

AN INTRODUCTION TO ABLE ACCOUNTS AND THE NC ABLE PROGRAM

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INTRODUCTION

ABLE accounts, such as those offered by the NC ABLE Program, encourage savings for disability-related expenses, while preserving Supplemental Security Income (SSI) and Medicaid benefits and providing tax-free investment earnings.

Federal legislation

The Federal “Achieving a Better Life Experience Act of 2014”¹ (Federal ABLE Act) authorized states and the District of Columbia to establish ABLE programs, and 38 states and the District of Columbia have launched ABLE programs, with additional state programs in development. The tax provisions of qualified ABLE programs are codified in Section 529A of the Internal Revenue Code (IRC).² There is no Federal certification program. States are permitted, though not required, to enroll participants³ who are residents of other states.⁴ The Tax Cuts and Jobs Act,⁵ enacted in December 2017, amended the Federal ABLE Act by increasing the contribution limit for working participants, permitting rollovers from IRC § 529 college savings accounts to ABLE accounts, and making participants’ contributions eligible for the Saver’s Credit.

Federal regulations and guidance

There are no final Federal regulations for ABLE programs, although in 2015 the Treasury Department and Internal Revenue Service (IRS) issued proposed regulations⁶ as well as guidance on the proposed regulations.⁷ In July 2018, the Treasury Department and IRS released an intent to issue regulations for rollovers from IRC § 529 college savings accounts to ABLE accounts⁸ and an intent to issue regulations on the increased contribution limit for employed participants and on excess contributions.⁹ The proposed regulations and guidance may be relied upon pending the issuance of final regulations,¹⁰ and the intent to issue regulations may be relied upon pending the issuance of proposed regulations.¹¹

¹ Pub.L. 113-205 (H.R. 647, December 3, 2014).

² The Internal Revenue Code (IRC) is in Title 26 of U.S. Code.

³ The owner and the beneficiary of an ABLE account are the same person, so throughout this paper, the owner/beneficiary are referred to for convenience as the “participant.”

⁴ The prohibition on out-of-state participants in the original version of IRC § 529A was repealed effective December 18, 2015.

⁵ Pub.L. 115-97 (H.R. 1, December 22, 2017)

⁶ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015).

⁷ IRS Notices 2015-18 and 2015-81.

⁸ IRS Notice 2018-58.

⁹ IRS Notice 2018-62.

¹⁰ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), p. 35609 and IRS Notice 2015-81, § VI

¹¹ IRS Notices 2018-58, § VI and 2018-62, § 7

North Carolina legislation

In August 2015, the North Carolina General Assembly passed legislation establishing the NC ABLE Program (NC ABLE Act),¹² and in January 2017, the NC ABLE Program began offering ABLE accounts. NC ABLE Program accounts are open to residents of any state. In 2017, the NC ABLE Act was amended to allow parents, without the need of a guardianship of the estate or a general guardianship, to (1) open or manage an adult child's ABLE account; or (2) continue managing a child's account when the child reaches the age of 18.¹³ Prior to the amendment, parents needed a guardianship of the estate or a general guardianship in both situations.

NC ABLE Program

The NC ABLE Program is governed by the North Carolina ABLE Program Board of Trustees (Board)¹⁴ and is administered by the North Carolina Department of State Treasurer (Department). The NC ABLE Program is a member of the National ABLE Alliance (Alliance), a group of 14 states and the District of Columbia that have come together for the purpose of contracting for investment, recordkeeping, and other administrative services. Ascensus College Savings serves as the third-party administrator for the Alliance, providing recordkeeping for the member programs and, through subcontractors, investment options and custody of assets. Ascensus provides customer service for Alliance members and processes enrollments, contributions, investment decisions, and withdrawals.

Summary data for the NC ABLE Program and the National ABLE Alliance

Account data for the NC ABLE Program and the Alliance are shown in the following table.

NC ABLE Program and National ABLE Alliance as of August 31, 2018

	<u>Accounts*</u>	<u>Assets</u>	<u>Average Account Balance</u>
NC ABLE Program	434	\$2,103,967	\$4,848
Alliance	4,868	\$25,668,521	\$5,273

* Includes only funded accounts (balances > \$0).

ABLE programs are intended to provide for participants' short-term, as well as long-term, expenses; therefore, withdrawals from ABLE accounts, in addition to account balances, are an important measure of the value of ABLE accounts. As of September 2018, participants in the NC ABLE Program had withdrawn a total of \$543,630. While this number does not distinguish withdrawals qualified disability expenses from other withdrawals (specifically, non-qualified expenses and account closures), assuming a significant percentage of withdrawals are for qualified disability expenses, ABLE accounts are providing substantial support for short-term expenses.

