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MEMORANDUM OF LAW

DATE: December 11, 2009

TO: Gail Granewich, City Treasurer

FROM: City Attorney

SUBJECT: Applicability of Business Tax to Real Estate Agents

INTRODUCTION

In the attached memorandum of law dated January 8, 1991, this Office opined that real estate agents are employees under San Diego Municipal Code section 31.0110 and exempt from paying business tax to the City of San Diego. *See* Attachment 1. The Office of the City Treasurer [City Treasurer] has asked us to determine whether this memorandum of law is still valid.

QUESTION PRESENTED

Are real estate agents exempt from paying the City of San Diego's business tax because they are employees?

SHORT ANSWER

There is no blanket exemption for real estate agents. Real estate agents are required to pay the City of San Diego's business tax if the real estate agent is an independent contractor and not an employee. This determination may be made using one of the following methods:

1. By using the right to control test described in title 22, section 4304-1, of the California Administrative Code [Section 4304-1];
2. By relying on California Business and Professions Code section 16300, which allows the City to presume that a salesperson is an independent contractor if the salesperson reports income tax to the Franchise Tax Board or the Internal Revenue Service; or
3. By relying on an agreement between the real estate salesperson and his or her real estate broker defining the employment relationship as described in Business and Professions Code section 10032.

ANALYSIS

In 1991, this Office issued a memorandum of law, 1991 City Att’y MOL 1 [1991 MOL], wherein we determined that real estate agents are employees who are not required to pay the City of San Diego’s business tax. The 1991 MOL relied on the definition of “employee” described in Section 4304-1.¹ Section 4304-1 states, in pertinent part, as follows:

Whether an individual is an employee for the purposes of Sections 621(b) and 13020 of the code² will be determined by the usual common law rules applicable in determining an employer-employee relationship. Under those rules, to determine whether one performs services for another as an employee, the most important factor is the right of the principal to control the manner and means of accomplishing a desired result. If the principal has the right to control the manner and means of accomplishing the desired result, whether or not that right is exercised, an employer-employee relationship exists. Strong evidence of that right to control is the principal's right to discharge at will, without cause.

Section 4304-1 also provides factors to consider when determining whether one is an employee or an independent contractor.³ These factors include the type of occupation; the skill required in performing the services and accomplishing the desired result; who supplies the instrumentalities, tools, and the place of work; the length of time for which the services are performed; the method of payment; whether or not the work is part of the regular business of the principal; whether the parties believe that they have created an employer-employee relationship; the extent of actual control exercised by the principal; and whether the principal is engaged in a business enterprise.

In concluding that real estate agents are employees and not independent contractors, the 1991 MOL relied on sections 10132, 10160, and 10177 of the California Business and Professions Code. California Business and Professions Code sections 10132, 10160, and 10177 describe the employment relationship between a real estate agent and a real estate broker. Namely, a real estate agent “is employed by a licensed real estate broker” to do the acts set forth in section 10132 and works exclusively under one broker who retains custody of the agent’s real estate license. Cal. Bus. & Prof. Code §§ 10132, 10137, and 10160.

The 1991 MOL also relied on the case of *Grubb & Ellis Co. v. Spengler*, 143 Cal. App. 3d 890, 895 (1983). In *Grubb*, a real estate broker sued a real estate agent formerly employed by the broker to recover monies owed. The broker claimed that the agent was an independent contractor because he paid the agent commission, but the agent claimed that he was an employee entitled to minimum wages. Based on the facts presented, the trial court held that the agent was an independent contractor. In affirming this decision, the Court of Appeal noted that although a sales agent is an employee “for the purposes of the *administration* of real estate law,” the

¹ Section 4304-1 is cross-referenced in San Diego Municipal Code section 31.0110.

² This refers to the California Unemployment Insurance Code.

