

Real Estate Professionals Classification as Independent Contractors

June 2, 2021

Of the 1.4 million members of the National Association of REALTORS® (NAR), approximately 87 percent are classified as independent contractors. This classification is essential to the real estate industry, homeowners across the country, and to boosting the economy. The ability to work as an independent contractor is recognized and protected under many state and some federal laws. However, litigation and new federal and state legislation continue to threaten workers' ability to be classified as independent contractors, including many real estate professionals.

NAR supports the protection of, and efforts to further secure, the right of real estate salespeople to work as independent contractors and for brokers to choose to classify real estate salespeople as independent contractors. NAR will resist efforts at the federal level to weaken those rights while also supporting actions at the state level to strengthen the rights of brokers to make these determinations. The following summary outlines the current landscape and the latest efforts to preserve the ability of real estate professionals to be classified as independent contractors.

BACKGROUND

What are the independent contractor classification tests?

There are two primary tests used to classify workers as independent contractors: the ABC test and the Common Law test.

Under the ABC test, in order to be classified an independent contractor, all of the following must apply:

- A. An individual is free from direction and control applicable both under the contract for the performance of service and in fact.
- B. The service is performed outside the usual course of business of the employer.
- C. The individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.

Based on these factors, the state statutory supervisory and control requirements imposed on brokers over agents make it challenging to classify real estate professionals as independent contractors (see [here](#) for state real estate laws). In fact, courts have held that compliance with the various controls set forth in real estate licensing statutes make it difficult for a real estate salesperson to meet the ABC test, jeopardizing their classification as an independent contractor.

Under the Common Law test, [as defined by the Internal Revenue Service](#), a multi-factor analysis is used, examining three categories:

1. **Behavioral:** Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. **Financial:** Are the business aspects of the worker's job controlled by the payer?
3. **Type of Relationship:** Are there written contracts or employee type benefits?

The Common Law test encourages businesses to weigh all these elements when determining a worker's status, where no one factor is determinative. Under this test, real estate professionals



Real Estate Professionals Classification as Independent Contractors

March 2021

would more likely be classified as independent contractors because the totality of the relationship is considered rather than one single disqualifying factor.

How are real estate professionals currently classified?

Real estate professionals have an explicit protection in the Internal Revenue Code, [26 U.S.C. §3508](#), which provides the framework to classify them as statutory non-employees for federal tax purposes. The rule has been in place since 1982, and NAR strongly opposes any erosion of this protection.¹ The federal tax treatment of real estate agents under the I.R.C. demonstrates the federal government's long-standing recognition of the unique nature of the real estate industry and, as such, the need to treat it differently than other industries.²

Additionally, there are a number of state statutes that follow the federal lead and specifically address how real estate salespersons may be classified as independent contractors. While these state statutes range from workers' compensation laws to real estate specific statutes, each are explicit in qualifying a licensed real estate agent (or salesperson or licensee) as an independent contractor based on certain criteria and/or are expressly permitting the ability of a real estate broker to treat their real estate sales agents as independent contractors. See [here](#) for a comprehensive list of state real estate laws.

What are states doing to classify real estate professionals?

California passed legislation (AB 5) codifying a state supreme court decision that adopted the ABC test for determining a worker's status under the state wage orders (*Dynamex Operations West, Inc. v. Superior Court of Los Angeles*), effectively abandoning a less stringent multi-factor test (*S. G. Borello & Sons, Inc. v. Department of Industrial Relations*).

However, the changes enacted under AB 5 also included certain exemptions – including for real estate licensees – that follows the existing state Business and Professions' code exemption for real estate professionals and maintains the multifactor (Borello) test for specific industries. This exemption was strongly supported by the California Association of REALTORS®. Other states, including New Jersey, are starting to follow suit in considering legislation to adopt the ABC test and allowing exemptions for real estate professionals. See [here](#) for recent state legislative proposals.

On the litigation front, there have been several challenges to the classification of real estate professionals as independent contractors, where agents may be seeking additional wages or commissions from their brokerages. Many courts have held in favor of the defending brokerages classifying the agents as independent contractors based on existing state laws and fact specific

¹According to the IRC, real estate agents are "statutory nonemployees" if three factors are met. First, the real estate agent must be licensed. Second, substantially all payments for the licensed real estate agent's services must be directly related to their sales or other output rather than based on number of hours worked. Lastly, the real estate agent's services must be performed pursuant to an agreement that states the real estate agent will not be treated as an employee for federal tax purposes.

²Similarly, the Affordable Care Act's "Shared Responsibility for Employers" provision recognizes that "qualified real estate agents" are statutory nonemployees under the IRC and thus are also not counted as employees for purposes of the provision that requires certain employers to provide health care coverage to full-time employees. 26 C.F.R. §54.4980H-1(a)(15).



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March 2021

analyses of the working relationship (for example, method of payment; tax deductions; independent contractor agreements; etc.).

FEDERAL LEGISLATIVE AND REGULATORY UPDATE

In the current and previous Congresses, there have been several bills introduced that include the ABC test. While none of the bills directly impact the I.R.C. exemption for real estate professionals (26 U.S.C. §3508), nor should they preempt existing state laws outlining real estate professionals' status, **there is concern that a new federal standard adopting the ABC test will set the stage for increased litigation challenging real estate professionals' ability to be classified as independent contractors, as well as influence more states to adopt this problematic classification method.** Further, should more federal laws be modified to include the ABC test, it increases the likelihood of changes to existing federal and state laws that ensure real estate professionals may be properly classified as statutory non-employees.

As a result, NAR has been educating Members of Congress and their staff on the problems with the ABC test while also supporting legislative efforts to adopt the more favorable Common Law test. NAR also supports federal regulatory clarity in favor of classifying workers as independent contractors.

The Department of Labor (DOL) withdrew the independent contractor rule that was finalized under the Trump Administration, which was set to go into effect on March 8, 2021. DOL delayed the effective date of the rule after the Biden Administration issued a memorandum requesting federal agencies to review or delay certain pending regulations. NAR [commented](#) on this delay, requesting that the effective date not be delayed, as the regulation provides needed clarity and certainty for how an employer may classify a worker. The Trump Administration's [final independent contractor rule](#) outlined two core factors to determine whether a worker is an employee based on an economic dependence on someone else's business (nature and degree of control; worker's opportunity for profit or loss) and three other guideposts to use in the support of that analysis (amount of skill; degree of permanence; integrated unit of production).

It is anticipated DOL will effectively delay this rule and potentially modify or rescind it in the future. While again, these regulatory modifications have no direct impact on real estate professionals' classification under the I.R.C., a new rule could be more problematic, especially if the ABC test standards are incorporated.

RESOURCES

[NAR's Advocacy Efforts To Protect Independent Contractors](#)

[Independent Contractor Status Frequently Asked Questions](#)

[NAR Comment Letters to the Department of Labor on the Independent Contractor Rule](#)

[NAR Focus Brief: Independent Contractors and Real Estate Exemptions \(March 4, 2021\)](#)

[IRS Website: Guide to Worker Classification \(November 9, 2020\)](#)

[State Laws: Independent Contractor Survey Table \(June 15, 2020\)](#)

