Support Independent Contractor Status for Real Estate Professionals

May 2021

Additional information on federal activity that may impact independent contractor classification

To further support meetings with Members of Congress, below is some additional information on federal legislation being considered that may impact real estate professionals' ability to be classified as independent contractors, including the PRO Act (H.R. 842). Also, be sure to check out the 2021 Legislative Meetings Talking Points and the full FPC E-Packet for all the advocacy information for this year's meetings.

BACKGROUND:

As policymakers in Congress and the Administration look to address changes in the U.S. workforce brought about by the rise of the "gig economy," reexamination of independent contractor status has become a topic of intense discussion. Many of these new companies classify workers who had traditionally been viewed as "employees" as "independent contractors." As these policy debates continue, it is important to remember that more than 87 percent of NAR's 1.4 million members are classified as independent contractors, most of whom *choose to be classified as such* to benefit from the greater freedom, flexibility, and autonomy to work as entrepreneurs.

REALTOR® Asks:

- **Support the longstanding federal recognition of the real estate professionals to operate as independent contractors.** For decades, real estate agents have been classified as statutory non-employees for federal tax purposes and operate their businesses in a way that is very different than "gig economy" workers (see 26. U.S.C. §3508 and state laws). Policymakers must preserve protections that recognize the uniqueness of the real estate industry.
    - If Congress considers adopting a federal ABC test, real estate professionals should be explicitly exempted (following language in 26 U.S.C. §3508) to ensure protection of the independent contractor classification. See suggested amendment to the PRO Act.
    - Should any ABC test be included in federal legislation, protection of *all* existing state laws classifying real estate professionals as independent contractors should be clear. See suggested amendment the PRO Act.

Commonly Asked Questions:

What is the PRO Act and who does it impact?

- The PRO Act is a bill designed to provide gig workers with greater rights and protections. The legislation has a number of key provisions, including adoption of an ABC test under the *National Labor Relations Act* (NLRA), an expanded joint employer standard, and other major unionizing provisions.

Does NAR oppose the PRO Act?

- No. NAR does not oppose the PRO Act, but remains concerned about language contained within the PRO Act that would adopt a federal ABC test to classify workers and potential liability threats with an expanded joint employer standard.

What is the ABC test and what is the major concern?

- The ABC test is one of two primary tests used to classify workers as independent contractors. Under the ABC test, all three factors must be met for a worker to be classified as an independent contractor. See here for more information.
- Based upon the ABC test factors, state statutory supervisory and control requirements imposed on brokers over agents make it challenging to classify real estate agents as independent contractors.

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- NAR is also concerned about how federal adoption of an ABC test could impact other state and federal labor laws beyond the NLRA, resulting in potential misclassification challenges for real estate professionals and increased litigation.

Does the PRO Act revoke REALTORS®' independent contractor status for federal tax purposes?

- No, the PRO Act would not revoke real estate professionals' statutory exemption under the federal tax code.
- It could create a situation where conflicting federal and state laws would make it difficult for real estate professionals to continue operating as independent contractors.
- Should any federal legislation or regulation including an "ABC test" be considered, it must be clear that real estate professionals would be exempt, mirroring and protecting the current rights under 26. U.S.C. §3508.

Your industry already has a statutory definition that classifies REALTORS® as independent contractors for federal tax purposes, why are you worried?

- REALTORS® are concerned that federal adoption of an ABC test in any legislation or regulation could impact the industry and how real estate professionals are currently classified, along with the potential for this test to influence other labor law changes at the federal and state level.

Don't you want the protections and benefits that employees have that you miss out on as an independent contractor?

- As independent contractors, we are empowered to be entrepreneurs, with maximum flexibility to thrive in a dynamic and flourishing real estate field. We benefit from this freedom and are able to protect our health and financial futures in a way that best fits our unique needs.
- *Please provide your personal stories of what being an independent contractor means to your business, your family, etc.*

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JOINT EMPLOYER STANDARD

Background:

The joint-employer standard of liability is used to determine when two or more entities are jointly responsible for the terms and conditions of employment over the same group of **employees**. The terms and conditions include, but are not limited to, having the ability to hire, fire, discipline, supervise, or direct employees.

