Untaxingly Yours

Code Sec. 529A UnABLE to Serve America's Most Deserving

By Brian T. Whitlock

The Stephen Beck Jr. Achieving a Better Life Experience Act of 2014 (the ABLE Act) was enacted on December 19, 2014. The ABLE Act added new Code Sec. 529A which provides for a tax-advantaged savings program, the "qualified ABLE program," to help in meeting the financial needs of blind and disabled individuals and of families raising children with disabilities.

Millions of individuals with disabilities and their families depend on a wide variety of public benefits for income, health care, food and housing assistance. Eligibility for these public benefits [*i.e.*, Supplemental Security Income (SSI), Social Security Disability Income (SSDI), Supplemental Nutrition Assistance Program (SNAP), and Medicaid] require meeting a means or financial resource test that limits eligibility for individuals that report more than $2,000 in cash savings, retirement funds and other assets of significant value. To remain eligible for these public benefits, an individual typically must "spend down" the value of any such assets held in excess of $2,000.

Qualified Disability Expenses

The ABLE Act recognizes that there are frequently significant costs of living associated with a disability that are not covered under public benefit programs. Under the ABLE Act, an account may be created for the benefit of the disabled person and funds may be accumulated in the account to pay for some of the extra costs without impacting the family's eligibility for public benefits. These "Qualified Disability Expenses" which are related to raising a child with significant disabilities or a working-age adult with disabilities, include "education, housing, transportation, employment training and support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses approved by the Secretary of Treasury" under future regulations.[1] These expenses are generally not covered by insurance, Medicaid or Medicare.

BRIAN T. WHITLOCK, CPA, J.D., LL.M., is an Adjunct Member of the faculty in the Gies College of Business at the University of Illinois at Urbana-Champaign.

Protected Savings

The ABLE Act permits the disabled individual, possessing limited assets, or capable of working in some fashion, to save their assets and accumulate balances above the $2,000 "spend down" limit. It also encourages family members to assist the

disabled person by encouraging them to deposit funds into the same account. Under the ABLE Act, only one account may be created for each beneficiary. The account balance is protected from the "spend down" requirements, and it is permitted to grow income tax-free, so long as the proceeds are limited to paying "Qualified Disability Expenses." Additionally, some States will also exempt the income of ABLE Accounts from State Income tax.

State Contribution Limitations

Similar to the Code Sec. 529 College Savings Plan, the Code Sec. 529A "qualified ABLE program" must be established and maintained by a State or state agency. The total annual contributions by all participating individuals, including family and friends, for a single tax year is equal to the gift tax annual exclusion under Code Sec. 2503(b) which is adjusted for inflation and currently stands at $15,000 per calendar year. The total limit that can be contributed over time to an ABLE account is subject to the guidelines established by each individual state and is typically tied to the limit for similar state-sponsored education-related 529 savings accounts. Many states have set this limit at more than $300,000 per plan.

The most significant downside to accumulating a large balance in a Code Sec. 529A account is that when the qualified beneficiary dies, the State may seek reimbursement from the account for any benefits paid to the disabled person during his/her lifetime.

The ABLE Act originally required beneficiaries to reside in the same state that served as the sponsor of the qualified ABLE account. This requirement was removed in 2015, and now qualified persons are permitted to open a qualified ABLE account in any state that offers the program. As of February 15, 2018, 33 states had adopted qualified ABLE programs.[2]

Federal Account Balance Limitations

The ABLE Act sets limitations on the account balances that individuals with disabilities who are recipients of SSI are permitted to maintain. The first $100,000 in an ABLE account would be exempted from the SSI $2,000 individual resource limit. If and when an ABLE account exceeds $100,000, the beneficiary's SSI cash benefits would be suspended until such time as the account falls back below $100,000. It is important to note that while the beneficiary's eligibility for the SSI cash benefits is suspended, this has no effect on the individual's ability to receive or be eligible to receive medical assistance through Medicaid.

Post Death Account Balances

The most significant downside to accumulating a large balance in a Code Sec. 529A account is that when the qualified beneficiary dies, the State may seek reimbursement from the account for any benefits paid to the disabled person during his/her lifetime. In reality, the entire account balance will likely be paidback to the State at the time of the beneficiary's death.

