



Advertisement

BUSINESS LAW & TAXES ► ACCOUNTING SYSTEMS

Using Cash to Pay Employees and Independent Contractors



BY [JEAN MURRAY](#) • Updated January 25, 2019



Certain types of businesses do most of their selling with cash. Many of these "cash businesses" also pay their employees and non-employee workers in cash.

While it is not illegal to pay employees and independent contractors in cash, it's not a

good business practice for many reasons. Some businesses use cash to pay employees in an attempt to [avoid paying payroll taxes](#), and some employees ask for cash payments to [evade income taxes](#).

This article discusses legal and tax issues and federal laws relating to income taxes, payroll taxes, and other tax matters.

Payroll and Tax Issues When Paying Employees In Cash

- Employers must withhold payroll taxes (federal and [state income tax](#) and FICA (Social Security/Medicare) tax) from employee pay;
- Employers must also report and pay those payroll taxes, including both the employee and the employer portion of FICA taxes, to the IRS
- Other employment taxes must be paid on [employee earnings](#), including [unemployment taxes](#), and state workers compensation fund payments
- Employers must report employee income on [Form W-2](#) each year. It includes cash income.
- Employers must verify the work [eligibility](#) of newly hired employees, using Form I-9 or the E-Verify system. This verification put the employee in the federal system, and if these employees are paid in cash, agency cross-checks can uncover attempts to avoid payroll taxes by paying in cash.

Effect on Employees

- Employees paid in cash who have no [FICA taxes](#) withheld are denied Social Security earnings that could have been used in calculating potential Social Security benefits.
- Likewise, employees who are not "on the payroll" are not eligible for [workers compensation](#) or unemployment benefits.

CPA Gail Rosen says this about paying employees with cash:

Paying workers illegally in cash can lead to serious problems in addition to tax problems. When a worker is "not on the books" you can suddenly have contingent liabilities that can truly be disastrous. If a worker gets injured on the job and lands up in the hospital, they will be asked if they got hurt on the job. If the injured worker answers yes, then they will be covered under workers compensation. You are in serious trouble, if you did not pay in workers compensation because you paid them in cash. The same thing is true for not paying into the state disability and unemployment fund. If for example, you fire the worker and they apply for unemployment, then you will have auditors knocking at your door.

Paying Children, Spouses, or Family Members

The wages of [children under age 18](#) who work in your business are subject to the same withholding, payroll tax, and employment tax requirements as other employees. If you hire your own children, they may not be subject to FICA taxes, but their wages must be reported to the IRS.

Hiring your spouse or other family members to work for your business and paying in cash can also deprive this person of Social Security benefits. And all the other issues mentioned above, including your legal responsibility to report and pay payroll taxes, apply.

Paying Independent Contractors

Many businesses pay contract workers (casual labor, summer workers, While payments to [independent contractors](#) have fewer issues than those of employees, two issues are worth noting:

- Payments to [contract workers](#) must be reported annually on Form [1099-MISC](#), and
- You must verify taxpayer ID for independent contractors; if the [taxpayer ID](#) cannot be verified, you must take [backup withholding](#) from the contractor's pay.

Cash payments made to vendors and others with whom you do business must still be substantiated if you want these cash payments to be deducted as expenses on your [business tax return](#). Even small payments in cash should be paid through a [petty cash fund](#), with appropriate documentation.

Disclaimer:

The information in this article is NOT intended to assist employers in evading taxes.

Please note that the information provided, while authoritative, is not guaranteed for accuracy and legality. The site is read by a worldwide audience, and employment laws and regulations vary from state to state and country to country. Please seek legal assistance, or assistance from State, Federal, or International governmental resources, to make certain your legal interpretation and decisions are correct for your location. This information is for guidance, ideas, and assistance.

Advertisement

Advertisement

Advertisement

Advertisement

Advertisement

Advertisement

DISPUTES
Important Facts You Need to Know About a Cash Business

LAWS AND TAXES
Understand How "Payroll" Works, the Proper Way to Keep Records

TAX ISSUES
What's the difference between tax avoidance and tax evasion?

CONTRACTOR STATUS
Before you hire a household employee - What you need to know

GLOSSARY
What is an Employee? 3 Ways to Help You Know

BUSINESS LAW & TAXES
Learn About Payroll Taxes and How to Calculate and Report Deductions

LAWS AND TAXES
Learn About FICA, Social Security, Medicare Taxes, and How Each Works

STARTING OR BUYING
What is a Tax Identification Number? Which Number Should I Use?

SMALL BUSINESS
Here's What Common Law Employee Status Looks Like

BUSINESS TYPES
The Benefits and Drawbacks of Working for a Husband or Wife's Business

CONTRACTOR STATUS
3 Documents You Need When Hiring a Contract Worker

CONTRACTOR STATUS
Important Terms to Include in an Independent Contractor Agreement

LAWS AND TAXES
How Do I Process Payroll and Payroll Taxes?

GLOSSARY
What Is a Form 1099-MISC for Independent Contractor Income?

LAWS AND TAXES
Before You Shake Hands with Your First New Hire - A Checklist

TAX ISSUES
How Do I Deal With Employee Tips as an Employer?