³ A copy of Section 4304-1 is attached for future reference. See Attachment 2.

employment relationship is determined by facts and the type of law involved. *Id.* at 895, emphasis added. The broker would, for instance, be liable under the doctrine of respondeat superior for the tortuous acts of his agents. *Id.* In the context of unemployment law, an agent that receives commissions is an independent contractor, and the common law “control” test would be applied in determining federal tax liability. *Id.* at 897-8.

Thus, although sections 10132, 10160, and 10177 of the California Business and Professions Code and *Grubb & Ellis Co. v. Spengler*, 143 Cal. App. 3d 890, 895 (1983) are good law, they do not constitute an across-the-board finding that a real estate agent is an employee. Rather, these authorities emphasize that employment is determined by the facts and the type of law involved.

The issue, therefore, is how the Office of the Treasurer should determine the employment status of a real estate agent. We believe that the City Treasurer may utilize one of three methods: the “right to control” test; the taxpayer presumption; or the employment agreement between the broker and agent.

The “right to control” test cited in San Diego Municipal Code section 31.0110 is an accurate determinant of who is and who is not subject to the City’s business tax. Although a broker is an employer and an agent is an employee “for purposes of *the administration of the Real Estate Law*,” which is limited to regulation, discipline, and legal obligations owed to the public, the employment relationship requires a different analysis. *Miller & Starr*, 2 Cal. Real Est. § 3:18 (3d ed. 2009). Employment is determined using the “right to control” test:

Generally, the most significant test of whether a person is an employee of an independent contractor is determined by the common law test of the right to control. If the broker only has the right to control the results to be achieved and not the method or means of achieving the result, the salesperson is an independent contractor. However, if the broker has the right to control the details of how the salesperson will perform the services, whether or not actual control is exercised, the salesperson is an employee under the accepted common law test. The unlimited right to discharge at will and without cause also has been stressed by some decisions as a strong factor demonstrating an employment relationship.

Id. See also *Witkin, Summary of California Law*, vol. 3, *Agency* § 53 (10th ed. 2005); and *Witkin, Summary of California Law*, vol. 3, *Agency* § 22 (10th ed. 2005).

Our opinion is also based in California Business and Professions Code section 16300 [Section 16300] which limits the circumstances under which cities and counties may impose a business tax. It states, in pertinent part, as follows:

(a) Notwithstanding any other provision of this part . . . no city, including a charter city, city and county, or county may require an employee to obtain a business license or home business occupation permit for, or impose a business tax or registration fee based on income earned for services performed for an employer by the employee in an employment relationship as determined by reference to the common law factors reflected in rulings or guidelines used by either the Internal Revenue Service or the Franchise Tax Board. *When there is a dispute between a city, city and county, or county and a taxpayer, the manner in which a taxpayer reports or reported income to the Franchise Tax Board or the Internal Revenue Service shall create a presumption regarding whether the taxpayer performed services for an employer as an employee, or operated a business entity.* For purposes of this section, "income" includes income paid currently or deferred and income that is fixed or contingent.

Cal. Bus. & Prof. Code § 16300 (emphasis added).

Thus, if a person's employment status is unclear, then that person is presumed to be an independent contractor if she or he reports income to the Franchise Tax Board or to the Internal Revenue Service.

Finally, section 10032 of the California Business and Professions Code, added in 1991, permits a real estate agent and a real estate broker to establish their employment relationship as employer-employee or as an independent contractor for purposes of defining their obligations to one another. Although this would be determinative for purposes of imposing the business tax, it would not be for purposes of determining entitlement to workers' compensation and unemployment compensation. *See also* Cal. Unemp. Ins. Code § 650 and §§ 13000-54; and Cal. Lab. Code § 3200.