¹² North Carolina Session Law 2015-203 (H.B. 556), N.C.G.S. Chap. 147, Art. 6F.

¹³ North Carolina Session Law 2017-212 (S.B. 582), Section 3.2.

¹⁴ N.C.G.S. § 147-86.72.

The growth of the NC ABLE Program is shown in the table below.

Growth of the NC ABLE Program

	<u>3/31/2017</u>	<u>6/30/2017</u>	<u>9/30/2017</u>	<u>12/31/2017</u>	<u>3/31/2018</u>	<u>6/30/2018</u>
Accounts*	87	129	180	238	319	383
Assets	\$76,010	\$322,484	\$556,410	\$855,241	\$1,351,826	\$1,767,228
Average Account Balance	\$874	\$2,500	\$3,091	\$3,593	\$4,238	\$4,614

Note: The NC ABLE Program was launched in January 2017.

* Includes only funded accounts (balances > \$0).

Based on a report prepared for the NC ABLE Program in October 2016, the number of people in North Carolina who are eligible for an ABLE account is estimated at approximately 141,000.¹⁵

BENEFITS

An ABLE account allows disabled individuals to save for disability-related expenses, while preserving means-tested benefits, including Supplemental Security Income (SSI) and Medicaid, and providing tax-free investment earnings.

Qualified disability expenses

Qualified disability expenses (QDEs) is a broad term that supports the “legislative purpose of assisting eligible individuals in maintaining or improving their health, independence, or quality of life.”¹⁶ The Code defines QDEs as *any* expenses that are both (1) related to the participant’s disability or blindness; and (2) for the benefit of the participant. Section 529A lists the following examples of QDEs: “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, [and] funeral and burial expenses.”¹⁷ Furthermore, the preamble to the proposed regulations states that QDEs:

“should be broadly construed to permit the inclusion of basic living expenses and should not be limited to expenses for items for which there is a medical necessity or which provide no benefits to others in addition to the benefit to the eligible individual. For example, expenses for common items such as smart phones could be considered qualified disability expenses if they are an effective and safe communication or navigation aid for a child with autism.”¹⁸

QDE compliance

¹⁵ *ABLE Quantitative Analysis*, AKF Consulting Group, October 5, 2016.

¹⁶ Federal Register, Vol. 80, No. 119 (June 22, 2015), p. 35608.

¹⁷ IRC § 529A(e)(5).

¹⁸ Federal Register, Vol. 80, No. 119 (June 22, 2015), p. 35608.

The compliance burden regarding QDEs is on participants, and by extension on any guardians and parents who care for participants. Participants are required “to categorize distributions in order to properly determine the [participant’s] federal income tax obligations.”¹⁹ Therefore, participants, guardians, and parents should maintain sufficient documentation to support the aggregate amount of QDEs claimed for a taxable year.

A qualified ABLE program is not required to establish procedures to determine which distributions are for QDEs and which are for non-QDE purposes; instead, a program is required to “report only aggregate distributions and distinguish such distributions as basis, earnings, or returned contributions.”²⁰ Following each taxable year, the recordkeeper for an ABLE program sends IRS Form 1099-QA (Distributions from ABLE Accounts) to the IRS and to the participant (or other person (*e.g.*, for return of excess contributions)). Form 1099-QA includes the total distributions, basis, and earnings.

Medicaid and SSI benefits

The Federal ABLE Act generally excludes an ABLE account’s contributions, distributions for QDEs, earnings, and account balance “for the purpose of determining eligibility to receive, or the amount of, any assistance or benefit authorized by” any “Federal law that requires consideration of [one] or more financial circumstances of an individual.”²¹ Therefore, the account balance, earnings on the account balance, contributions, and distributions for QDEs do not count toward the Income Limit or Resource Limit used to determine eligibility for Medicaid and SSI (except as described below). The Social Security Administration also does not consider distributions for *non-QDEs* as income,²² although they may count toward the Resource Limit (see below).

The effect of this benefit can be significant. The Resource Limit for Medicaid and SSI is \$2,000 for an individual and \$3,000 for a couple;²³ therefore, an ABLE account allows much greater asset accumulation for paying disability-related expenses. For example, the average balance of a funded account in the NC ABLE Program as of August 31, 2018 was approximately \$4,848, well over twice the Resource Limit for an individual.²⁴

There are two exceptions to the ABLE account exclusion regarding SSI:

1. Distributions from an ABLE account for housing expenses, as defined in Title 16 of the Social Security Act, are includible in the participant’s resources;²⁵ and
2. The balance of a participant’s account in excess of \$100,000 is an includible resource.²⁶

¹⁹ IRS Notice 2015-81, p. 4-5.

²⁰ IRS Notice 2015-81, p. 4.

