New Able Accounts for the Disabled

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The Achieving a Better Life Experience (ABLE) Act of 2014 authorizes states to establish tax-exempt ABLE accounts to help people with disabilities build an account to pay for qualified disability expenses. Michigan has enacted legislation authorizing ABLE accounts to be established beginning January 1, 2016, although it may still take some time for Michigan to get its program up and running.

Similar to a Qualified Tuition Program or Section 529 plan, a tax exemption is allowed for an ABLE program. The amounts in an ABLE account accumulate on a tax-exempt (or, in some cases, tax-deferred) basis. ABLE programs established and maintained by a state or an agency or instrumentality of a state would have to meet the following conditions:

a. Under the program, a person may make contributions for a tax year to an ABLE account established for the purpose of meeting the “qualified disability expenses” of the designated beneficiary of the account.

b. The program must limit a designated beneficiary to one ABLE account. If an ABLE account is established for a designated beneficiary, then no account established later for that beneficiary is treated as an ABLE account.
c. Originally, a program could permit 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. However, the Protecting Americans from Tax Hikes Act of 2015, eliminated the residency requirement for qualified ABLE programs.
d. The program must meet the other requirements similar to a Section 529 plan.

An ABLE account’s principal tax advantage is that funds used to pay disability expenses build up tax-free. Although contributions to an ABLE account aren’t deductible, once the money's in the account, all income on it is earned tax-free, and there's no tax on those earnings unless distributions exceed qualified disability expenses. “Qualified disability expenses” means any expenses related to the eligible individual's blindness or disability that are made for the benefit of an eligible individual who's the designated beneficiary.

An ABLE account also has an important non-tax advantage in that the account balance and distributions used to pay qualified disability expenses are disregarded for most federal means-tested programs (although an account balance over $100,000 and distributions to pay for housing are taken into account under SSI). This allows contributions to be made to an ABLE account for a beneficiary without disqualifying the beneficiary for those means-tested benefits.

An individual is eligible to participate in an ABLE account for a tax year if during that tax year:

a. The individual is entitled to benefits based on blindness or disability under the social security disability insurance (SSDI) program or the SSI program, and that blindness or disability occurred before the date on which the individual reached age 26; or
b. A disability certification for the individual has been filed with IRS for the tax year.

A qualified ABLE program must provide that only cash contributions will be accepted. Except for a rollover contribution from another account, a qualified ABLE program must limit the aggregate contributions from all contributors to an ABLE account for a tax year to the amount of the annual gift tax exclusion for that tax year ($14,000 for 2016, adjusted annually for inflation). A 6% excise tax is imposed on excess contributions to an ABLE account. The excess contributions tax doesn't apply if the ABLE account's trustee makes a corrective distribution of the excess amount within the tax year. Each state sets its own aggregate contribution limit. An account that has reached the limit may continue to grow due to investment earnings. But no further contributions are allowed unless the account balance drops below the limit.

If distributions from an ABLE account do not exceed the designated beneficiary's qualified disability expenses, then no amount is includible in gross income. 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.

All amounts remaining in the ABLE account, up to the total medical assistance paid for the designated beneficiary under a state Medicaid plan after the account was established, will be distributed to the state as a creditor (and not a beneficiary) of the ABLE account. The state must file a claim for the payment. The additional 10% tax doesn't apply to distributions to the state or to payments or distributions made to a beneficiary or to the designated beneficiary's estate on or after the designated beneficiary's death.