Definition of Qualified Beneficiaries Is Narrow

The ABLE Act limits the definition of Qualified Beneficiaries to persons that were disabled prior to reaching age 26. While this definition meets a large segment of children that are born with Downs Syndrome, Severe Autism, and other conditions that would manifest themselves at a young age, the definition excludes millions of other equally deserving Americans.

"One in five adults living in the US have a disability and over 22 million families nationwide have a member with a disability. Disability cuts across race, gender, ethnicity, age and geography. Whether occurring at birth or acquired later in life, individuals with disabilities are three times more likely than their non-disabled peers to live at or below the poverty line, twice as likely to be unemployed and seven times more likely to have a majority of their total income to be from public assistance sources."[3] It is sad that the statutory definition of disability does not include people suffering traumatic brain injuries suffered by adults over the age of 26, members of our Armed Services injured or suffering from Post-Traumatic Stress Disorder (PTSD) or athletes where brain injuries do not manifest themselves until many years after the initial injury may have occurred.

The Tax Cut and Jobs Act Adds Incentives

The Tax Cut and Jobs Act (TCJA) attempts to create a couple of additional incentives. First, the TCJA gives the

disabled person a Savers Credit (Code Sec. 25B) for funds that they personally add to their own ABLE account. Secondly, the $15,000 annual contribution limitation, referred to above, would be increased temporarily by the lesser of the Federal poverty line for a one-person household (roughly $12,000) or the disabled person's total compensation earned for the calendar year at issue. Third, the TCJA would permit amounts previously held in Code Sec. 529 College Savings Plan accounts, for the now disabled person, to be rolled-over to a Code Sec. 529A (ABLE) account established for a qualified disabled individual, provided that the beneficiary became blind or disabled prior to having attained age 26.

While each of these changes might appear at first blush to be beneficial, questions remain. First, it is unclear whether the rollover of Code Sec. 529A Account assets would qualify for the Savers Credit, since the roll-over provision is limited to $15,000 annual contribution limit. For low-income taxpayers (*i.e.*, with income under $18,500) the Savers Credit could be as much as $1,000 on a contribution of $2,000 or more. The amount of the Savers Credit decreases as the income of the disabled person increases. Second, the limitation on tax-free rollovers is far too small to be meaningful. Since the roll-over funds under TCJA would be counted as part of the overall limitation on amounts that can be contributed to an ABLE account within a single calendar year (*i.e.*, $15,000 in 2018). Amounts in excess of annual limitation would be includable in the income of the disabled person.

Finally, when compared to other alternatives, a Code Sec. 529 College Savings Account rollover to the disabled person is ill-advised. Better rollover options exist within Code Sec. 529 itself. Where funds are held in a Code Sec. 529A Account for the benefit of the disabled person, the family would be better served to change the beneficiary on the Code Sec. 529 Account, as currently permitted under the rules applicable to Code Sec. 529, and name another member of the family (a sibling, child, parent, or cousin) as the beneficiary of the Code Sec. 529 College Savings Plan rather than put these assets into an ABLE Account that might ultimately be paid to the State upon the death of the disabled.

Code Sec. 529A UnABLE to Impress

ABLE Accounts can offer a meaningful benefit to qualified individuals that are among the working poor. Disabled individuals frequently hold minimum wage jobs that nevertheless permit them the ability to participate in the world in a manner that promotes self-esteem. To the extent that their savings can be protected to defray Qualified Disability Expenses then ABLE Accounts can serve a purpose, by helping to improve health, independence and/or the quality of life.

Nevertheless, Congress continues to miss the mark with Code Sec. 529A ABLE Accounts. Congress has failed to expand the usage of Code Sec. 529A Accounts to all disabled persons regardless of age. The most notable omission is the most obvious, ABLE ignores the men and women who have served in the Armed Forces and who have suffered injuries that result in disability. Thousands of America's most valiant and brave have succumbed to disabilities after age 26 as a result of traumatic brain injuries, PTSD, and exposure to chemical weapons. Our veterans comprise a group that is easy to identify in a statute and they are certainly deserving of aid.

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Better Options Are Available to Clients of Tax Professionals

Families of disabled individuals, that can afford the advice of tax professionals, have a number of better options that are available them. OBRA Payback Trusts, Pooled Payback Trusts, and Supplemental Needs Trusts (SNTs) offer families far greater coverage and flexibility than the Code Sec. 529A ABLE Account.

