RIA Special Study: Achieving a Better Life Experience Act of 2014 Includes New "ABLE" Accounts for Disabled & Non-Extender Provisions

New Tax-advantaged ABLE Accounts

Under pre-Act law, there wasn't a tax-advantaged savings program specifically targeted to persons with disabilities, that was similar, for example, to a qualified tuition program (QTP, or 529 plan). A QTP provides taxpayer favorable rules for paying qualified higher education expenses. Under a QTP, a person can make nondeductible cash contributions on behalf of a designated beneficiary to an account established by a state. The earnings on the contributions build up tax-free, and distributions from the QTP are excludable to the extent used to pay qualified higher education expenses. A 10% additional tax is imposed on distributions that are includible in gross income. But the contributor can do either of the following without tax consequences: a) change the beneficiary to be a member of the prior beneficiary's family, or b) roll over amounts from one QTP to another for the same beneficiary or for a beneficiary who is a member of the prior beneficiary's family.

A "qualified disability trust"-a disability trust described in Sec. 1917(c)(2)(B)(iv) of the Social Security Act, all the beneficiaries of which are determined to be disabled (within the meaning of Sec. 1614(a)(3) of the Social Security Act)-may be used to provide financial assistance to a disabled person (the trust beneficiary) without disqualifying the beneficiary for certain government benefits. Amounts distributed to a child who is a beneficiary of a qualified disability trust are treated as earned income for purposes of the "kiddie" tax and so aren't taxed at parents' tax rates.

New law. For tax years beginning after Dec. 31, 2014, TIPA allows states to establish tax-exempt "Achieving a Better Life Experience" (ABLE) accounts to assist persons with disabilities in building an account to pay for qualified disability expenses. Similar to a QTP, a tax exemption would be allowed for an ABLE program; amounts in an ABLE account would accumulate on a tax-exempt (or, in some cases, tax-deferred) basis.

General rules on taxation of the ABLE program. A qualified ABLE account is generally exempt from income tax but is subject to the tax imposed by **Code Sec. 511** on the unrelated business income of tax-exempt organizations. A "qualified ABLE program" (see below) is subject to the excise tax on non-plan tax-exempt entities that are parties to prohibited tax shelter transactions and subsequently listed transactions. Any person may make contributions to an ABLE account. (Summary of H.R. 647) Contributions to an ABLE account aren't deductible for income tax purposes.

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Qualified ABLE program defined. A qualified ABLE program is a program established and maintained by a state or state agency or instrumentality that:

. . . (a) provides that non-cash contributions and contributions that exceed the annual contribution limit won't be accepted. (Non-cash contributions won't violate this rule if they are returned before the return due date). Except in the case of a rollover contribution from another account, an ABLE program must limit the aggregate contributions from all contributors for a tax year to the amount of the annual **Code Sec. 2503(b)** gift tax exclusion for that tax year ($14,000 for 2015, adjusted annually for inflation). A 6% excise tax is imposed on excess contributions to an ABLE account;
. . . (b) provides separate accounting for each designated beneficiary;
. . . (c) limits the designated beneficiary's investment direction to no more than two times in a calendar year;
. . . (d) prohibits the use of any interest or any portion of an interest in the program as security for a loan; and
. . . (e) provides adequate safeguards to prevent excess aggregate contributions.

RIA observation: Contributions to a QTP, which are also required to be made in cash, may be made by check, money order, credit card, electronic funds transfer, payroll deductions, or automatic deductions from a bank account. Presumably, the same rules will apply to ABLE accounts.

The program must limit a designated beneficiary to one ABLE account. If an ABLE account is established for a designated beneficiary, no account later established for that beneficiary is treated as an ABLE account.

Who can be a beneficiary of an ABLE account. The program must allow an ABLE account to be established only for a beneficiary who is a resident of either the state that maintains the program (a "program state") or of a contracting state that hasn't established an ABLE program but has entered into a contract with a program state to provide the contracting state's residents with access to the program state's ABLE program.

The designated beneficiary of an ABLE account is an eligible individual who established the account and is its owner. An individual is an eligible individual for a tax year if, during that tax year:

. . . the individual is entitled to benefits based on blindness or disability under the Social Security disability insurance program (title II of the Social Security Act) or the SSI program (title XVI of the Social Security Act), and that blindness or disability occurred before the date on which the individual reached age 26, or
. . . a disability certification for the individual has been filed with IRS for the tax year. A disability certification is one made by the eligible individual or his parent or guardian, that certifies that:
(1) the individual has a medically determinable physical or mental impairment, which

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results in marked and severe functional limitations, and that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months, or is blind, within the meaning of Sec. 1614(a)(2) of the Social Security Act , and
(2) that blindness or disability occurred before the date on which the individual attained age 26.

