



Innovative

MYTH SERIES

**#2 ALL HIGHLY
COMPENSATED
EMPLOYEES
ARE DEFINED BY
SALARY ALONE**

With Innovative You Can

ARE ALL YOUR PLAN PARTICIPANTS CATEGORIZED APPROPRIATELY?

THE PROBLEM:

Innovative's retirement team was hired in early 2018 by a family-owned, multi-generational entertainment company. Its 401(k) plan had narrowly passed its 2017 ADP (Actual Deferral Percentage) testing, one of the annual non-discriminatory tests to retain qualified status with the IRS. Due to concerns over the previous year's test, Innovative requested a mid-year test for 2018. We found three employees who were members of the owner's immediate family that had been classified as non-highly compensated employees based solely on their salaries. However, the IRS categorized immediate family members as highly compensated employees, even if they do not meet the other requirements (\$125,000 in salary or own at least 5% of the company).

THE SOLUTION:

Once the three employees were reclassified, the client passed the ADP test for 2018. We also reran the 2016 and 2017 tests using the correct classifications, and the client updated their files with those results. If they are audited in the future, this documentation demonstrates the company already found and corrected the issue. Correcting the classification also helped the client avoid potential fines and closer auditor scrutiny. They also avoided the possible need to refund some contributions to highly compensated participants, who are then fully taxed on those amounts.

IRS rules governing qualified plans can present many challenges to plan sponsors and administrators.

Contact Innovative today for a free, no obligation review of your plan.

FAST FACTS

- Client is in the entertainment industry
- Plan type 401(k)
- 200+ employees

HOW WE HELPED THE CLIENT



Corrected misclassification of three family members.



Avoided future plan test failure and potential fines for misclassified employees.



Prevented need to refund contributions to highly compensated employees.



Educated plan committee and management on classification rules.



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