EMPLOYEE BENEFITS

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Services

Employee Benefits and Executive Compensation

College Savings and ABLE Plans

IRS Issues Final Regulations for ABLE Programs

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In December 2014 Congress passed The Stephen Beck, Jr. Achieving a Better Life Experience ("ABLE") Act to address some of the financial burdens unique to disabled individuals and their families. The Act created tax-advantaged savings accounts that certain disabled individuals can use to pay for qualifying disability expenses. What sets ABLE accounts apart from other savings vehicles is that assets may be excluded from certain means-tested federal benefit programs, such as Medicaid and Supplemental Security Income.

In June 2015 the Internal Revenue Service ("IRS") released proposed regulations under Code Section 529A. Since then, Congress amended Section 529A through various legislation—namely, the PATH Act and the Tax Cuts and Jobs Act—and issued a second set of proposed regulations in 2019. The final regulations issued by the IRS last week incorporate these amendments and respond to public comments. We summarize the major changes in the final ABLE regulations below.

- Establishing an ABLE account. The 2015 proposed regulations provided that an ABLE account may be established on behalf of an eligible individual by his or her agent under a power of attorney or, if none, by the eligible individual's parent or legal guardian. The final regulations greatly expand the number of persons who may establish an ABLE account and, because an eligible individual is only permitted to have one ABLE account, imposes a hierarchy on those persons. The hierarchy consists of: the person selected by the eligible individual or the eligible individual's agent under a power of attorney; conservator or legal guardian; spouse; parent; sibling; grandparent; or a representative payee appointed by the Social Security Administration. ABLE programs can accept a person's certification (under penalty of perjury) that he or she is authorized to establish the ABLE account for the benefit of the eligible individual and that there is no other person with higher priority willing and able to do so.

- Signature authority. Similar to who may establish an ABLE account, the 2015 proposed regulations provided that if an eligible individual is unable to, or chooses not to, exercise signature authority over their account, signature authority may be exercised by an agent under a power of attorney or, if none, by the eligible individual's parent or legal guardian. The final regulations expand the persons who may exercise signature authority over an account to the same persons listed above. The hierarchy is also the same. In addition, the final regulations allow an account owner with legal capacity to remove and replace the person(s) with signature authority, and to name a successor signatory. If an account owner lacks legal capacity, a person with signature authority may name a successor signatory. Co-signatories are also permissible.

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- Residency requirement. Code Section 529A originally required that an eligible individual reside in the state sponsoring the ABLE program. The PATH Act eliminated this requirement. The final regulations eliminate all references to a residency requirement.

    - Additional ABLE accounts. Due to the removal of the residency requirement, the IRS recognizes there is an increased risk that an eligible individual may open an additional account through a different ABLE program (and thereby put their eligibility for government benefits at risk). The final regulations provide that, if an additional account is opened for an eligible individual, the additional account will be treated as an ABLE account if either: (i) all contributions made to the additional account are returned to the contributor(s) as though they were excess contributions; or (ii) the additional account is transferred into the individual's preexisting ABLE account (and any excess contributions are returned to the contributor(s)). Action must be taken on or before the eligible individual's federal tax return due date (including extensions) for the year in which the additional account was established.

- Establishing eligibility. In order to establish an ABLE account, an individual must provide evidence that he or she meets the definition of an "eligible individual." This can be done two ways. The first is a certification by the person establishing the ABLE account that the account owner is eligible for benefits under title II or XVI of the Social Security Act and that the blindness or disability that qualified the account owner for those benefits occurred on or before he or she attained age 26. The second is by obtaining a disability certification and a copy of a physician's diagnosis and submitting these materials to the ABLE program.[1]

  The final regulations add a safe harbor provision to the certification process. The safe harbor provides that an ABLE program may establish eligibility if the individual (or the person establishing the individual's account) certifies under penalties of perjury: (i) the basis for the individual's status as an eligible individual under Treasury Regulations Section 1.529A-1(b)(8); (ii) that the individual is blind or has a medically determinable physical or mental impairment as described in the final regulations; (iii) that such blindness or disability occurred before the individual attained age 26; (iv) if the basis of the individual's eligibility is a disability certification, that the individual has obtained and will retain a copy of the written diagnosis relating to the disability, the name and address of the diagnosing physician and the date of the diagnosis; (v) that the individual has provided the applicable diagnostic code from Form 5498-QA; (vi) that the person establishing the account is the account owner or an authorized person; and (vi) if required by the ABLE program, that the individual has provided the information from a physician that is necessary to determine the appropriate frequency of required recertifications.