The certification must include a copy of the individual's diagnosis relating to the individual's relevant impairment(s), signed by a licensed physician meeting the criteria of Sec. 1861(r)(1) of the Social Security Act.

Distributions from, and other amounts coming out of, ABLE accounts. No amount of a distribution from an ABLE account is includible in gross income if distributions from the account don't exceed the designated beneficiary's qualified disability expenses. "Qualified disability expenses" are any expenses related to the eligible individual's blindness or disability that are made for the benefit of an eligible individual who is the designated beneficiary. They include:

. . . education,
. . . housing,
. . . transportation,
. . . employment training and support,
. . . assistive technology and personal 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 that are approved under IRS regs and consistent with Code Sec. 529A's purposes.

If the distributions exceed the qualified disability expenses, then the amount otherwise includible in gross income is reduced by an amount that bears the same ratio to the distributed amount as the qualified disability expenses bear to that amount.

Distributions from a qualified ABLE program are includible in the distributee's gross income under the **Code Sec. 72** annuity rules to the extent not excluded from gross income under any other income tax provision.

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A taxpayer who receives a distribution from a qualified ABLE program that's includible in gross income is subject to an additional 10% tax on the includible part. An exception to this rule applies to the distribution of certain contributions made during the tax year on the designated beneficiary's behalf.

A payment or distribution from an ABLE account isn't taxable to the extent that the amount received is paid, no later than the 60th day after the date of the payment or distribution, into another ABLE account for the benefit of the designated beneficiary or an eligible individual who's a family member of the designated beneficiary.

A change in the designated beneficiary of an interest in a qualified ABLE program during a tax year isn't treated as a taxable distribution if the new beneficiary is both an eligible individual for the tax year and a member of the family of the former beneficiary.

Upon the death of an eligible individual, any amounts remaining in the account (after Medicaid reimbursements) would go to the deceased's estate or to a designated beneficiary and would be subject to income tax on investment earnings, but not to the 10% penalty.

Except for SSI, ABLE Accounts Disregarded for Federal Means-Tested Programs

Federal means-tested programs typically include income and resource limits that are designed to target benefits to individuals with limited income and other financial resources. These limits vary from program to program or, for state-administered programs such as Medicaid, from state to state. For example, the supplemental security income (SSI) program, which is federally-administered, has a $2,000 resource limit for individuals. In most states, SSI receipt confers Medicaid eligibility. When SSI recipients have income and resources over the limit, their SSI benefits are suspended but they remain eligible for Medicaid.

New law. Amounts in an individual's qualified ABLE account (including earnings), contributions to the individual's account, and distributions to pay qualified disability expenses are disregarded for purposes of determining an individual's eligibility for, or the amount of, any assistance or benefit authorized by any federal means-tested program. This rule overrides any other federal law that requires those amounts to be taken into account.

However, in the case of the SSI program, distributions from an ABLE account for housing expenses are considered income; and amounts (including earnings) in an ABLE account in excess of $100,000 are considered a resource of the designated beneficiary. (Act Sec. 103(a) Div B) The SSI benefits of an individual who has excess resources because the individual's ABLE account balance exceeds $100,000 aren't terminated. Instead, the benefits are suspended (Act Sec. 103(b)(1) Div B) until the individual's balance falls below $100,000.

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(Committee Report) The suspension of SSI benefits doesn't apply for purposes of Medicaid eligibility.

> **RIA observation:** 32 states and the District of Columbia provide that anyone who is eligible for SSI benefits is also eligible for Medicaid. In those states, an individual would remain eligible for Medicaid during any period where his ABLE account balance exceeded $100,000 and thus his SSI benefits were suspended.

For purposes of determining SSI eligibility, states must submit to the Commissioner of Social Security, in the manner specified by the Commissioner, monthly electronic statements on relevant distributions and account balances from all ABLE accounts. This requirement is effective for tax years beginning after Dec. 31, 2014.

Some ABLE Accounts Get Bankruptcy Exemption

New law. Property of a bankruptcy estate doesn't include funds placed in an ABLE account no later than 365 days before the filing date of the bankruptcy petition. but only if the designated beneficiary of the account was the debtor's child, stepchild, grandchild, or step-grandchild for the tax year for which funds were placed in the account.

And, the exclusion is limited to $6,225 for funds placed in all ABLE accounts having the same designated beneficiary no earlier than 720 days nor later than 365 days before the filing date.

