

# Independent contractor



# or employee?

What you need to know  
about worker classification

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Recently there has been an uptick in litigation around the country revolving around the issue of whether an independent contractor is truly an independent contractor or whether the person is really an employee.

The distinction between independent contractors and employees is an essential one because misclassifying workers can have serious consequences. Not only could a broker, or agent who has hired an assistant, face penalties, fines, back pay and overtime, misclassifying a worker could lead to costly litigation. So how do you know what to classify someone as?

There is no one thing that differentiates an employee from an independent contractor. The primary difference between an employee and independent contractor is the degree of control the business exerts over the individual – employers are able to direct when, how and where employees accomplish their tasks and responsibilities; and often provide the necessary “tools of the trade.” Independent contractors, on the other hand, usually provide their own “tools of the trade” and determine when, how



and where they will accomplish tasks. A good way to think about this distinction is to consider the example of a delivery. An employee may be told “Immediately take the company car, drive down Main Street, turn left onto Elm, then right on Second, and deliver the package to 123 Second Street” while an independent contractor may be told “This package must be delivered to 123 Second Street by Friday at 2 p.m.” and are left to determine how to get there. Ultimately the same outcome is achieved, but the details of how it was achieved are very different. In the first example, the business provided a vehicle and exerted a great deal of control over when and how the package got delivered. In the second example, the independent contractor was told the desired outcome and left to determine the best way to handle the situation. Keep in mind that these are two extremes, and it is rarely so clear whether an individual is an employee or an independent contractor.

Unlike traditional independent contractors, brokers must exert some level of control over real estate licensees as required by statute. This creates a balancing act for real estate professionals who have independent contractors working under them. While it is important that you provide the supervision required under the law, watch how much control you exert over when, how and where the individual performs tasks.

Because brokers are expected to supervise agents working under them, the Internal Revenue Service (IRS) has a statutory exemption for real estate agents, and when all three elements are met, licensees can be considered independent contractors: 1. The individual must be a licensed real estate professional; 2. Substantially all of their payments must be directly related to sales or other output, rather than the number of hours worked; and 3. Their services must be performed under a written contract providing that they will not be treated as employees for federal tax purposes. If all three elements are met, then for federal income tax purposes, real estate licensees can

be classified as independent contractors. In Virginia, the determination of whether an employer-employee relationship exists for the purposes of tax withholding is made under federal law. This means that as long as you have properly classified an individual as an independent contractor under the IRS regulations, you are not obligated to withhold state income tax.

There are two other areas of law that regulates potential employees: Virginia workers' compensation laws and Virginia unemployment laws. Both of these statutes have specific carve-outs for real estate licensees. The Virginia workers' compensation and unemployment statutes have three requirements for a licensed real estate salesperson to remain an independent contractor: substantially all compensation from the business is

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derived from real estate commissions; the services are performed under a written contract specifying the person is an independent contractor; and the contract includes a provision that says the person will not be treated as an employee for federal income tax purposes. Note that this exemption is narrowly tailored for licensed real estate salespersons – if you have an unlicensed assistant that you want to treat as an independent contractor, make sure to consult with an attorney to ensure that she can be classified as an independent contractor not only for tax purposes, but also under workers' comp and unemployment statutes.

VAR offers an Independent Contractor Agreement as part of its Standard Forms library which can be used in creating an independent contractor relationship between brokers and salespersons. **G**