²¹ Pub.L. 113-205 (H.R. 647), Sec. 103(a).

²² Program Operations Manual System (POMS), SI 01130.740 Achieving a Better Life Experience (ABLE) Accounts, §C.4.

²³ 20 C.F.R. § 416.1205.

²⁴ Report by Ascensus at the Board’s August 15, 2018 meeting, p. 3. The report is available at www.nctreasurer.com/able/Documents/Administrative%20Update%20Q2%20Report%20Tab%205%20.pdf.

²⁵ Pub.L. 113-205 (H.R. 647), Sec. 103(a)(1).

²⁶ Pub.L. 113-205 (H.R. 647), Sec. 103(a)(2).

The Social Security Administration includes the following expenses in the definition of “housing expenses” for purposes of ABLE distributions:

- “Mortgage (including property insurance required by the mortgage holder);
- Real property taxes;
- Rent;
- Heating fuel;
- Gas;
- Electricity;
- Water;
- Sewer; and
- Garbage removal.”²⁷

Resource determinations for SSI are made as of the first of the month;²⁸ therefore, if a distribution is used for a housing expense during the month in which the participant receives the distribution, then the amount of the distribution is not counted toward the Resource Limit. However, if an ABLE account distribution is retained until the following month (or later), then the amount becomes an includible resource for purposes of SSI eligibility.²⁹

If a participant exceeds the Resource Limit due to the inclusion of ABLE account assets in excess of \$100,000, then the participant’s SSI eligibility is suspended until the participant’s assets (non-ABLE account assets plus ABLE account assets in excess of \$100,000) are once again below the Resource Limit.³⁰ Typically, SSI payments are terminated after 12 consecutive months of suspension;³¹ in contrast, SSI eligibility remains in suspended status during the period that the participant’s ABLE account balance causes the participant to be ineligible for SSI – even if such period extends 12 months or longer.

However, the participant remains eligible for Medicaid notwithstanding the suspension of SSI due to the inclusion of distributions for housing expenses or ABLE account assets in excess of \$100,000.³²

Distributions used for expenses other than QDEs also may be counted toward a participant’s Resource Limit. As mentioned above, resource determinations are made as of the first of the month; therefore, as in the case of housing expenses, if a distribution is received *and* used for a non-QDE within the same month, then the amount of the distribution is not counted toward the Resource Limit. However, if a distribution is retained until the following month (or later), then the amount becomes an includible resource for purposes of SSI eligibility. In addition, even if a

²⁷ Program Operations Manual System (POMS), SI 01130.740 Achieving a Better Life Experience (ABLE) Accounts, § B.9.

²⁸ 20 C.F.R. § 416.1207(a)

²⁹ Program Operations Manual System (POMS), SI 01130.740 Achieving a Better Life Experience (ABLE) Accounts, §§ C.5 and D.2.

³⁰ Pub.L. 113-205 (H.R. 647), Sec. 103(b)(1) and 20 C.F.R. § 416.1324. *See also* POMS SI 01130.740 Achieving a Better Life Experience (ABLE) Accounts, § D.1.a.

³¹ 20 C.F.R. § 416.1335

³² Pub.L. 113-205 (H.R. 647), Sec. 103(b)(2).

distribution is used for a non-QDE during the same month it is received, the assets or other items purchased using the non-QDE distribution are subject to the normal resource counting rules (and therefore may count toward the Resource Limit in the following month).³³

In a similar manner, under the NC ABLE Act assets in and distributions from an NC ABLE Program account are not considered resources or income, respectively, for purposes of determining eligibility for state benefit programs. Specifically, the assets in an ABLE account “shall not be considered a resource for purposes of means-tested State benefits.”³⁴ Likewise, “[d]istributions for qualified disability expenses shall not be considered income for any State benefits eligibility program that limits eligibility based on income.”³⁵

Tax benefits

The tax benefits of ABLE accounts are discussed below. In general, an ABLE account’s contributions, distributions, and earnings are excluded from a participant’s taxable income for Federal and North Carolina tax purposes. In addition, contributions by a participant prior to January 1, 2026 to his or her ABLE account are eligible for the Saver’s Credit in IRC § 25B, which provides for a credit against Federal income tax for certain retirement account contributions.³⁶ The maximum Saver’s Credit from all sources, including contributions to an ABLE account, is \$2,000 per year.³⁷

ELIGIBILITY

SSI/SSDI eligibility

A person is eligible for an ABLE account if the person is entitled to SSI or Social Security Disability Insurance (SSDI) benefits based on blindness or disability *and* such blindness or disability occurred before the age of 26, even if the formal diagnosis was received after the age of 26.³⁸ Eligibility for an ABLE account is based on eligibility for – not actual receipt of – SSI or SSDI.

