



White Paper

Independent Contractor

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Independent Contractor

PART ONE: INDEPENDENT CONTRACTOR STATUS UNDER THE LAW

I. Introduction

Most real estate brokers in Ohio and throughout the country consider sales agents affiliated with them to be independent contractors, rather than employees. This is not simply a “name game” since different legal responsibilities accrue to brokers depending upon whether sales agents are independent contractors or employees. For example, and without attempting to be exhaustive, brokers’ responsibilities differ in the areas of workers’ compensation, unemployment compensation, social security and federal, state and local taxation if sales agents are employees instead of independent contractors.

However, the mere fact that brokers consider their sales agents to be independent contractors does not mean that a court will agree. In fact, courts apply two distinct legal tests — one prescribed by Ohio law and one prescribed by federal law — to determine the employment status of sales agents. State law applies to a broker’s state obligations and federal law applies to his federal obligations. Because the two tests are different, each must be examined and complied with separately if a broker wants his sale agents to be considered independent contractors for both state and federal purposes.

II. Independent Contractor Status Under Ohio Law

All aspects of the broker/agent relationship must be considered in order to determine whether an individual is an independent contractor or an employee under Ohio law. Of primary importance is the degree of control that the broker exercises over the actions of the sales agent. The right to control the manner and means of performing the work is crucial, not necessarily the actual exercise of such control. This is known as the “right to control” test.

In one recent case containing a general discussion of independent contractor status under Ohio law (1), the Ohio Supreme Court discussed the factors to be considered when applying the right-to-control test. These factors include: who controls the details and quality of the work; who controls the hours worked; who selects the materials, tools and personnel used; and who selects the routes (or territories) traveled. Other factors that the Court indicated should be taken into account to determine if an employer/employee relationship exists are the length of employment, the type of business, the method of payment for services, and any pertinent agreements or contracts.

Generally, if a broker has the right to control the day-to-day activities of the sales agent, then the sales agent is likely to be classified as an employee. Where a broker does not have absolute control, the more control the broker exercises over the day-to-day activities of the sales agent, the more likely that a Court will consider the sales agent to be an employee. For example, if the broker prescribes the uniform that must be worn by the sales agent, directs the manner in which the sales agent markets the broker’s listings, requires a certain number of open houses at specified times,

requires certain kinds of advertising and promotion, directs the sales agent as to when and to whom to show the property, specifies working hours and schedules “in office” time for the sales agent, makes specific assignments as to properties to be listed or prospects with whom to work, or otherwise attempts to control the manner and means used by the sales agent to promote the sale and transfer of real property, then the sales agent will be considered an employee. On the other hand, if the broker is merely concerned with the final result, i.e., the listing and sale of real property, and for the most part leaves to the sales agent the day-to-day decisions regarding the means to accomplish the final result, then under Ohio law, the broker may confidently consider the sales agent to be an independent contractor.

This does not mean that a broker can exercise no control whatsoever over the day-to-day activities of the sales agent. With respect to the list in the preceding paragraph, a broker can surely require one or more of the activities listed without risking a finding that the sales agent is an employee. Courts are required to look at the entire relationship when they evaluate the extent of the “right to control.” In another landmark Ohio case involving independent contractors, the Ohio Supreme Court indicated that the employer may exercise limited control over the work performed without creating an employee/employer relationship. The case indicated that a person retained to perform certain work is not necessarily an employee because the contract provides that the work will be subject to the final approval or satisfaction of the person for whom it is to be performed (2). Still, brokers should be extremely cautious with respect to any control over the manner and means of a sales agent’s performance if the broker wants the sales agent to be considered an independent contractor.

Some Ohio courts have looked to Ohio Revised Code (“R.C.”) Chapter 4735, which governs real estate brokers and sales agents, to determine if a real estate sales agent is an independent contractor or an employee of a broker. At least one Ohio court(3) found that sales agents can have no independent status from brokers, because R.C. 4735.21 prohibits a real estate salesman from collecting any money in connection with a real estate transaction, or from maintaining any action for commissions or other compensation, unless the salesman does so in association with, on behalf of, and with the consent of, a licensed real estate broker. More recently, however, a different court of equal stature held that the prohibitions found in Chapter 4735 do not preclude independent status for real estate agents(4). The court held that although Chapter 4735 requires that the sales agent be associated with a broker, the association may take the form of a contractor/independent contractor relationship, and does not necessarily have to take the form of an employer/employee relationship.