Other rules limit this exemption; one such rule provides that no exemption is provided for contributions in excess of the annual contribution limit, which, as discussed under "Qualified ABLE program defined," above, is equal to the annual gift tax exclusion amount.

These provisions apply to bankruptcy cases begun under title 11 of the U.S. Code on or after the date of enactment.

Other Non-extender Tax Provisions

In addition to its ABLE account provisions, Division B of the Act contains the following non-extender provisions, all but the first of which are considered to be revenue offsets:

Investment direction rule for 529 plans. The Code provides that a program isn't treated as a QTP unless it provides that any contributor to, or designated beneficiary under, the program may not directly or indirectly direct the investment of any contributions to the program (or any earnings on the contributions). However, in **Notice 2001-55, 2001-39 IRB 299** , as modified by **Notice 2009-1, 2009-2 IRB 250** , IRS announced that it expects that final regs will provide that a program won't violate the above no-investment-direction rule if it allows a change in the

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investment strategy once per calendar year and/or upon a change in the designated beneficiary of the account.

New law. For tax years that begin after Dec. 31, 2014, the Act allows Code Sec. 529 QTPs to permit investment direction by an account contributor or designated beneficiary up to two times per year.

Inland Waterways Trust Fund financing rate. Subject to various exemptions, the inland waterways fuel tax is imposed on any liquid used during any calendar quarter by any person as a fuel in a vessel in commercial waterway transportation. The tax consists of two components, one of which is the 20¢ per gallon inland waterways trust fund financing rate.

New law. For fuel used after Mar. 31, 2015, the Act increases this financing rate to 29¢ per gallon.

Certified professional employer organizations. Under current law, when a business contracts with a professional employer organization (PEO) to administer its payroll functions, the business customer remains responsible for all withholding taxes with respect to its employees. Thus, even though the PEO pays the employees, the customer remains liable if the PEO fails to withhold or remit the taxes or otherwise comply with related reporting requirements.

New law. For wages paid by a certified PEO for services performed by an employee on or after January 1 of the first calendar year beginning more than 12 months after enactment (presumably, Jan. 1, 2016), the Act authorizes IRS to certify qualifying PEOs, which would allow the PEO to become solely responsible for the customer's employment taxes. To be certified by IRS, a PEO has to satisfy various requirements-such as reporting obligations, posting a bond in case the PEO fails to satisfy its employment tax withholding and payment obligations, and submitting audited financial statements-intended to ensure that the PEO properly remits wages and employment taxes. The PEO is also subject to an annual fee of $1,000. (Act Sec. 206 Div B) IRS would be required to establish the PEO certification program not later than six months before this effective date (presumably, by July 1, 2015).

Exclusion of dividends from controlled foreign corporations from the definition of personal holding company income. Under current law, the personal holding company tax, i.e., an additional 20% tax on personal holding company income, applies to the retained passive income of corporations that are majority-owned by five or fewer individuals and more than 60% of whose income consists of certain types of passive income such as dividends, interest, and royalties-including dividends derived from an active trade or business of a foreign.

New law. For tax years ending on or after the date of enactment, the Act excludes dividends received from a foreign subsidiary from personal holding company income, though the dividends would remain subject to corporate income tax.

Inflation adjustment for certain civil penalties. Tax penalties generally do not contain inflation-adjustment provisions. Exceptions to this general rule apply under **Code Sec. 6721(f)** (failure to file correct information returns) and **Code Sec. 6722(f)** (failure to furnish correct payee statements), for which an inflation adjustment applies every five years.

New law. For returns required to be filed after Dec. 31, 2014, the Act indexes for inflation each calendar year the fixed-dollar civil tax penalties under current law for: (1) failure to file a tax return or to pay tax (**Code Sec. 6651**); (2) failure to file certain information returns, registration statements, and certain other statements (**Code Sec. 6652**); (3) failure of a paid preparer to meet certain obligations (**Code Sec. 6695**); (4) failure of a partnership or an S corporation to file a return; and (5) failure to file correct information returns and payee statements.

Increase in continuous levy. The effect of a levy on "specified payments" payable to or received by a taxpayer is continuous from the date the levy is first made until the levy is released, if the levy is approved by IRS. Specified payments include certain government payments and certain amounts otherwise exempt from levy. With exceptions not relevant here, this continuous levy attaches to up to 15% of any specified payment due to the taxpayer.

New law. For payments made after 180 days after the date of enactment, IRS is authorized to continuously levy up to 30% of specified payments to a Medicare provider.

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