An ABLE program has discretion in determining the documentation required to establish eligibility – both initial eligibility at enrollment and continued eligibility during ongoing participation. During enrollment in a member program of the National ABLE Alliance, a participant, or the participant’s parent, guardian, or agent acting under a power of attorney, is required to certify to the participant’s eligibility for SSI or SSDI based on a disability that occurred before the age of 26. In addition, the enrolling party certifies that the participant has a disability verification letter from the Social Security Administration and the enrolling party will retain the letter and provide it to the ABLE program or the IRS upon request. Members of the Alliance do not verify eligibility for SSI or SSDI.

³³ Program Operations Manual System (POMS), SI 01130.740 Achieving a Better Life Experience (ABLE) Accounts, §§ C.5 and D.2.

³⁴ N.C.G.S. 147-86.73(d).

³⁵ *Id.*

³⁶ IRC § 25B(d)(1)(B)(ii).

³⁷ IRC § 25B(a).

³⁸ IRC § 529A(e)(1)(A).

Disability certification

Alternatively, a participant, parent, guardian, or agent can establish eligibility for an ABLE account by providing a certification that (1) the participant is disabled or blind; (2) such disability or blindness occurred before the age of 26; and (3) the participant has a diagnosis signed by a physician.³⁹ The disability/blindness requirement can be satisfied in three ways:

1. Blindness as defined in Section 1614(a) of the Social Security Act;⁴⁰
2. A “medically determinable physical or mental impairment” that includes the following:
 - a. “Marked and severe functional limitation;” and
 - b. “[C]an be expected to result in death or [] has lasted or can expect to last for a continuous period of not less than 12 months.”⁴¹
3. A condition included in the Social Security Administration’s “List of Compassionate Allowances Conditions.”⁴²

A “marked and severe functional limitation,” in turn, is determined according to “the standard of disability in the Social Security Act for children claiming [SSI] benefits based on disability.”⁴³

The Federal ABLE Act requires that a disability certification be “filed with the Secretary [of the Treasury].”⁴⁴ However, the U.S. Department of the Treasury and the IRS have interpreted the filing requirement to be fulfilled if a participant, or the participant’s parent, guardian, or agent acting under a power of attorney, certifies to the ABLE program that (1) the participant meets the disability or blindness requirement; (2) the certifying party has a signed diagnosis from a physician; and (3) the certifying party will retain the diagnosis and provide it to the ABLE program or the IRS upon request.⁴⁵ Programs in the National ABLE Alliance accept this three-part certification during enrollment instead of requiring participants, parents, guardians, or agents to provide diagnoses or other documentation.

Raising the age limit

As mentioned above, to be eligible for an ABLE account a person’s disability or blindness must have occurred before the age of 26. However, bills have been introduced in Congress to raise this age limit to 46.⁴⁶

Recertification and continued eligibility

A participant must meet ABLE’s eligibility requirements for each taxable year that a participant has an ABLE account, but such eligibility, once established during a year, applies for the entire year, even if the participant otherwise becomes ineligible during the year.⁴⁷ At the beginning of the next taxable year following the year in which eligibility ceases, no additional contributions

³⁹ IRC § 529A(e)(1)(B) and 529A(e)(2)(A).

⁴⁰ IRC § 529A(e)(2)(A)(i)(I).

⁴¹ *Id.*

⁴² Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A–2(e)(3). The List of Compassionate Allowances Conditions can be found at www.socialsecurity.gov/compassionateallowances/conditions.htm.

⁴³ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A–2(e)(2).

⁴⁴ IRC § 529A(e)(1)(B).

⁴⁵ IRS Notice 2015-81, § V.

⁴⁶ S.817 and H.R.1874.

⁴⁷ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A–2(d)(1).

may be made to the ABLE account and no distributions may qualify as QDEs until such time as the participant again becomes eligible.⁴⁸ Importantly, a participant’s account remains an ABLE account even during the period in which a participant no longer meets the eligibility requirements; there is no deemed distribution, and the funds in the account retain their tax-advantaged status.⁴⁹

An ABLE program has discretion to determine the method and frequency of eligibility recertification for participants, and the frequency may vary “for different types of impairments.”⁵⁰ The National ABLE Alliance conducts annual recertification for all participants using notice and opt-out. Once a year, each participant’s account statement includes a notice that the ABLE program will assume that the participant remains eligible for an ABLE account unless the participant notifies the program otherwise.

The following table shows the number of accounts and the average account balance for the seven categories on which ABLE programs report enrollment to the Federal government.