Until the Ohio Supreme Court rules definitively on this issue, some confusion may arise, but the more recent decision appears to offer the more logical interpretation of the statute.

Liability for Fraud under the Doctrine of Apparent Agency

A real estate sales agent’s independent contractor status does not necessarily protect a broker from liability for the agent’s fraudulent acts. Under Ohio law, even when actual agency does not exist, agency may be conferred if the principal, intentionally or by lack of ordinary care, causes or allows third persons to act upon an apparent agency relationship (5). This doctrine of “apparent agent” may apply if a principal permits an agent to use the principal’s business or trade name (6). In order to establish such an agency under Ohio law, it must be shown that the principal held the

agent out to the public as possessing sufficient authority to act on his behalf, and that the person dealing with the agent knew these facts and, acting in good faith, had reason to believe the agent possessed the necessary authority (7). In one case where a broker had held an agent out as his representative (8), a court held that a real estate broker was liable for the fraudulent acts of a real estate sales agent even though the broker did not benefit from the fraudulent transaction.

It is important to note that the apparent authority of an agent is determined by the act of the principal, in this case the broker, and not by the acts of the agent. Therefore, a broker will only be responsible for the acts of a sales agent within the sales agent's "apparent authority" where the broker by his own acts has "clothed the agent with the appearance of authority" and not where merely the agent's own conduct has created the appearance of authority (9).

Ohio's real estate licensing laws (R.C. Chapter 4735) virtually require brokers to hold their sales associates out to the public as authorized to act on their behalf. For example, real estate sales agents are required to place their licenses with a broker (R.C. 4735.13); sales agents can take listings only in the names of their brokers and only brokers may receive real estate commissions from the public (R.C. 4735.21); real estate advertisements by sales agents must include the name of the broker (R.C. 4635.16); and monies received in a fiduciary capacity by the sales agent must be placed in the broker's trust account (R.C. 4735.18). Therefore, brokers will be liable in most cases for the misconduct of their sales agents, regardless of whether the sales agent is an independent contractor or an employee. However, the fact that brokers may be liable to the public for the misconduct of sales agents because of the "apparent agency" created by the licensing statutes does not preclude a finding that a sales agent is an independent contractor for all other purposes.

III. FEDERAL TAX TREATMENT OF REAL ESTATE SALES AGENTS

Under Federal tax law, a "qualified" real estate agent is deemed not to be the employee of a broker if the relationship between broker and agent satisfies certain requirements found in Section 3508 of the Internal Revenue Code of 1986 (the "Code") Section 3508 sets forth a three-part test to define whether an individual is a "qualified real estate agent." Satisfying this three-part test relieves the employer of requirements with respect to both Federal income and unemployment taxation. The three-part test is as follows:

1. The individual claiming to be a qualified real estate agent must be a licensed real estate agent;
2. Substantially all of the remuneration the individual claiming to be a real estate agent receives must be directly related to sales of real estate or other related sales activities, rather than to the number of hours the individual works for the broker; and
3. There must be a written contract between the broker and the agent that expressly provides that "for Federal tax purposes," the agent will not be treated as an employee with respect to the services the agent performs for the broker.

The first part of the test is self-explanatory; the individual must have a license to sell real estate.

With respect to the second part of the test, the services performed for the broker by the real estate agent include any activities that customarily are performed in connection with the sale of an interest in real property. This includes advertising or showing real property, acquisition of a lease of real property and appraisal activities performed in connection with a sale of real property. It also includes recruitment training or supervision of other real estate salespersons.

“Substantially all” remuneration, as that term is used in the second part of the test, means that at least 90% of the agent’s total compensation from the broker, including advances and draws received by the agent from the broker, is directly related to sales or “other output,” rather than the number of hours the agent worked. Compensation paid to a sales agent that is based on the sale or productivity of some other individual will be treated as directly related to the sales of “other output” if it is linked to one or more particular sales transactions, or to another individual’s accomplishment of one or more specific tasks.