OBRA Payback Trusts

Where a disabled person receives litigation proceeds, inherits assets outright or otherwise owns significant assets, prior to the beneficiary having attained age 65, family members can create a private Special Needs Trust (or sometimes referred to as an OBRA Payback Trust). The passage of the Omnibus Budget Reconciliation Act (OBRA) of 1993 lead to the creation of OBRA Payback Trusts. Using the disabled person's own assets as the source of funding, the OBRA Payback Trust permits the person to receive government benefits. Similar to Code Sec. 529A ABLE Account, the assets remaining in the trust at the time of the beneficiary's death must be used to repay the government for any benefits that were advanced during the disabled person's lifetime. A significant difference is

that OBRA Trusts can cover not only Qualified Disability Expenses referred to in the ABLE Act, but the OBRA Trust can also be used to provide for a broad array of activities that enhance the beneficiary's life and their day to day experience.[4] Payments made in the form of in-kind distributions for food or shelter are considered "unearned income" and will generally reduce SSI payments by a maximum of one-third.[5] Payments for goods and services other than food and shelter will not reduce SSI benefits.[6]

Since OBRA Trusts are funded with the disabled persons' assets, these trusts for Fiduciary Income Tax purposes are treated as Grantor Type Trusts under Code Sec. 677, and all of the income earned on the OBRA Trust account is taxable to the disabled person whether or not the income is in fact distributed.

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Pooled Payback Trusts

Where the intended beneficiary has already attained 65 years of age, a private OBRA Payback Trust is no longer available. For individuals over age 65 a Pooled Payback Trust may be created through a trust company or a not for profit organization offering a pooled plan. Pooled trusts require the contributed assets to be liquidated and invested under the management of the institutional trustee. The master trust holds the assets of many different individuals, each in a separate account. Similar to a bank account, the beneficiary's pooled fund account is tracked separately by the institutional trustee. The account is increased by its proportionate share of the pool's earnings and decreased by specific expenditures made for the benefit of the individual. If the account is funded with the individual's personal assets, then the account is taxed under the Grantor Trust rules, and a separate Grantor information letter is generated for each beneficiary. If an account, created for the beneficiary, is funded with gifts from family members (*i.e.*, third parties), then the Complex Trust rules under Code Sec. 641 apply to those accounts, and they are reported on a single fiduciary tax return under the separate share trust accounting rules. It is possible for a beneficiary to have a self-funded account and a third-party account in the same master trust. Accounts funded with the individual's personal assets must be used to payback the State for that individual's benefits. Accounts funded with third-party assets will generally pass to the not-for-profit sponsoring the pooled trust fund or be used to benefit other participants generally.

Supplemental Needs Trusts

Where a disabled person does not possess funds outright, but family members wish to make future gifts (either during lifetime or death) that will not be subject to the payback rules and will also not cause the loss of government benefits, then the family can create a SNT. An SNT is not confined by any statutory definition of disability set forth in the ABLE Act, and thus it may cover a beneficiary of any age that is receiving government benefits. An SNT is a fully discretionary trust, meaning the trustee is not obligated to provide for the beneficiary's support or maintenance. Instead, the trust is designed to provide for supplemental expenses not covered by any government assistance program, similar to the broad array of expenses covered by the OBRA Trust.

The primary advantage of the SNT over the OBRA Trust is that the remaining balance of the SNT after the death of the disabled beneficiary may pass to anyone, including siblings, nieces, nephews and descendants of the disabled person.

The SNT agreement should provide that no distribution should be made to, or for the benefit of the beneficiary if a governmental benefit, program or other resource can fully satisfy the need, or if the manner of the distribution would adversely affect the beneficiary's eligibility for such programs. Where government benefits fall short, the SNT may make up the difference. However, as mentioned above any payments made from the SNT in the form of in-kind distributions for food or shelter are considered "unearned income" and will generally reduce SSI payments.