NC ABLE Program Accounts by Disability Category as of June 30, 2018

<u>Disability Category</u>	<u>Accounts*</u>	<u>Average Account Balance</u>
Developmental disorders (including autism)	183	\$3,440
Intellectual disability	52	\$4,755
Congenital anomalies (including Down syndrome)	43	\$3,971
Psychiatric disorders	39	\$4,356
Nervous disorders (including blindness and deafness)	35	\$7,564
Other	29	\$4,645
Respiratory disorders	0	NA

* Includes only funded accounts (balances > \$0).

PROGRAM ENROLLMENT AND ACCOUNT MANAGEMENT

The owner and the beneficiary of an ABLE account are the same person, in contrast to an IRC § 529 educational savings account (529 Account), where, for example, the parent is the owner but the child is the beneficiary. This structure affects who can open and manage an ABLE account (versus a 529 Account). As noted above, throughout this paper the owner/beneficiary of an ABLE account is referred to for convenience as the “participant.”

A participant is limited to one ABLE account,⁵¹ except in the limited, and temporary, case of rolling over an ABLE account from one program to another. As part of enrollment, a participant must certify that the participant “has no other existing ABLE account (other than an ABLE

⁴⁸ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A–2(d)(3).

⁴⁹ *Id.*

⁵⁰ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A–2(d)(2).

⁵¹ IRC 59A(b)(1)(B).

account that will terminate with the rollover or program-to-program transfer into the new ABLE account).”⁵²

An ABLE account can be opened and managed by the participant, as account owner, unless the participant is a minor or has been adjudicated incompetent. A parent, guardian of the estate, or general guardian can open and manage an account on behalf of a minor or an incompetent adult. In addition, enrollment and account management can be discharged pursuant to a power of attorney.

In 2017, the NC ABLE Act was amended to allow parents, without the need of a guardianship of the estate or a general guardianship, to (1) to open or manage an adult child’s ABLE account; or (2) continue managing a child’s account when the child reaches the age of 18.⁵³ Prior to the amendment, parents needed a guardianship of the estate or a general guardianship in both situations.

Programs in the National ABLE Alliance, including the NC ABLE Program, offer the opportunity to appoint four different types of authorized individuals to assist participants with managing their accounts – ranging from someone who receives duplicate account statements to a full power of attorney.

For programs in the National ABLE Alliance, a guardian or agent acting under a power of attorney who is opening or managing an account for a participant must provide a copy of the person’s guardianship or power of attorney documentation, respectively. In addition, Alliance programs will require a guardian or agent to certify periodically that the agent’s guardianship or power of attorney is still in effect. Likewise, a parent who opens an account for an adult child must provide a copy of the participant’s birth certificate. No birth certificate is required for a parent to open an account for a minor child.

In addition, a participant, or the participant’s parent, guardian, or agent, must provide the eligibility certifications and recertifications described above.

A participant’s parents, guardian, authorized individuals, and agents are prohibited from obtaining “any beneficial interest in the account” and “must administer the account for the benefit of the [participant].”⁵⁴

CONTRIBUTIONS AND ACCOUNT BALANCES

Annual contribution limit

The annual contribution limit for an ABLE account is tied to the gift tax exclusion and the participant’s compensation for a given year. Specifically, if a participant does not receive compensation during the year, then the annual contributions to an ABLE account from all

⁵² Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-2(b)(2).

⁵³ North Carolina Session Law 2017-212 (S.B. 582), Section 3.2.

⁵⁴ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-2(c)(3).

sources, excluding certain rollovers as discussed below, cannot exceed the amount of the gift tax exclusion under IRC § 2503(b) (\$15,000 in 2018).⁵⁵

In addition, if a participant earns compensation during the year, then the participant may contribute to his or her ABLE account in excess of the standard annual contribution limit above, up to the lesser of (1) the participant's compensation during the year; and (2) "the poverty line for a one-person household" (\$12,140 in 2018).⁵⁶ This additional contribution amount was added to the Federal ABLE Act in December 2017 by the Tax Cuts and Jobs Act and applies to contributions prior to January 1, 2026.⁵⁷ However, this additional contribution amount is not available during a taxable year in which an employee-participant contributes, or whose employer contributes on his/her behalf, to a defined contribution plan (*e.g.*, a 401(k) or 457(b) plan).⁵⁸

An ABLE program is responsible for monitoring compliance with the standard contribution limit; however, the participant – and therefore, any parent, guardian, or agent responsible for the participant's financial affairs – owns the compliance responsibility for any additional contributions resulting from the compensation earned by the participant. To that end, an ABLE program "may allow a [participant] to certify under penalties of perjury that ... his or her contributions do not exceed the limit set forth in [IRC] § 529A(b)(2)(B)(ii) [*i.e.*, the additional contribution amount related to the participant's compensation]".⁵⁹