Finally, the third part of the test indicates that there must be a written contract between the broker and the sales agent expressly stating that for Federal tax purposes the agent will be treated as an independent contractor. Therefore, any agreement purporting to establish an independent contractor relationship between a broker and a sales agent should contain the words that “for Federal tax purposes under 3508 of the Internal Revenue Code,” the agent will be considered an independent contractor, and not an employee of the broker.

Therefore, it is not necessary to apply the “right to control” test when evaluating the employment status of the sales agent with respect to federal obligations. It is only necessary to apply the three-part test of Section 3508. Naturally, though, this creates the possibility that a sales agent may be considered an independent contractor for federal purposes but an employee for Ohio purposes.

PART TWO: DRAFTING AN AGREEMENT

It is strongly recommended that all Brokers enter into written agreements with their sales agents. These written agreements should define all aspects of the Broker/Sales Agent relationship and should be drafted with the Ohio “Right to control” test and the federal test (I.R.C. 3508) with independent contractor status in mind. Such written agreements may be as complicated and complex, or as simple and “barebones” as the Broker chooses, but the more subjects that are expressly covered in the agreements, the less likely it will be that disputes and uncertainties will arise between Brokers and their sales agents.

Since the types of business relationships between Brokers and sales agents are as varied as the number of such relationships, it is not possible to establish one “form agreement” to be used by all Brokers throughout Ohio. Nor is it advisable. Brokers must be free to establish their own management provision, and their flexibility should not be restricted by a recommended form agreement. The creation of an Independent Contractor Agreement must be the product of careful thought and consideration by the Broker, not only with respect to the type of relationship to be established, but also with respect to the types of business the Broker determines to be appropriate for his office.

Still, there are certain subjects that Brokers should at least consider addressing in their agreements. Therefore, rather than attempt to draft a form agreement for all Brokers, we thought it would be more appropriate to set forth and discuss the subjects that Brokers may want to cover in their agreements. The Broker may consciously decide not to address one or more of the subjects listed on the following pages, or may choose to address them differently than suggested, but that is the prerogative of the Broker. The guidelines set forth can provide a reasonable structure for an Independent Contractor Agreement with the specific provisions drafted to meet each Broker’s particular way of doing business. Naturally, a Broker may wish to consult his own legal counsel, with these guidelines in mind, when he begins the process of preparing his own agreement.

CONSIDERATIONS AND GUIDELINES FOR DRAFTING AN INDEPENDENT CONTRACTOR AGREEMENT WITH A REAL ESTATE SALES AGENT

I. OPENING LANGUAGE

- A. Identify parties and indicate the type of legal entity each party is (partnership, individual, etc.);
- B. Make names of parties defined terms; indicate who is Broker and who is Agent;
- C. Establish the date of agreement.

EXAMPLE:

“This agreement is made _____, 20_____, between _____ (broker’s full legal name), and Ohio general partnership (or other type of legal entity if applicable) (“Broker”), and _____ (Agent’s full legal name), an individual (“Agent”).

II. BACKGROUND INFORMATION

- A. Describe Broker’s business; include geographic area, type of real estate transactions exercisable by Broker; list primary real estate activities engaged in by Broker (i.e., sale of single family homes or leasing commercial office space);
- B. Indicate that Broker desires to retain services of Agent as an independent contractor and that Broker routinely (perhaps exclusively) retains independent contractors as sales agents for its business;
- C. State that Agent is a licensed real estate sales person engaged in business in the State of _____; state any other pertinent information applicable to Agent;
- D. State that the parties to the agreement have determined that it is in the best interest of both that they enter into an independent contractor relationship whereby Agent will sell real estate on behalf of Broker.

