



BUSINESS TAX REQUIREMENT FOR REAL ESTATE AGENTS & BROKERS FREQUENTLY ASKED QUESTIONS

I've never heard of this before. Is this a new requirement?

The Newport Beach business license requirement is not new; in fact, it has existed since 1906. Interestingly, some of the first people to obtain City business licenses were involved in real estate sales.

Why hasn't anyone told me about this before? How come other agents in my office do not have licenses or have not received these notices?

The City is diligent in sending *courtesy* notices. If one does not receive a notification, does not mean that they are not required to obtain a business license. If a colleague has not yet been notified, it is an indication that the City is not yet aware of them. In fact, if a person/entity does not apply for a business license and they are identified in the future, with a credible source of discovery, they will be liable for all back taxes and penalties.

I am already licensed by the State of California. Why is the City asking me to get a license?

The license you hold, issued by the Department of Real Estate is a **regulatory** license. A City Business "License" tax certificate represents a tax payment and has no regulatory function.

My broker already has a City Business Tax Certificate. Don't I operate under their "umbrella"?

Your broker may have a City of Newport Beach business license, which has a provision for covering W2 employees. Unless your broker pays you as a W2 employee rather than a 1099 Independent Contractor, her/his business license cannot and does not cover you.

I have to work under a broker. Why is the City requiring a separate business license from me?

While California Real Estate law, for regulatory purposes, defines a salesperson to be an employee of a broker, it does not speak to employment for taxation purposes. Real Estate law requires a written agreement between the salesperson and the broker to define their relationship for tax purposes, as well as the way the salesperson reports income to the Franchise Tax Board and IRS define whether the salesperson is an employee, or a separate business. If your written contract with your broker defines the relationship as being that of "employer and employee" *and* you report income to the Franchise Tax Board and the IRS as a W2 employee, then you are an employee and not a separate business. Otherwise, as an "independent contractor", you are considered a separate business and require a business license.

Why does the City think I'm a "business?" I work for a broker and use a desk at his office.

State law requires the City to use the way in which a taxpayer reported income to the Franchise Tax Board to determine whether the taxpayer acted as an employee, or rendered services as a separate business entity.

Can you substantiate your position about Real Estate salespeople needing City Tax Certificates? On which laws do you base your assertion that real estate professionals are a separate "business" and require their own business license?

State law (Business and Professions Code §16300) prohibits the imposition of business license tax on employees. In the case of a dispute between a taxpayer and the local agency, the local agency must defer to how the taxpayer reported income to the Franchise Tax Board in determining whether the taxpayer is an employee or a separate business entity.

Real Estate Law says I am an employee and not a separate business. Why are you calling me a separate business when I have to work under a Broker?

Under California Real Estate Law (Business and Professions Code §10032), brokers and salespeople may define their relationship, for **tax** purposes, as either an "independent contractor" or as "employer and employee". It also states this relationship shall have no effect on either the brokers' or agents' regulatory obligations to the public. In other words, Real Estate law distinguishes the regulatory requirements of California real estate professionals from the tax structure. For **tax** purposes, real estate salespeople are required to maintain a separate business tax certificate.

Why do you say the IRS and Franchise Tax Board consider me a "business?" They have never called me that and I never told them I was one.

The Franchise Tax Board notified the City that you reported income as a separate business entity according to their regulations. For example, you had filed a Schedule C ("Profit or Loss from Business"), which is the appropriate location to report 1099 income. The Franchise Tax Board may only turn over information from those that have filed as a business return.

Does every real estate salesperson in the City need a license?

Any person employed as a 1099 independent contractor who works in the City must get a Business Tax Certificate. Therefore, all agents employed as 1099 independent contractors by their brokers who are based in, or work in the City must have their own City tax certificate.

State Laws

Business & Professions Code 10032

10032. (a) All obligations created under Section 10000, and following, all regulations issued by the commissioner relating to real estate salespersons, and all other obligations of brokers and real estate salespersons to members of the public shall apply regardless of whether the real estate salesperson and the broker to whom he or she is licensed have characterized their relationship as one of "independent contractor" or of "employer and employee."

(b) A real estate broker and a real estate salesperson licensed under that broker may contract between themselves as independent contractors or as employer and employee, for purposes of their legal relationship with and obligations to each other. Characterization of a relationship as either "employer and employee" or "independent contractor" for statutory purposes, including, but not limited to, withholding taxes on wages and for purposes of unemployment compensation, shall be governed by Section 650 and Sections 13000 to 13054, inclusive, of the Unemployment Insurance Code. For purposes of workers compensation the characterization of the relationship shall be governed by Section 3200, and following, of the Labor Code.

