

# INDEPENDENT CONTRACTOR STATUS

## FREQUENTLY ASKED QUESTIONS

LEGAL AFFAIRS DEPARTMENT

### **1. What is the difference between an independent contractor and an employee?**

Employers have a significant degree of control over their employees, and are able to direct when, how, and where employees accomplish their tasks and responsibilities. Employers also often provide the necessary “tools of the trade” to their employees. In contrast, an independent contractor generally can determine when, how and where to perform their work, and is responsible for any necessary tools or equipment necessary to provide the services.

For legal purposes, the key distinction between an employee and an independent contractor is often determined by the amount of *control* a business exerts over the worker. The more control a business exerts over the worker, the greater the likelihood the worker will be deemed an employee.

### **2. Are brokers required to classify their salespeople as independent contractors?**

No. Brokers can classify their real estate salespeople as either employees or as independent contractors.

### **3. What laws and regulations apply to a brokerage’s classification of its salespeople?**

Worker classification laws at the federal and state levels as well as state real estate license laws will apply to a brokerage’s classification of its salespeople. At the federal level, the Internal Revenue Service has carved out a special statutory non-employee status for real estate professionals, qualifying them as independent contractors when all of the following requirements are met:

- a. The individual must be a licensed real estate professional;
- b. Substantially all of their payments must be directly related to sales or other output, rather than the number of hours worked; and
- c. Their services must be performed under a written contract providing that they will not be treated as employees for federal tax purposes.

State statutes for worker classification and real estate licenses vary in regards to determining proper classification of real estate licensees. Some states explicitly

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recognize real estate licensees as independent contractors when certain conditions are met, and other states are silent as to real estate licensees so the courts must apply the applicable test for determining proper classification. This is why it is vital for real estate professionals to know the laws that pertain to worker classification in their states.

**4. Is an independent contractor written agreement sufficient to classify workers as independent contractors?**

Having an independent contractor agreement is a very important element of establishing an independent contractor relationship with a real estate salesperson, but the existence of an agreement is not enough to avoid misclassification. Courts and regulatory agencies will look to the reality of the relationship, how the parties interacted, and how much control a broker exerts over the real estate salesperson in order to determine the true nature of the relationship between the parties.

**5. What types of activities should brokers avoid in order to properly classify salespeople as independent contractors?**

Under many state, and federal, laws, making certain acts “mandatory” may be considered an indication of employer-like control over the worker. One of the hallmarks of an independent contractor relationship is that the independent contractor has the ability to direct and control where, when and how they perform their work.

In order to establish an independent contractor relationship, the following is a list of the types of activities that should be *avoided*:

- Requiring the worker perform the services during set work hours.
- Requiring the worker perform the services at a specific location.
- Making attendance at staff meetings mandatory.
- Providing training to the worker.
- Supplying tools and materials to the worker.

**6. Since worker classification is often dependent on the level of control an employer exerts over a worker, does this mean that brokers should not supervise their independent contractor salespeople?**

No. In fact, according to real estate licensing laws brokers *must* maintain a certain amount of supervision over their salespeople. Brokers must therefore make sure that they are balancing their state real estate license laws’ supervision requirements with the applicable requirements in state and federal worker classification laws.

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**7. Do federal income taxes have to be withheld from a real estate professional's earnings?**

No, if the independent contractor meets the three elements of the IRS's carve out. The IRS recognizes the unique nature of the real estate industry and created a statutory non-employee status for real estate professionals, provided three elements are met: 1) the individual is a licensed real estate professional; 2) substantially all of their payments be directly related to sales or other output, rather than number of hours worked; and 3) their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes. If these three elements are met, no federal income taxes need to be withheld from the real estate professional's earnings.

**8. Does qualifying as a statutory independent contractor under IRS rules also mean that state income taxes do not have to be withheld from a real estate professional's earnings?**

No, qualifying as a statutory independent contractor under IRS rules applies *only* to federal income taxes. The question of whether state income taxes must be withheld from a real estate professional's earnings is a question of state law. Brokers should check the applicable state law where they operate.

**9. Can a broker provide its independent contractors with benefits such as health insurance and 401K participation?**

The provision of employee-type benefits, such as health insurance, vacation pay and 401k participation, can be factors pointing to an employer-employee relationship, rather than that of an independent contractor. The provision of these types of benefits may compromise the argument that the relationship with the worker is that of an independent contractor.

**10. What happens if a broker misclassifies an employee as an independent contractor?**

Improper classification of workers can cause businesses a number of tax and other legal problems. At the federal level, the IRS may levy unpaid payroll taxes against a business it believes is misclassifying its workers, as well as interest and other penalties. In addition, the United States Department of Labor, the National Labor Relations Board, and the Equal Employment Opportunity Agency have an interest in a business's classification of its workers, and may pursue penalties and legal action against businesses believed to be engaging in worker misclassification.

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At the state level, businesses may face fines and penalties for violations of state workers' compensation laws, tax laws, and state unemployment compensation laws. Improper classification can also expose businesses to private causes of action and costly litigation.

### **11. What resources are available to help further guide real estate professionals on this topic?**

A number of resources on this topic are available on [www.REALTOR.org](http://www.REALTOR.org)'s Independent Contractor resources page: <http://www.realtor.org/topics/independent-contractor>. These resources include:

- [“Ten Ways to Successfully Manage Your Independent Contractor Relationships”](#)
- [Legal Affairs video on recent worker classification litigation](#)
- [Chart detailing various state labor laws approach to classifying real estate professionals](#)
- Coming soon - Sample independent contractor agreement

Outside resources include:

- [The IRS website's guide to worker classification](#)
- [U.S. Department of Labor – Wage and Hour Division guidance on worker classification](#)
- Your state's Department of Labor website
- Your state's real estate licensing authority's website.