SSI rules on SNTs can be found in the Social Security Program Operations Manual System (POMS).[7] The POMS provides that the SNT may own and maintain a home, where the beneficiary resides, without the associated costs acting to reduce SSI Benefits.[8]

CAVEAT: An SNT may only be created for the benefit of a spouse when it is created under the terms of the Grantor's Will (and not pursuant to a Will substitute such as a Revocable Living Trust).[9]

The SNT is treated as a Complex Trust, under Code Sec. 641, for fiduciary income tax purposes. As a Complex Trust, the beneficiary must generally include the trust's

Distributable Net Income (DNI) in his or her income to the extent that he or she receives distributions from the trust. DNI that is not distributed is taxed inside of the trust at fiduciary income tax rates. An SNT may also qualify as a "qualified disability trust" under Code Sec. 642(b)(2)(ii) and be entitled to a deduction equal to the exemption that a single taxpayer could claim under Code Sec. 151(d).[10]

Summary

The National Disability Institute should be applauded for its efforts in lobbying for the creation of Code Sec. 529A ABLE Accounts. The ABLE Act, as modified over the years, has embraced many of the points espoused in the National Disability Institute's White Paper to the White House in 2009, but it continues to disappoint. For reasons that are unclear to this author, neither the 111th Congress, nor subsequent legislators have seen fit to provide a comprehensive solution in the form of a 529A ABLE Account that is available not merely to those that were diagnosed with a disability prior to age 26, but to all disabled persons regardless of age. To repeat the quote from the National Institute White Paper "Disability cuts across race, gender, ethnicity, age and geography."[11] Why then does Congress choose to limit this Statute, especially to the apparent exclusion of our veterans?

ENDNOTES

1 Code Sec. 529(e)(5).

2 What Can the White House Do to Have Real Economic Impact for Americans with Disabilities? (National Disability Institute White Paper, June 19, 2009).

3 Alabama, Alaska, Colorado, District of Columbia, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, and West Virginia (ABLE National Resource Center website *www.info@ablenrc.org*, Feb. 14, 2018).

4 Permissible "routine" expenditures that should not affect a beneficiary's means-tested government benefits, include: reasonable compensation for the SNT Trustee, investment manager, attorney, and accountant; reasonable compensation of care providers, including family members in limited circumstances; medical services and equipment not covered by government programs; domestic and personal care services (*e.g.*, housekeeper, grooming and cook); prepaid funeral and burial arrangements, computer or augmentative communication devices, and Internet services; television, cable TV service, and other electronic equipment; apparel; membership in fitness or recreational clubs, cultural institutions; academic or recreational classes; dry cleaning and laundry services; home security alarm and monitoring services, yard service and maintenance; home and liability insurance, linens, towels and bedding, personal care supplies, non-food groceries and sundries, music lessons and cost of instruments, over the counter medications; pets and pet services, supplies and veterinary services, sporting goods and equipment; stationery and stamps; cell phone service and equipment; tickets to cultural or sporting events; transportation costs; vacation for beneficiary and one attendant; and such expenditures as the trustee deems appropriate under all circumstances for the sole benefit of the beneficiary. Special thanks to Patricia E. Kefelas Dudek, Esq. of Farmington Hills, Michigan for her excellent materials presented as part of an American Bar Association Panel Discussion on Special Needs Trusts.

5 The Social Security Act, 42 USC §1382(a)(2)(A); 20 CFR §416.1130(b).

6 *Id*.

7 "Trusts – General, Including Trusts established prior to 1/1/00, Trusts Established with the Assets of Third Parties and Trusts Not Subject to Section 1613(e) of the Social Security Act," Social Security Program Operations Manual System at SI 01120.200. The POMS is a primary source of information used by Social Security employees to process claims for Social Security benefits. It can be found online at *https://secure.ssa.gov/poms.nsf/home?readform*.

8 *Id*., SI 001120.200F.1.

9 The Social Security Act, 42 USC §1382(b)(e); 20 CFR §416.

10 The Tax Cut and Jobs Act of 2017 repeals personal exemptions previously available to taxpayers under Code Sec. 151 for calendar years beginning after December 31, 2017; however, the Act also amended Code Sec. 642(b)(2)(C)(iii)(I) in order to specifically grant Qualified Disability Trusts an exemption of $4,150 (adjusted for inflation) for any tax year in which the exemption amount under Code Sec. 151(d) is zero.

11 What Can the White House Do to Have Real Economic Impact for Americans with Disabilities? (National Disability Institute White Paper, June 19, 2009).