Joint-employer status, therefore, may result in significant liabilities and responsibilities under the law, including for franchised real estate brokerages. For the most part, an entity can only be a joint-employer if it **exercises direct and immediate control** over essential terms and conditions of another employer's employees.[1] However, there has been a federal push to expand the joint employer standard beyond direct and immediate control of employees to **indirect or even unexercised potential control.**

While right now these federal proposals are limited to the *National Labor Relations Act* (NLRA) as included in the PRO Act, which means joint employer liability would be expanded to NLRA violations, there is concern this standard could be added to other labor laws where franchisors could be liable for misclassification or overtime violations of franchisees under the *Fair Labor Standards Act* (FLSA) for example.

Federal proposals to reinstate the expansive joint employer standard, including under the PRO Act under the NLRA, follows what was articulated in *Browning-Ferris Industries of California,* 362 NLRB 1599 (Aug. 27, 2015). In *Browning-Ferris*, the Board held that the joint employer evaluation must include consideration of the purported joint employer's:

a. *reserved* authority to control (even if that authority is never exercised) the employees' terms and conditions of employment, and
b. exercise of *indirect* control, such as through an intermediary, over such terms and conditions of employment.

Under the PRO Act, evidence of either reserved authority to control or indirect control, standing alone, would be sufficient to establish a joint employment relationship. This could therefore impact nearly every contractual relationship

Therefore, franchise owners advocate for a joint employer standard that makes clear businesses are not liable for other businesses they do not control. Otherwise, such language could turn many employees of local small businesses into employees of large corporations – and put them all at risk of more lawsuits. Such expanded liability may also limit the ability of many small mom-and-pop businesses to control aspects of how they work with their employees. An expanded joint employer standard may also lead to increased costs, less equity, and less support from their brands.

Commonly Asked Questions:

How could an expanded joint-employer standard impact franchised real estate brokerages?

The expansion of the joint employer standard (whether as articulated in the PRO Act or elsewhere) poses potential risk for real estate franchisors. However, the degree of control exerted by real estate franchisors over franchisee brokers varies more than in other industries, and may make them less at risk than others, such as compared to restaurant franchises.

[1] For three decades before *Browning-Ferris* (see insert), the National Labor Relations Board (NLRB) had held that a putative joint employer must actually exert "direct and immediate" control over a group of employees' essential terms and conditions of employment to be found liable as a joint employer.

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Some real estate franchisors exercise little control over their franchisee brokerages while others exercise a fair amount of control over the employment relationships at their franchisee brokerages. For those exercising increased control, there is similar risk of joint employment as franchisors in other industries from an expanded joint employer standard. If real estate franchisors provide training to such employees, template employment policies or forms for brokerages to use with such employees, job-related guidance and direction to brokerage employees, and/or workplace technology to assist the brokerage with staffing or scheduling its employees, as some examples, these are potential sources of evidence in a joint employer case.

There may be lesser risk of joint employment for real estate franchisors regardless of the standard because brokerages most often engage agents as independent contractors, not employees. Unless agents are engaged by the brokerage as an employee or later found to be an employee as a matter of law, the real estate franchisor has no risk becoming a joint employer (because not even the brokerage is an employer). **However, changes in federal or state law that make it harder for brokerages to classify agents as independent contractors (e.g., expansion of the ABC test as articulated above in the PRO Act) increase the joint employer risk for real estate franchisors under any joint employer standard.**

How could an expanded joint-employer standard impact agent teams and a real estate brokerage?

If the employees on these teams are employees of one or more agents, then a more expansive joint employer standard, such as the standard articulated in the PRO Act, would increase the likelihood that the brokerage would be found to be the joint employer of the agent's employees (with the agent being the employees' direct employer). As noted above, the PRO Act expands the joint employer standard such that a putative joint employer's *indirect* control over a group of employees, including control exerted through an intermediary, is on its own sufficient to establish a joint employer relationship. Thus, if a brokerage established rules and policies for its agents that the agents' employees must comply with or if the brokerage provides directives to its agents that ultimately result in control over the terms and conditions of employment of the agent's employees, the broker or brokerage may be found to be a joint employer of those employees through the exercise of indirect control.

If the team is comprised of agents who are a mix of employees of the brokerage and independent contractors, an expanded joint employer standard would not impact the liability of the brokerage. Namely, the brokerage would have liability under employment laws with respect to the agents who are employees as their direct employer, but would not have liability under most employment laws with respect to the agents who are independent contractors unless those independent contractors are misclassified as a matter of law. Having independent contractors on the same team and in the same position and performing the same duties as brokerage employees are facts that would support a misclassification claim against the brokerage by the independent contractor agents.[2] However, if the agents exercise sufficient control over the employees' terms and conditions of employment, they could be held liable as a joint employer of the employees alongside the brokerage (the direct employer).

