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SHOULD YOU CONTINUE TO PAY CASH WAGES?

By Victor Sy, CPA, MBA

Some business establishments pay cash wages “under the table.” Why? Is it worth it? What are the risks?

What does paying cash wages “under the table” mean?

This common phrase means the payment of wages to employees by cash. It also includes payments of wages by checks that are disguised to look like other types of disbursement.

Why do business entities pay cash wages “under the table”?

1. To avoid tax and insurance expenses associated with payroll.
2. To accommodate employees who want to receive all of their gross earnings.
3. To reduce bookkeeping burden.
4. To create an unfair competitive advantage.
5. To follow industry practice.

Why should I not follow industry practice to pay “under the table” and save payroll taxes?

1. It is illegal. You can be audited, fined, and even face criminal prosecution.
2. This practice is financially dangerous to your business.
3. Claim for unemployment or disability creates an automatic investigation of your firm.

Does it pay?

Initially, yes. For the long haul – No, Definitely No! If you have not been caught, it’s becoming a dangerous game of Russian roulette. IRS, EDD, and DOL formed a Joint Underground Economy Task Force to catch you. If audited, an employer may have to pay penalty, interest, and audit defense costs – many times over - to EDD! This liability could grow substantially if the data is shared with IRS for federal payroll taxes and DOL for overtime and workers’ compensation insurance. Dealings in cash could also be referred to the IRS Criminal Investigation Division for aiding and abetting employees to avoid paying taxes.

What should I do if my employees request cash wages “under the table”?

Deny the request. This is not an option. You have a legal obligation to withhold payroll taxes and report wages. If your employees are injured on the job, they have the right to file a claim for Worker’s Compensation or State Disability Insurance benefits. If your employees’ wages have not been reported, an investigation by EDD will follow. The injured employee may also team up with personal injury lawyers to milk the system – you and insurance carriers!

Are you really reducing your bookkeeping burden? Initially – yes, but if EDD finds unreported wages, you will be required to reconstruct payroll for many years, a time-consuming task. If fraud or intent to evade the law is found, there is no statute of limitations to protect you and the audit could go back to the start date of your business. Your business may not be able to survive such costly audit. Thus, it could end up costing far more for reconstructing records from time cards, cancelled checks, and other records that may have already been discarded, than if you had correctly reported wages from the beginning.

What happens to your employees who received cash wages “under the table”?

1. They are subject to state and federal income tax audits for not reporting their wages.
2. They will be denied Unemployment or Disability Insurance benefits.

Recent Development: A San Diego roofer was convicted of tax evasion for paying cash wages to employees and underreporting payroll of more than \$300,000. This case involved a cash scheme that was pursued by an underground economy task force composed of the Franchise Tax Board, Employment Development Department, and the State Compensation Insurance Fund. If one survives such attacks by state agencies, how would you rate one’s chance of survival after the IRS joins the investigation? ☹