CONCLUSION

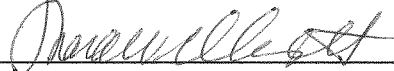
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JANI GOLDSMITH, City Attorney

By



Mara W. Elliott
Deputy City Attorney

MEW:jab
Attachments
ML-2009-18

DATE: January 8, 1991

TO: Conny M. Jamison, City Treasurer
FROM: City Attorney
SUBJECT: Taxation of Real Estate Salespersons

BACKGROUND

In November you sent a memo to this office asking whether real estate salespeople, or associate realtors, should be considered employees under "our Business Tax Code." We assume that you refer to San Diego Municipal Code section 31.0101 et seq. In subsequent conversation, you said that the City Auditor is under the assumption that all real estate salespeople are independent contractors, but that the San Diego Association of Realtors claims that salespeople should be considered employees. If the answer is unclear under the existing Code, you asked that we suggest appropriate action to clarify this issue, i.e., whether it could be handled administratively, or whether a Code revision would be in order.

ANALYSIS

We begin our analysis with the definition of "employee" found in San Diego Municipal Code section 31.0110(c). In that section, Business Taxes - Definitions, subsection (c), "'EMPLOYEE' refers to a person defined in Title 22, section 4304-1 of the California Administrative Code." That section of the Administrative Code is contained within Title 22, Social Security, Division 2.5, Withholding Tax on Wages, and states in pertinent part that:

¶The most important factor is the right of the principal to control the manner and means of accomplishing a desired result. If the principal has the right to control the manner and means of accomplishing the desired result, whether

or not that right is exercised, an employer-employee relationship exists. Strong evidence of that right to control is the principal's right to discharge at will, without cause.

That section of the California Administrative Code as well as the following section, 4304-2, Specific Application of Rules for Determination of Employment Status to Circumstances in the Real Estate Industry, provides specific application

ATTACHMENT

of section 4304-1 rules to the real estate industry and incorporates quite extensive criteria to be examined in each individual case to determine whether a person is an independent contractor or an employer. It is unrealistic for The City of San Diego to attempt to answer numerous questions in every single business tax case where a real estate salesperson is involved.

You informed us that the San Diego Association of Realtors claims that federal and state law treat real estate salespeople "differently." In fact, statutes do differ according to the context in which the question is raised. For example, regarding federal employment taxes, 26 USCS 3508(a)(1) states that "a real estate agent shall not be treated as an employee." However, under California law, a real estate salesperson cannot act as an in-dependent contractor, but must work under a broker. Real Estate Regulations, found in California Business and Professions Code, section 10130 et seq., are quoted here in pertinent part:

Section 10132. Salesman

A real estate salesman . . . is a natural person who, for a compensation or in expectation of a compensation, is employed by a licensed real estate broker to do one or more of the acts set forth in ~~fotherσ~~ Sections

Section 10137. Unlicensed persons, employment; salesman payments through broker; violations

No real estate salesman shall be employed by or accept compensation from any person other than the broker under whom he is at the time licensed.

Section 10151. Salesman; application

Application for the real estate salesperson license examination shall be made in writing to the commissioner. . .

Section 10160. Custody of salesman's license

The real estate salesman's license shall remain in the possession of the licensed real estate broker employer until canceled or until the salesman leaves the employ of the broker; and the broker shall make his license and the licenses of his salesman available for inspection by the commissioner or his

designated representative.

Section 10177. Grounds for suspension or
revocation of license

The commissioner may suspend or revoke
the license of any real estate licensee

...
(h) If, as a broker licensee, failed to
exercise reasonable supervision over the
activities of his salespersons.

In addition, a California appellate court, Second District,
has held that "for purposes of the administration of the real
estate law, the salesperson is the employee and agent of the
broker." *Grubb & Ellis Co. v. Spengler*, 143 Cal. App. 3d 890,
895 (1983).

CONCLUSION

California statutes hold that real estate salespeople must work
under a broker; hence, they are employees of that broker.
Therefore, for purposes of the City's Business Tax Code, real
estate salespersons should be considered as employees, not as
independent contractors.

JOHN W. WITT, City Attorney

By

Mary Kay Jackson

Deputy City Attorney

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ML-91-1