***COMMENT:** Background information should describe, in a general fashion, the parties and the type of relationship they are entering into. Include reference to the fact that Agent will be an independent contractor with respect to Broker.*

III. DECLARATION OF AGREEMENT

- A. Indicate that in consideration of the mutual promises contained in the real estate sales agent agreement, the parties agree as follows:

EXAMPLE:

“The parties hereto acknowledge the accuracy of the foregoing Background Information and in consideration of the mutual promises contained herein agree as follows:”

IV. AGENT'S OBLIGATIONS

- A. Include a statement that Agent will faithfully and lawfully perform his duties on behalf of real estate Broker according to the terms of the agreement and any policies, handbooks, etc., enacted by Broker, copies of which Agent should acknowledge receiving upon execution of the agreement;
- B. Consider inclusion of a standard of effort to be put forth by Agent, (i.e. best efforts, reasonable efforts, etc.);
- C. State any limitations or special considerations applicable to Agent’s performance of services on behalf of Broker, e.g. work for other Brokers, special considerations with respect to certain types of property, type of agency relationship Agent may create, (i.e. buyer’s broker/tenant representative, subagent, or both (perhaps only with Broker’s consent), etc.);
- D. List any other services to be performed by Agent on behalf of Broker, (i.e. will Agent be required to assist other Agents or provide services other than sales efforts in the performance of his duties under the agreement?);
- E. Provide that Agent will comply with the Ohio real estate licensing laws and will keep his license in good standing, particularly with respect to continuing education requirements;
- F. Establish whether Broker will require Agent to join REALTOR® associations or other associations, and at whose expense;
- G. Establish that Agent shall not represent himself as an employee of Broker and further agrees that at all times Agent will remain an independent contractor with respect to Broker.

***COMMENT:** Bear in mind that the more control the Broker exercises over the execution of Agent’s duties, the more likely Agent will be found to be an employee rather than an independent contractor.*

V. BROKER'S OBLIGATIONS

- A. State the level of support Broker will extend to Agent, (i.e. clerical support, office space, uniforms, motor vehicles, etc.);
- B. Describe manner in which Broker will provide listings to Agent, including any terms for exclusive listings, as well as any other opportunities Broker agrees to offer for Agent to perform services for Broker;
- C. State any obligation of Broker to assist sales person by providing the efforts of other salespersons or by training Agent, or by any other means;

- D. Include representation that Broker shall verify that with respect to Broker, Agent is an independent contractor for purposes of state law, federal law, and any particular federal tax purposes.

COMMENT: *The more control Broker retains over the methods used by sales person, including requiring that the sales person utilize particular methods that Broker has trained him or her in, the more likely Agent is to be considered an employee. Also, bear in mind that the more “tools of the trade” Broker provides for Agent, the more likely that Agent might be determined to be an employee.*

VI. COMMISSIONS

- A. Discuss whether Broker will have the sole right to establish commissions charged or whether Agent may suggest an adjustment to a commission, subject to approval of Broker;
- B. Consider whether Broker can waive total commission owed by seller without Agent’s consent;
- C. Establish the method or formula to determine the share of commission owed to Agent; consider whether to incorporate or reference a commission schedule. If so, attach schedule as an exhibit;
- D. Indicate when commission will be paid to Agent, including any conditions to be fulfilled before commission are to be paid;
- E. Establish whether Broker will have the right to deduct any amounts owed Broker from commissions (i.e. for advertising, overhead expenses, board or license fees, or advances that are owed to Broker). If so, establish whether such set-offs are limited to expenses associated with the particular transaction for which the commission is owed, or if any monies owed Broker from Agent can be set off against the commission;
- F. Establish the manner in which agreements between Agents to split or share commissions will be handled;
- G. Discuss the manner in which disputes between Agents as to entitlement to a commission will be handled;
- H. Establish whether Broker will have sole authority to determine whether or not to pursue collection of a commission from seller, and whether Broker will have any liability to Agent for commissions not collected;

COMMENT: *Commissions should be the exclusive means of compensation for Agent for sales services rendered if the relationship is to retain its status as that of Broker and independent contractor.*

- I. Establish whether Agent will be entitled to any bonus offered by another real estate Brokerage or seller, or whether such bonus will be subject to the regular commission schedule.

COMMENT: *Providing that receipt of any such bonus will be subject to a regular commission schedule may be an indication that the relationship is more in the nature of an employee than an independent contractor.*

VII. EXPENSES

- A. Establish expenses for which Agent will be responsible (i.e. travel, business cards, advertising, licensing or board expenses, continuing education costs or insurance premiums);
- B. Describe expenses for which Broker will be responsible (i.e. overhead, clerical, etc.).

