



Urban Justice Center

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SEX WORKERS PROJECT FACT SHEET: SEX WORKERS AND TAXES

Many sex workers, especially those who engage in unlawful activity, wonder whether they should, or are allowed to, pay taxes, or if they will be penalized for failing to do so. The Sex Workers Project (“SWP”) at the Urban Justice Center created this fact sheet as an informational tool on general tax issues for sex workers. This is not a comprehensive guide, and sex workers should consult a tax preparer or attorney for specific guidance. You may also contact the SWP at 646/602.5617 with general questions about this issue.

Accounting for Unlawfully Earned Income

- The Internal Revenue Service (IRS) imposes a tax on all income for taxpayers who earn more than a certain amount a year, regardless of the source. The amount varies based on a number of factors. In any case, you will want to file a return if taxes were withheld from your paychecks and you are entitled to a refund or if you may be eligible for the Earned Income Tax Credit. Some sex workers may consider themselves “sole proprietors,” who report profits and losses from business. They will need to “[d]escribe the business or professional activity that provided [her/his] principal source of income . . .”
- This means that under the law, even illegal income is subject to the federal income tax and must be accurately reported to the IRS. However, this also means that those who report income from illegal activities may also be concerned about protecting themselves from criminal liability.
- People who do not report income should also be concerned about civil and criminal liability. The IRS has pursued women it believes derived income from sexual activities for failure to file a return or tax evasion. It is not clear how a taxpayer comes to the attention of the IRS, but it is possible that a tax return, or a failure to file a return, has somehow triggered an audit or has flagged this taxpayer as unusual in some way.

In some cases, taxpayers have defended their failure to file a return or to pay taxes by arguing that the money received was a gift rather than taxable income. While income is taxable, gifts are not taxable to the recipient. Whether a payment is a gift depends on the donor’s intent in making the payment. A payment is considered a gift where it is motivated by feelings of “detached and disinterested generosity . . . out of affection, respect, admiration, charity or like impulses.” This test has been applied in the context of payments made by men to women with whom they had sexual relationships on a number of instances. In one case from 1955, the U.S. Tax Court decided that the taxpayer “used her home to operate a house of prostitution” and that she “staged immoral shows for a fee and personally acted as a prostitute.” Another court has decided that “a person is entitled to treat cash and property received from a lover as gifts, as long as the relationship consists of something more than specific payments for specific sessions of sex.”

Confidentiality of Communications Between Accountant/Tax Preparer and Client

- This is a very grey area, and the law around the issue of confidentiality of communications between an accountant or tax preparer and his or her client is very muddled—however, it is clear that there is only a very limited privilege that exists only in specific circumstances. For most questions that sex workers have about how to file their taxes, no such privilege seems to exist, and your tax preparer could be forced to disclose information that you have shared with him or her.

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- New York State does not have a specific accountant-client confidentiality protection by law. Federal law has provided an extremely limited confidentiality protection with respect to tax advice, but it is not very useful for sex workers—it offers the same confidentiality protections which apply to a communication between a taxpayer and an attorney to a communication between a taxpayer and any federally authorized tax practitioner to the extent it would be considered a privileged communication if it were between a taxpayer and an attorney.

The privilege **only** applies to conversations that would have been considered privileged had they taken place between a taxpayer and an attorney, where a client asks for legal advice. More importantly, this privilege only applies in any **non-criminal tax matter** before the IRS and any **non-criminal tax proceedings** in Federal court brought by or against the United States. This privilege does **NOT** extend to criminal proceedings. If a tax preparer is subpoenaed to appear as a witness in a criminal proceeding, his or her communications with the taxpayer would not be covered by the privilege.

- Information shared for the sole purpose of preparing a tax return, which is intended for viewing by the government, is not privileged. However, a person believing that he or she may have committed a crime may seek the advice of any attorney as to how and what to prepare regarding such criminal activities for income tax purposes.
- A sex worker can seek the advice of a lawyer on how to prepare their taxes and that will be privileged since it is seeking the professional legal advice of an attorney. But if the attorney merely files forms, then there is no privilege. A sex worker may be able to discuss illegal activity and ask for advice from an attorney who is also a tax preparer, but discussing the same information with a tax preparer who is not an attorney is not privileged. A sex worker's best chance for confidentiality is to ask questions about illegal activity of a lawyer who performs other legal work for you and is also your tax preparer, but even this is not a guaranteed protection in all cases. Finally, it is unlikely that an accountant who works for an attorney enjoys a privileged relationship with clients.

Employee v. Independent Contractor Status

- Whether a worker is characterized as an employee or independent contractor has major tax implications for both the worker and the employer. For example, when an employer mischaracterizes an employee as an independent contractor, the employee will pay taxes that are the responsibility of the employer. There may be times when a sex worker believes that he or she has been wrongly identified by an employer as an independent contractor instead of as an employee. Whether a particular worker is considered an employee is a fact-intensive inquiry, and for tax purposes, there is a twenty-factor test that addresses the issue of control. The greater the degree of control exerted over a worker, the more likely it is that the worker is properly considered an employee.
- If a taxpayer feels that he or she is wrongly classified as an independent contractor, it is in his or her best interest to pay the taxes up front and file grievances with the IRS directly to obtain any refund that is due. While a worker suffers an economic harm—already having paid higher taxes because of the independent contractor classification—the employee has no right to sue the employer. Instead, the worker must make a claim for a refund for overpayment of taxes with the IRS.

This fact sheet is based on a legal memo written for the SWP by Anika Singh of the Community Development Project at the Urban Justice Center. We greatly appreciate her assistance with this project.
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