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1 | IRS Notice 2015-81 established that a certification that an individual has a signed physician's diagnosis and that the signed diagnosis will be retained and provided to the ABLE program or the IRS upon request is sufficient to satisfy the disability certification filing requirements.

- Change in eligible status. The 2015 proposed regulations provided that if an account owner is no longer an "eligible individual," no contributions may be made to their ABLE account starting the year immediately following the year in which the account owner lost eligibility. Beginning that same year, the account owner can no longer incur "qualified disability expenses." The final regulations affirm these rules and add that at any time an account owner does not qualify as an eligible individual—including the remaining portion of the year after losing eligibility—no expense can constitute a qualified disability expense. In the event an account owner loses eligibility, the ABLE account account remains an ABLE account and all tax provisions continue to apply to that account, except with regard to distributions (i.e., the earning portion of any distribution will be includable in the account owner's income).

- Sub-accounts. The final regulations permit (but do not require) an ABLE program to establish sub-accounts within an account owner's single account. Sub-accounts may be authorized by either the account owner or a person with signature authority over the account, and different signatories may be authorized to take distributions from different sub-accounts. Sub-accounts must be aggregated for all program purposes, including calculating contribution limits.

- Qualified disability expenses. The final regulations continue to utilize an expansive definition of qualified disability expenses. However, they no longer require an ABLE program to identify distributions made from accounts for housing expenses. Account owners remain responsible for determining whether a distribution is for a qualified disability expense and maintaining supporting documentation for each tax year.

    - Grace period for distributions. The 2015 proposed regulations provide that if distributions do not exceed an account owner's qualified disability expenses for the year, no amount is includible in the account owner's gross income. However, an account owner could take a distribution for an expense incurred at the end of one year and pay it in the next year. To avoid such timing issues, the final regulations create a grace period that allows account owners to treat qualified disability expenses paid by the 60th day immediately following the end of the tax year as if they had been paid in the immediately preceding tax year.

    - Earnings ratio of distributions. The 2015 proposed regulations defined the earnings ratio as the amount of earnings attributable to an account as of the last day of the calendar year, divided by the total account balance on that same date, after taking into account all contributions and distributions made during that year. The final regulations redefine the earnings ratio as the amount of earnings attributable to an account as of the date of the distribution, divided by the total account balance on that date. This change brings the ABLE earnings ratio calculation in line with college savings plan rules, and using the date of distribution rather than the year-end total does not change the income tax impact on the account owner.

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- Account transfers and gift tax consequences. Code Section 529A(c)(2) generally treats funds deposited into an ABLE account as taxable gifts, unless there is a change of beneficiary and the new beneficiary is a sibling of the former beneficiary. The 2015 proposed regulations stated that notwithstanding Code Section 529A(c)(2)(C), if an ABLE account owner transfers money in their account to any other person, including a sibling, the account owner is a donor for gift tax purposes and the transferor for generation-skipping transfer ("GST") tax purposes. The final regulations instead treat transfers of ABLE account funds as a completed gift by the account owner, unless the new beneficiary is the account owner's sibling. This makes it unnecessary for ABLE programs to separately track contributions made by account owners.

    - Change in designated beneficiary. The 2015 proposed regulations allow an ABLE program to permit a change in account ownership, but only during the lifetime of the designated beneficiary and only if the successor beneficiary is an eligible individual. There may be gift or GST tax consequences associated with a change in beneficiary when the new beneficiary is not a sibling of the current beneficiary. While the final regulations do not restrict changes in account ownership to beneficiaries' siblings, they do permit ABLE programs to impose such a limitation.

    - Successor beneficiary. The final regulations also allow ABLE programs to permit a successor designated beneficiary to be named during the lifetime of the current beneficiary. The designation will take effect upon the beneficiary's death. If no successor is named, assets in the ABLE account are payable to the deceased beneficiary's estate.

If you have questions regarding the final ABLE program regulations, please contact a member of the Kutak Rock **Employee Benefits Practice Group**.

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