An ABLE program must report contributions to the IRS and the participant on IRS Form 4598-QA (ABLE Account Contribution Information) and return any excess contributions, plus applicable earnings, to the contributor(s). A program's obligation to return excess contributions also applies to the additional contribution amount related to the participant's compensation, although "it will be the sole responsibility of the [participant] (or the person acting on the [participant's] behalf) to identify and request the return of any excess contributions of such compensation income."⁶⁰

Lifetime contribution limit

In addition to the annual contribution limits, the aggregate lifetime contributions to a participant's ABLE account are not permitted to exceed the analogous limit established by a state under IRC § 529(b)(6) for 529 Accounts (the "529 Limit").⁶¹ In North Carolina, this amount is \$450,000. Included in this amount are any contributions made to any ABLE account(s) previously owned by the participant, whether in the participant's current ABLE program or in another state's program.

An ABLE program is responsible for having "adequate safeguards" in place to prevent excess aggregate contributions to a participant's account. The proposed ABLE regulations provide a safe harbor for complying with the requirement of adequate safeguards: An ABLE program satisfies the requirement "if it refuses to accept any additional contributions to an ABLE account

⁵⁵ IRC § 529A(b)(2)(B)(i).

⁵⁶ IRC § 529A(b)(2)(B)(ii).

⁵⁷ Pub.L. 115–97 (H.R. 1, December 22, 2017), Sec. 11024.

⁵⁸ IRC § 529A(b)(7)(a).

⁵⁹ IRS Notice 2018-62, p. 4.

⁶⁰ IRS Notice 2018-62, p. 5.

⁶¹ IRC § 529A(b)(6).

once the *balance* [not necessarily the aggregate contributions] in the account reaches the [529 Limit],”⁶² although the account can continue to receive investment gains. Contributions can be accepted again to the extent that the account balance falls below the 529 Limit due to a change in market value – and not a distribution.⁶³ The programs in the National ABLE Alliance, including the NC ABLE Program, have adopted the safe harbor.

Medicaid contribution limit

As discussed above, the balance of a participant’s ABLE account in excess of \$100,000 is counted toward the Resource Limit (\$2,000 for individuals and \$3,000 for couples) for the purpose of determining eligibility for SSI.

Sources of contributions

Participants, parents, other relatives, and any other person or entity are permitted to contribute to ABLE accounts; however, contributions from all sources, with the exception of certain rollovers as discussed below, are combined for purposes of compliance with the annual and lifetime contribution limits.

Another source of income is a rollover from another ABLE account or from a 529 Account. Rollovers from another ABLE account are not included in the participant’s gross income or the annual or lifetime contribution limit in the following situations: (1) the funds are rolled over from another qualified ABLE program within 60 days to the current ABLE account of (a) the participant; or (b) an eligible individual who is a “member of the family” of the participant; or (2) the designated beneficiary of a particular ABLE account is changed to the participant from an eligible individual who is a “member of the family” of the participant.⁶⁴ For an ABLE account, a member of the family is limited to a sibling or stepsibling of the participant,⁶⁵ whether by adoption or by birth.⁶⁶

Rollovers from 529 Accounts

The Tax Cuts and Jobs Act, which was enacted in December 2017, encouraged rollovers from 529 Accounts to ABLE Accounts. The owner of a 529 Account may exclude from the owner’s gross income the amount rolled over from a 529 Account to an ABLE accounts prior to January 1, 2026, but only to the extent that:

1. The recipient of the rollover (*i.e.*, the ABLE program participant) is the “designated beneficiary [of the 529 Account] or a member of the family of the designated beneficiary;” and
2. The amount of the rollover, when added to the other contributions to the ABLE Account during the year, does not exceed the standard annual contribution limit to the ABLE Account under IRC § 529A(b)(2)(B)(i) (*i.e.*, \$15,000 in 2018).

⁶² Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1-529A-2(g)(3)(ii), *emphasis added*.

⁶³ *Id.*

⁶⁴ IRC § 529A(c)(1)(C).

⁶⁵ IRC § 529A(e)(4), which refers to IRC § 152(d)(2)(B).

⁶⁶ IRC § 529A(e)(4) incorporates the rule of IRC § 152(f)(1)(B).

The term “member of the family” is defined more broadly in IRC § 529 than in IRC § 529A. For 529 Accounts under IRC § 529, a member of the family includes not only a sibling or stepsibling, as mentioned above for ABLE accounts, but also a spouse or first cousin of the designated beneficiary of the 529 Account as well as a child (or descendant a child), parent (or ancestor of a parent), stepparent, aunt, uncle, niece, nephew, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, sister-in-law, or any spouse of one of the foregoing relations.