COMMENT: *Bear in mind that the more expenses Broker pays for Agent and the more services broker provides (without remuneration) for Agent, the more the relationship will resemble and employer/employee relationship as opposed to an independent contractor relationship.*

VIII. LISTINGS

- A. Establish that listings must be taken in the name of Broker and that they are the sole property of Broker;
- B. Establish Agent's duty to file listing with the Broker and when listing must be submitted.

IX. TERMINATION OF RELATIONSHIP

- A. Establish the right of either party to cancel the relationship, any notice required prior to termination, and the manner in which it is to be given;

COMMENT: *Bear in mind that the more notice the Broker may require Agent to give upon termination of the relationship, the less the relationship may look like an independent contractor relationship.*

- B. Establish mechanism to determine Agent's right to commissions after the agreement is terminated including, for example, whether commissions will be forfeited; whether Agents are entitled only to commission on transactions that are actually in contract; whether the Broker can deduct for any outstanding amount owed to Brokerage (regardless of whether expenses are related to any transaction in existence);
- C. Establish if Agent will be paid a commission on any options that are exercised or leases that are renewed following termination;
- D. Consider whether the Broker should require Agent to provide the Broker with a list of leads, prospects, or negotiations in progress at the time of termination;
- E. Establish whether all negotiations in progress must be continued through the Brokerage;
- F. Establish whether Broker may deduct any amount from Agent's share of a commission for a transaction that Broker or other Agents of the firm are required to complete due to termination of the sales agent agreement;
- G. Establish Agent's responsibilities to return keys, files, books, publications and such other materials that are property of Brokerage in the event of contract termination.

X. LITIGATION/LEGAL FEES; INSURANCE

- A. Establish whether Broker will have sole discretion to decide whether to sue, defend, compromise, or settle any legal matters;
- B. Establish who will carry errors and omissions insurance and whether insurance will cover Agent; if so, establish whether Agent must share in deductible and whether Broker's attorney will represent Agent if Agent is named in a law suit;
- C. Establish whether Agent will be required to share in legal fees charged by legal counsel and who will choose and direct the work of any attorney working for both Broker and Agent;
- D. Establish whether Broker will be permitted to deduct Agent's share of errors and omissions insurance deductible, common legal fees, or any joint and severed judgment from any commissions Broker owes Agent. If Brokerage is found liable as a result of transactions involving Agent, establish to what extent, if any, Agent must share in satisfying the judgment. Consider as a possibility that Agent will contribute the same percentage as Agent's share of the commission with respect to the transaction.

COMMENT: *Bear in mind that if the firm carries errors and omissions insurance and covers Agent, and in particular if Agent is not required to share in the deductible and is defended by Broker's attorney in the event of any law suit, Agent will be more likely to be considered an employee of Broker.*

- E. Indicate Agent's obligation to report complaints, disputes, or threats of litigation to Broker.

COMMENT: *Stringent requirements that such information be reported may be a good idea, particularly to head off any misunderstanding on the part of a party to a transaction that Agent has "apparent authority" to make representations on behalf of Broker.*

XI. AGENT'S REPRESENTATION

- A. Include a representation that Agent is licensed to sell real estate, is a member of the Ohio Association of REALTORS®, or any other associations or organizations Broker requires Agent to be a member of;
- B. Establish that Agent is familiar with and agrees to conduct his activities on behalf of Broker in compliance with all applicable laws, rules, regulations and ordinances;
- C. Obtain representation of Agent that except where specifically granted with respect to particular transactions, Agent will not represent that he or she has the ability to bind Broker or otherwise make representations on behalf of Broker, except as otherwise contained in the agreement.

XII. BROKER'S REPRESENTATIONS

- A. Establish that Broker is a licensed real estate Broker, etc.;

- B. Include Broker's representations pertaining to various associations it is affiliated with and that it is a member in good standing with such organizations.

XIII. NATURE OF RELATIONSHIP

- A. Establish that the relationship of the parties is that of Broker and independent contractor;

EXAMPLE: "For all federal tax and state purposes Agent shall be considered an independent contractor with respect to Broker."

XIV. INFORMATION; DOCUMENTATION; FORMS

- A. Establish whether Agent will be precluded from giving company forms, customer or client lists, or any other business information to Broker's competitors.
- B. Establish whether Agent must use listing, purchase, and/or loan contracts, and any other forms provided by Broker.
- C. Indicate Agent's responsibility to submit originals or copies of documents pertaining to real estate transactions; indicate whether Agent will have the right to remove or make copies of files or records regarding transactions.