Manner in which a Taxpayer Reports Income Creates Employment Presumption

Business & Professions Code 16300(a)

16300. (a) Notwithstanding any other provision of this part, Chapter 1.5 (commencing with Section 7284) of Part 1.7 of Division 2 of the Revenue and Taxation Code, or Chapter 3 (commencing with Section 37100) of Part 2 of Division 3 of Title 4 of the Government Code, 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. (Emphasis added).

FTB Only Allowed to Provide Business Taxpayer Data to Cities

Revenue & Taxation Code §19551.1

19551.1. (a) The Franchise Tax Board may permit the tax officials of any city to obtain tax information pursuant to subdivision (a) of Section 19551.

(b) The information furnished to tax officials of a city under this section shall be limited as follows:

(1) When requested pursuant to a written agreement, the taxing authority of a city may be granted tax information only with respect to taxpayers with an address as reflected on the Franchise Tax Board's records within the jurisdictional boundaries of the city who report income from a trade or business to the Franchise Tax Board.

(2) The tax information that may be provided by the Franchise Tax Board to a city is limited to a taxpayer's name, address, social security or taxpayer identification number, and business activity code.

(3) Tax information provided to the taxing authority of a city may not be furnished to, or used by, any person other than an employee of that taxing authority.

(4) Section 19542 applies to this section.

(5) Section 19542.1 applies to this section.

(c) The Franchise Tax Board may not provide any information pursuant to this section until all of the following have occurred:

(1) An agreement has been executed between a city and the Franchise Tax Board, that provides that an amount equal to all first year costs necessary to furnish the city information pursuant to this section shall be received by the Franchise Tax Board before the Franchise Tax Board incurs any costs associated with the activity permitted by this section. For purposes of this section, first year costs include costs associated with, but not limited to, the purchasing of equipment, the development of processes, and labor.

(2) An agreement has been executed between a city and the Franchise Tax Board, that provides that the annual costs incurred by the Franchise Tax Board, as a result of the activity permitted by this section, shall be reimbursed by the city to the board.

(3) Pursuant to the agreement described in paragraph (1), the Franchise Tax Board has received an amount equal to the first year costs.

(d) This section does not invalidate any other law. This section does not preclude any city or, city and county, from obtaining information about individual taxpayers, including those taxpayers exempt from this section, by any other means permitted by state or federal law.

(e) This section shall remain in effect only until December 31, 2008, and as of that date, is repealed. (Emphasis added).

Newport Beach Municipal Code

5.04.020 License and Tax Payment, and Fingerprinting Fee Requirements.

Except when operating under a permit issued pursuant to Chapter 5.16, no person, either for himself or any other person, shall operate any business specified in this title in the City without first having, obtained a license from the City to do so, or without complying with any and all regulations of such business contained in this title; and the carrying on of any such business without first having obtained a license from the City to do so, or without complying with any and all regulations of such business contained in this title, shall constitute a separate violation of this title for each and every day that such business is so carried on. Where fingerprinting is required as a condition of obtaining a license to operate any such business, in addition to any other fees imposed pursuant to this title, a fee equal to that currently charged to the City by the State of California will be charged for each person required to be so fingerprinted. (Ord. 1757 § 1 (part), 1977)

5.04.120 Revenue Measure

This chapter is enacted solely to raise revenue for municipal purposes and is not intended for regulation. (Ord. 1757 § 1 (part), 1977)

5.04.210 License Nontransferable

Each license granted or issued under any provisions of this title shall authorize the licensee to transact or carry on the business therein named, at the place therein designated and at no other place and the license shall not be assignable or transferable. A change of location shall be allowed to the holder of the license upon the payment to the Finance Director of the sum of ten dollars (\$10.00) within thirty (30) days of such change taking place. If licensee fails to apply for the change of address within thirty (30) days of such change taking place, his license shall terminate and expire at midnight of the thirtieth day.

In the event of any such termination and expiration of a license, there shall be no rebate of any portion of the tax or fee paid by such licensee and in any application for a new license, there shall be no proration of the required tax or fee. (Ord. 1757 § 1 (part), 1977)

Excerpt from DRE Reference Manual

http://www.dre.ca.gov/pdf_docs/ref10.pdf (Pages 25-18)

BROKER - SALESPERSON RELATIONSHIP

Broker - Salesperson Employment Contract: Commissioner's Regulation 2726 requires that a real estate broker have a written agreement with each of his or her salespersons, whether licensed as a salesperson or a broker under a broker-salesperson arrangement. An employment contract between broker and salesperson may be instrumental in establishing the relationship between them, but only to the extent that the provisions do not conflict with the relationship as mandated by the Real Estate Law, other statutes, and applicable case law. The details of the association, including supervision, duties and compensation, must be spelled out in the contract and adhered to in practice.