In 2018, the General Assembly excluded a rollover from a 529 Account to an ABLE Account from North Carolina’s recapture tax on prior tax deductions for contributions to a 529 Account.⁶⁷ For taxable years 2006 through 2013, a contribution to an NC 529 Program account was deductible from North Carolina state income tax, up to a maximum of \$2,500 per year for individuals and \$5,000 for couples.⁶⁸ The recapture tax is intended to recapture the amount of deducted contributions that are not used for qualified educational expenses under IRC 529.

Methods of contributions

The NC ABLE Program and other members of the National ABLE Alliance accept one-time contributions by check and electronic transfers from a checking or savings account. In addition, participants, parents, relatives, and other contributors can establish recurring contributions through payroll deductions or electronic transfers from a checking or savings account.

INVESTMENTS AND FEES

Investment options

The goal of an ABLE account is to promote savings for disability-related expenses – both short-term and long-term – and the investment options in an ABLE program should support this goal. For example, the programs in the National ABLE Alliance offer six white label funds: Conservative, Moderately Conservative, Moderate, Growth, Moderately Aggressive, and Aggressive. In addition, many ABLE programs, including those in the Alliance, offer checking accounts and debit cards, which support the transactional goal of using ABLE accounts to pay for QDEs.

The following table provides account information for each of the investment options in the NC ABLE Program.

⁶⁷ North Carolina Session Law 2018-5 (S.B. 99), Section 38.1.(h), which amended N.C.G.S. § 105-153.5(c)(7).

⁶⁸ North Carolina Session Law 2006-66 (S.B. 1741), Section 24.12. North Carolina Session Law 2013-316 (H.B. 998), Section 1.1.(b).

NC ABLE Program Accounts by Investment Option as of June 30, 2018

<u>Investment Option</u>	<u>Funded Positions*</u>	<u>% of Participants Invested*</u>	<u>% of Assets Invested</u>
Checking account	162	42%	28%
Growth Fund	120	31%	15%
Moderately Aggressive Fund	99	26%	13%
Aggressive Fund	87	23%	12%
Moderate Fund	77	20%	15%
Conservative Fund	68	18%	8%
Moderately Conservative Fund	51	13%	9%

*An account be allocated to more than one investment option.

Fees

Fees are often divided into investment and administrative fees. For example, in the National ABLE Alliance, the following fees apply:

- Investment fee
Options other than the checking account: 0.02%-0.06% of account assets per year.
- Administrative fees
 - Program management fee: 0.32% year of account assets per year.
 - Checking fee: No fee if a participant receives electronic statements or maintains an average monthly balance greater than \$250. Otherwise, a \$2.00 monthly fee applies.
 - Account maintenance fee: \$45 per year if a participant receives electronic statements. Otherwise, the charge is \$60 per year.

Fee example

As mentioned above, the average account balance in the NC ABLE Program is approximately \$4,800. Also, in the NC ABLE Program the top three investment options, other than checking, are the Growth, Moderately Aggressive, and Aggressive funds, which are the three options with an investment fee of 0.05%. So for an account balance of \$4,800 with an investment fee of 0.05% and electronic delivery of checking and account statements, the annual cost of the ABLE account would be approximately \$63 (or 1.31% of the account balance).

Investment restriction

Participants are prohibited from directing the investment of assets in an ABLE account more than twice in any calendar year.⁶⁹ In the National ABLE Alliance, establishing the investment of future contributions (*i.e.*, the initial investment selection for a contribution) does not count toward the limit. Likewise, the Alliance does not count as investment direction the automatic

⁶⁹ IRC § 529A(b)(4). The same restriction applies to 529 Accounts.

transfers between investments pursuant to its Systematic Exchange Program. The Systematic Exchange Program allows a participant to automatically transfer assets from one investment option to another at monthly or quarterly intervals on an ongoing basis. For example, participants can systematically transfer money into their checking accounts from another investment, thereby automatically replenishing funds that they can readily use for QDEs. Enrolling in the Systematic Exchange Program (versus the transfers automatically executed pursuant to the program) counts as one of the two annual investment directions if the program is applied to assets that are currently in an ABLE account; however, enrollment in the program does not count toward the limit if the program applies to future contributions. A bill was introduced in Congress in January 2017 that may provide greater clarity for automatic transfers, such as those in the Systematic Exchange Program; specifically, the bill would exclude the following from the definition of investment direction: “rebalancing investments among broad-based investment strategies established under the program.”⁷⁰

DEATH OF A PARTICIPANT

Upon the death of a participant, the funds in an ABLE account are distributed in the following order:

1. To pay for any outstanding QDEs;
2. To reimburse a state’s Medicaid program for benefits received by the participant subsequent to the establishment of the ABLE account (Medicaid recapture); and
3. To the participant’s estate or beneficiary under a will.

