.0%		$7.00
State	4.35%		1.22
City	1.0%		.28
Federal Social Security	6.2%		1.74
Federal Medicare	1.45%		.41
	38.0%	=	$10.65
Property Taxes on $150,000 home (avg $2500/yr divided by 1800 hrs)			1.39/hour
Sales Tax on $1200/month in taxable purchases ($14,400/yr @ 6%) = $864 divided by 1800 hrs			.48/hour
			$12.52/hour

Employer Taxes	
Federal Social Security	6.2%
Federal Unemployment	.8%
State Unemployment	7.0%
Federal Business Tax	.5%
State Business Tax	1.0%
	15.5%

Employer Taxes ($28/hour x 15.5%)		$4.34/hour
Employer Property Taxes		1.39/hour
Total Employer-Paid Taxes		$5.73
	+	
Employee-Paid Taxes		$12.52
Total Employer-Employee Paid Taxes		$18.25 per hour

So, for every hour worked by a skilled-trades construction worker at a $28.00/hour base rate, there is at least $18.25 paid in taxes per hour.

If that skilled-trades worker works 1,800 hours a year, that means they have generated over $32,832 a year in taxes.

That also means that for every week that an undocumented/misclassified worker or unscrupulous contractor takes a job away from a tax-paying construction worker we lose $2,918.40 in tax revenue.

If a tax-cheating contractor has a crew of 10 undocumented/misclassified workers on a jobsite for a month, that's $29,184 dollars lost in tax revenue.

That means that the tax-cheating contractor can be $30,000 lower on his bid than a law-abiding contractor and still get the bid if it is a one-month long job. If it is a 12-month long construction project, for 10 workers, the tax-cheating contractor can be $360,000 lower on the bid. Also consider that dubious contractors apply similar schemes by not abiding by the state's prevailing wage law or the federal Davis-Bacon law.

Who do you think gets the next construction job if the tax-cheating contractor can be $360,000 cheaper than the law-abiding contractor? That is a $360,000 loss in tax revenue to city, county, state and federal units of government. In the construction industry, where it is often the lowest bid that gets the next construction project, tax avoidance schemes can certainly give an unethical and illegal competitive advantage to bogus contractors.

Unscrupulous construction contractors who use undocumented workers, employ "independent contractor" employee misclassification schemes, avoid paying prevailing wage, and out-of-state contractors that intentionally bid construction projects dirt cheap and can get away with it because they are not paying the taxes that Michigan-based fair contractors have to pay. Too often local units of government including schools don't have in place responsible contracting criteria in order to tell the difference.

Michigan needs to fix the current situation of owners through their construction managers of using undocumented workers, misclassified independent contractors or employing tax avoiding schemes such as not paying prevailing wage. At the Michigan Governor's Interagency Task Force on Employee Misclassification, which was held on March 24, 2009, a number of reports were discussed. The Task Force cited a report issued in December, 2008 by Dale L. Belman and Richard Block of Michigan State University's School of Labor & Industrial Relations. Based on their assessment of random audits by Michigan's unemployment insurance system, they estimate "30% of Michigan employers misclassify employees as self-employed workers or underreport employee payroll. In the construction industry, the MSU report estimated employers misclassify about 19% of the time.