

W-2 vs. 1099: The Real Cost of Worker Misclassification

Cash flow gets tight, payroll looms, and someone whispers the “easy fix”: “Just switch your staff to 1099s.”

It sounds tempting—no payroll taxes, no unemployment, no workers’ comp premiums. But here’s the catch: misclassifying employees as independent contractors isn’t just risky, it can trigger fines, lawsuits, and serious insurance gaps.

What Colorado Law Says

According to the Colorado Department of Labor & Employment (CDLE) [Interpretive Notice & Formal Opinion \(INFO\) #10](#), the difference between an employee (W-2) and an independent contractor (1099) comes down to the reality of the working relationship, not the label on a tax form or contract.

Key factors include:

- **Control** – Does the business decide when, where, and how the worker performs their job? The more control, the more likely they’re an employee.
- **Primary Work** – Is the worker doing the core work of your business (e.g., janitors for a janitorial company)? If yes, they’re likely an employee. Hiring out-of-scope specialists (e.g., electricians for a janitorial company) is more likely to qualify as contractor work.
- **Independence** – Does the worker operate their own business, serving multiple clients with their own tools, website, and insurance? That leans toward contractor status.

Penalties for misclassification:

- \$5,000 for the first violation (\$10,000 if not fixed within 60 days).
- \$25,000 for repeat violations within five years (\$50,000 if not fixed within 60 days).

And that’s just the labor side—misclassification bleeds into your insurance, too.

Insurance Ramifications

Workers' Compensation

- **Employees (W-2):** Must be covered under your workers' compensation policy.
- **Independent Contractors (1099):** Not automatically covered under your policy. If they get hurt on the job and don't carry valid workers' comp, the claim can roll up to your policy—driving up your experience mod and premiums. Even if no claim occurs, misclassification often surfaces at audit, triggering unexpected premium charges if proper documentation isn't in order.

General Liability (GL)

- If a 1099 causes damage or injury while working for you, plaintiffs will often name everyone in the lawsuit, including your business.
- If the contractor lacks sufficient GL coverage, your policy may be forced into play—or worse, your carrier could deny coverage, leaving you to handle defense costs out of pocket.

Commercial Auto

- If a 1099 drives on your behalf and causes an accident, their personal auto policy may exclude business use.
- Without proper commercial auto coverage in place, your company may be pulled into the claim.

Bottom line: "1099" doesn't always keep liability off your books.

Protecting Your Business

If you truly are working with legitimate independent contractors, protect yourself by requiring:

1. Certificates of Insurance (COIs):

- Proof of workers' comp coverage
- General liability coverage equal to or greater than your limits
- Commercial auto coverage if they drive on the job
- Always verify coverage is active and renewed

2. Written Contracts:

- Clearly define scope of work, responsibilities, and independence.
- Require contractors to indemnify and hold your company harmless.

- This is where your legal counsel comes into play
- Outline insurance requirements and proof obligations.

3. **Periodic Review:**

- Don't just file a COI once and forget it—track renewals and confirm coverage stays in place.
- You can request an updated COI any time you engage a contractor for a separate job.

The Takeaway

Misclassifying employees as contractors can look like a short-term cost savings, but it can also create long-term financial, legal, and insurance headaches. If a worker looks, acts, and works like an employee, they're probably an employee.

When in doubt, treat them as W-2s, or work with independent contractors who can prove their business independence with contracts, COIs, and proper insurance coverage.

Cheaper isn't always cheaper—especially when claims and fines start rolling in.

Ascent Insurance Solutions
(720) 672-9774
info@ascent-insurance.com