Employer – Employee: An employee is defined in the Labor Code as one who renders personal service to the employer and who performs the service under the direction and control of the employer. An employee works for his or her employer, while an agent not only does this but also acts for and in the place of the principal for the purpose of making agreements and thus bringing the principal into legal relationships with third persons. Thus, a filing clerk in an office or a machinist in a factory would be an ordinary employee. A broker normally would not be classified as an employee. For purposes of the Real Estate Law and the Civil Code, a real estate salesperson is an employee of the real estate broker under whom he or she is licensed. If the broker is a corporation, the salesperson is an agent of the corporation, not of the supervising qualifying broker in his or her individual capacity. (*Walters v. Marler* (1978) 83 Cal.App.3d 1,147 Cal. Rptr. 655)

Independent Contractor: An independent contractor is one who, in rendering services, exercises an independent employment or occupation and is responsible to the principal only for the results of his or her work. For the most part, an independent contractor sells final results rather than time, and the methods of achieving those results are not subject to the control of the principal. An independent contractor may also be an agent of the principal. For instance, a real estate broker is typically an independent contractor acting as an *agent* of the principal for a defined limited purpose.

An important factor in establishing independent contractor status is that the contractor determines the method of accomplishing the work for which the contractor has been engaged. Salespersons are usually characterized as independent contractors of the broker for purposes of state and federal income tax reporting and sometimes for certain other purposes such as Workers' Compensation Insurance coverage. (See, for example, Unemployment Insurance Code Section 650 and 26 U.S.C. Section 3508.) Accordingly, salespersons are agents and employees of the supervising broker in connection with dealings with the public, but may at the same time, be independent contractors for income tax reporting and certain other purposes.

CHAPTER TEN 204: To maintain independent contractor status for income tax reporting and related labor law purposes, it is necessary for the supervising broker to specify in contracts with salespersons that the associates are independent contractors and not employees for income tax reporting purposes. However, the real estate broker must distinguish between the implementation of independent contractor status of salespersons for tax reporting, Workman's Compensation, or other labor-related purposes and the broker's duty to supervise those salespersons under the Real Estate Law. Moreover, the independent contractor status does not diminish the broker's responsibilities and civil liabilities for the conduct of the broker's salespersons. (Business and Professions Code Sections 10032, 10132, 10177(h) and 10159.2)

Social Security and Income Taxes: A similar situation arises under the Federal Insurance Contributions Act and the Internal Revenue Code. A broker may submit to the District Director of Internal Revenue employment agreements and detailed data as to operating methods and obtain a ruling whether the salespersons are considered employees under these laws. The existing exemptions available to real estate brokers have extended primarily to brokerage sales and related services. Real estate brokers who are engaged in a broad list of licensed and non-licensed activities may wish to review with legal counsel the effect of these activities upon the available exemptions from employer and employee relationships for tax reporting purposes. (26 U.S.C. Section 3508; IRS Rev. Rulings 76-136 and 76-137; and California Attorney General Opinion 59 Ops. A.G. 369)

The consequences of mischaracterizing the relationship in this context are serious. For example, if the IRS rules that the salespersons are employees for income tax reporting purposes, the supervising broker may be liable for income taxes due from the salespersons which should have been withheld by the broker and paid to the IRS. Interest and penalties will typically be added.

Personal Income Tax - Additional Information: In recent years, the IRS has challenged the exemption available to real estate licensees under 26 USC Section 3508 when the activities involved are other than general sales brokerage and related services. Real estate licensees may still be treated as independent contractors for both federal and state personal income tax purposes, depending upon the fact situation. This issue has been addressed in part by the Federal Tax Equity and Fiscal Responsibility Act (TEFRA) and amendment of Section 650 and addition of Section 13004.1 to the California Unemployment Insurance Code. Under these laws, real estate licensees functioning on behalf of a supervising real estate broker, in certain fact situations, are and remain exempt from treatment as employees for income tax reporting and other labor-related purposes provided that certain conditions are met. Section 13004.1 provides that an individual will not be considered an employee for *state income tax purposes* if all of the following conditions are met: (1) the individual is licensed by the Department of Real Estate and is performing brokerage services as a real estate licensee on a commission basis; (2) substantially all remuneration for such services is related directly to sales or other output rather than the number of hours worked; and (3) the real estate services are performed pursuant to a written agreement between the individual and the supervising broker which includes a provision that the individual will not be treated as an employee with respect to those services for state tax reporting purposes. Similar standards apply for establishing independent contractor status for federal income tax purposes.