XV. MISCELLANEOUS

- A. Establish whether Agent will be required to use his/her own automobile and to carry a minimum amount of liability insurance, and if so, the type of coverage;
- B. Consider whether Broker wishes to include a non-competition clause in the agreement indicating that following termination Agent will be prohibited from selling real estate for another Broker for a particular (reasonable) period of time in a particular (reasonable) geographical area. Period of time and geographical area must be reasonable to be enforceable.

COMMENT: *Bear in mind that the more control Broker has to dictate the geographical areas to be served by Agent and the manner in which Agent carries out his/her sales activities, the more the relationship will resemble that of employer/employee.*

- C. Consider what training Broker will provide Agent.

COMMENT: *Bear in mind that extensive training and requirements that Agent use Broker's methods are a factor in favor of determining that Agent is an employee as opposed to an independent contractor. Requiring Agent to pay for training may be a factor indicating that Agent is independent contractor as opposed to an employee.*

- D. Establish whether Agent must list, sell, or purchase their own personal property through the Brokerage, and if so, whether Agent's typical commission split will apply or whether another split will be applicable.

- E. Consider whether to obligate Broker and Agent to arbitrate any disputes.

XVI. BOILERPLATE

- A. Establish the jurisdiction whose law shall apply (which state).
- B. Consider including representation as to the venue in which any legal action must occur (i.e. the court of a particular county or other jurisdiction);
- C. Consider including representation that the agreement represents the entire agreement of the parties;
- D. Consider including representation as to severability indicating that in the event that any portion of the agreement is determined to be invalid, the remaining portion shall be enforced as written.

***COMMENT:** Consider this provision carefully. For example, will the Broker wish to have the provision relating to this obligation to pay commissions enforced if the provision under which Agent is required to repay expenses is determined not to be enforceable?*

- E. Consider including a representation that the captions and headings are for labeling purposes only and shall not be considered in the interpretation of the agreement.

XVII. SIGNATURE BLOCK

- A. Be sure to indicate the names of Broker and Agent, to designate which is Broker and which is Agent, and to indicate the capacity in which each signs (i.e. that the individual signing for the Brokerage is one of its officers or other authorized employee).

EXAMPLE:

AGENT:

BROKER:

XYZ BROKER, INC.

By

(Name), Sales Agent

Its

BIBLIOGRAPHY

1. Bostic v. Connor, 37 Ohio St. 3d 144, 524 N.E. 2d 881 (1988), citing, Gillum v. Industrial Commission, 141 Ohio St. 373, 25 Ohio Ops. 531, 48 N.E.2d 234 (1943).
2. Gillum v. Industrial Commission, 141 Ohio St. 373, 25 Ohio Ops. 531, 48 N.E.2d 234 (1943).
3. Fulton v. Aszman, 4 Ohio App. 3d 64, 446 N.E.2d 803 (Warren County Court App. 1982).
4. Burton Minnick Realty, Inc. v. Leffel, Case No. 2680, 1990 Ohio App. LEXIS 4245.
5. Irving Leasing Corp. v. M & H Tire Company, 16 Ohio App. 3d 191, 1995, 475 N.E.2d 127, 132 (1984); Blackwell v. International Union, UAW, 9 Ohio App. 3d 179, 458 N.E.2d 1272, 1275 (1983).
6. Broock V. Nutri/System, Inc., 654 F.Supp. 11 (S.D. Ohio 1986); Agosto V. Leisure World Travel, Inc., 36 Ohio App. 2d 213, 304 N.E.2d 910 (1973).
7. Irving, supra, at 132.
8. DeSantis V. Smedly, 34 Ohio App. 3d 218, 517 N.E.2d 1038 (Cuyahoga County Court App. 1986).
9. Logsdon v. Main-Nottingham Investment Company, 141 N.E.2d 216, 223 (Montgomery County Court App. 1956).

The information presented in this White Paper is not intended to be--and should not be construed as--legal advice. Before applying this information to a specific legal problem, readers are urged to seek advice from their own legal counsel.



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