[2] *See, e.g., Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997).

ABC TEST INCLUDED IN FEDERAL UNEMPLOYMENT LEGISLATIVE PROPOSALS

Background:

In addition to the federal tax classification of real estate professionals as independent contractors (26 U.S.C. §3508), real estate professionals are often classified as independent contractors under state unemployment laws as well. However, there are new legislative proposals that would adopt the ABC test used for classifying workers to federal unemployment law under the Internal Revenue Code (§3304(a)).

The *Federal Unemployment Tax Act* imposes a payroll tax paid by employers on employee wages, where the current tax rate is 6% on the first $7,000 in employee wages. Federal law also permits employers to take a credit of up to 5.4%--or 90% of the tax—if their state's unemployment compensation program complies with federal requirements. The Department of Labor annually certifies whether state unemployment compensation programs satisfy the federal requirements for employers to take the tax credit.[3]

Does adding the ABC Test to the Internal Revenue Code for unemployment purposes impact real estate professionals' classification as independent contractors for federal tax purposes?

There is no impact on real estate professionals statutory protection under 26 U.S.C §3508 with the unemployment insurance legislation proposed by Sens. Wyden (D-OR) and Bennet (D-CO), which amends 26 U.S.C. §3304(a).

How would adding the ABC Test to the Internal Revenue Code impact existing state unemployment laws?

Adding the ABC test to Internal Revenue Code §3304(a) would not preempt any state laws, including any state laws classifying real estate professionals for unemployment purposes. However, adding the ABC test to the I.R.C. in this way would prohibit the Secretary of Labor from certifying that a state satisfies the federal requirements for employers to claim the tax credit until the state adopts the ABC test in its unemployment compensation scheme.[4] Thus, adding the ABC test would put pressure on states to adopt that test in their unemployment compensation laws. It is difficult to imagine any scenario where a state would not adopt the ABC test if this legislative proposal were enacted, as states cannot ignore the loss of the tax credit to employers, who would also could presumably put pressure on states to preserve the credit. The fact that all 50 states have conformed their unemployment insurance schemes to federal requirements underscores the immense pressure to do so that they face.[5]

As proposed in the Wyden-Bennet bill, several requirements would be added to 26 U.S.C. § 3304, including the ABC test. If the Wyden-Bennet bill were enacted, states would have to conform their unemployment compensation laws to those requirements, including the ABC test, in order to receive Department of Labor certification for the tax credit.

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[3] *See* 26 U.S.C. § 3304(a); *id.* § 3303; *see also* 20 C.F.R. §§ 601.2, 601.4. For this tax year, the Department certified all 50 states, D.C., Puerto Rico, and the Virginia Islands for the credit. *See* https://www.federalregister.gov/documents/2020/11/06/2020-24650/federal-state-unemployment-compensation-program-certifications-for-2020-under-the-federal

[4] See 26 U.S.C. § 3304.

[5] See n.3.

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As currently proposed, this bill contains no exceptions to the ABC test and no grandfathering for preexisting state laws. Accordingly, any state whose law provides an exemption (such as for real estate professionals or other industries) or deviates from a verbatim application of the ABC test would not satisfy the Wyden-Bennet federal requirements. However, if enacted, the Department of Labor may promulgate a regulation softening application of the ABC test as part of their certification process.

Additional Resources:

NAR Issue Brief: Real Estate Professionals Classification as Independent Contractors
Provides background on the issue, including the ABC Test, Common Law Test, and NAR's Advocacy Efforts.

NAR Focus Brief: Independent Contractors and Real Estate Exemptions
Explains state real estate exemptions, pending legislation, and the classification test used.

State Laws: Independent Contractor Survey Table
Summary of State statutory carve-outs for real estate professionals.

IRS Website: Guide to Worker Classification
Federal tax clarification on classifying workers as independent contractors or employees.

NAR Regulatory Comments on the Department of Labor's Actions:

- April 12, 2021 - NAR Comment Opposing Withdrawal of Final Independent Contractor Rule
- February 24, 2021 - NAR Comment Opposing Delay of Final Independent Contractor Rule
- October 26, 2021 - NAR Comment Supporting Proposed Independent Contractor Rule

If you have any questions, please contact Vijay Yadlapati, Director, Government Advocacy at 202-383-1090 or VYadlapati@NAR.REALTOR, or Nia Duggins, Senior Business Issues Policy Representative at 202-383-1085 or NDuggins@NAR.REALTOR.