The amount subject to Medicaid recapture is limited to the Medicaid benefits received *after* the ABLE account was established and is reduced by the amount paid (from the ABLE account or otherwise) for premiums in a Medicaid Buy-In program. A state Medicaid program is deemed a creditor and not a beneficiary, and the amounts received by the Medicaid program are not subject to the additional 10% tax in IRC 529A(c)(3).⁷¹

At least two states, Oregon and Illinois, have enacted statutes prohibiting the state from filing Medicaid recapture claims⁷² however, it is unclear whether a state can waive Medicaid recapture.

Under North Carolina law, within 30 days of receiving notice of a participant’s death, the North Carolina Department of State Treasurer is required to report the death to the North Carolina Department of Health and Human Services’ Division of Medical Assistance, which manages the state’s Medicaid program.⁷³ Once notice is provided, the state has 60 days to file a claim for Medicaid recapture.⁷⁴

⁷⁰ H.R.529, Sec. 5(b).

⁷¹ IRC § 529A(f).

⁷² O.R.S. § 178.380(4)(b); 15 ILCS 505/16.6(e).

⁷³ N.C.G.S. § 147-86.73(f).

⁷⁴ N.C.G.S. § 147-86.73(e).

SELECTED TAX ISSUES FOR ABLE ACCOUNTS

Contributions

Contributions to an ABLE account are made on an after-tax basis, which determines the “investment in the account”⁷⁵ that is used as the basis for calculating the “earnings”⁷⁶ that in certain situations may be includible in gross income⁷⁷ and subject to an additional 10% tax (as discussed below).⁷⁸ North Carolina does not provide an income tax deduction or credit, although this is offered in some of the other states that sponsor an ABLE program (*e.g.*, Ohio, Oregon, South Carolina, Virginia).

Contributions by a participant prior to January 1, 2026 to his or her ABLE account are eligible for the Saver’s Credit in IRC § 25B, which provides for a credit against Federal income tax for certain retirement account contributions.⁷⁹ The maximum Saver’s Credit from all sources, including contributions to an ABLE account, is \$2,000 per year.⁸⁰

Contributions by relatives or other donors are treated as completed gifts to the participant but not as qualified transfers under IRC § 2503(e) (*i.e.*, the educational and medical exceptions).⁸¹ Contributions by relatives or other donors are non-taxable gifts to the participant but are taxable to the donor to the extent that the donor’s total gifts to the participant (*i.e.*, ABLE contributions plus other gifts) exceed the annual gift exclusion.⁸² A participant’s contribution to his/her own ABLE account does not count as a gift because the participant is the owner of the ABLE account.⁸³

Rollovers from ABLE accounts

A rollover from another ABLE account is not included in the participant’s gross income or the annual or lifetime contribution limit in the following situations: (1) the funds are rolled over from *another* qualified ABLE program within 60 days to the *current* ABLE account of (a) the participant; or (b) an eligible individual who is a “member of the family” of the participant; or (2) the designated beneficiary of a particular ABLE account is changed to the participant from an eligible individual who is a “member of the family” of the participant.⁸⁴ A “member of the family” for purposes of rollovers of ABLE accounts is limited to a sibling or stepsibling of the participant,⁸⁵ whether by adoption or by birth.⁸⁶

⁷⁵ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-1(b)(12).

⁷⁶ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-1(b)(7).

⁷⁷ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-3(a). *See also* IRC § 529A(c)(1)(A)-(B).

⁷⁸ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-3(d).

⁷⁹ IRC § 25B(d)(1)(B)(ii).

⁸⁰ IRC § 25B(a).

⁸¹ IRC § 529A(c)(2)(A).

⁸² Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-4(a)(1).

⁸³ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-4(a)(3).

⁸⁴ IRC § 529A(c)(1)(C).

⁸⁵ IRC § 529A(e)(4), which refers to IRC § 152(d)(2)(B).

⁸⁶ IRC § 529A(e)(4) incorporates the rule of IRC § 152(f)(1)(B).

Rollovers from 529 accounts

The Tax Cuts and Jobs Act, which was enacted in December 2017, encouraged rollovers from 529 Accounts to ABLE Accounts. The owner of a 529 Account may exclude from the owner's gross income the amount rolled over from a 529 Account to an ABLE accounts prior to January 1, 2026, but only to the extent that:

1. The recipient of the rollover (*i.e.*, the ABLE program participant) is the “designated beneficiary [of the 529 Account] or a member of the family of the designated beneficiary;” and
2. The amount of the rollover, when added to the other contributions to the ABLE Account during the year, does not exceed the standard annual contribution limit to the ABLE Account under IRC § 529A(b)(2)(B)(i) (*i.e.*, \$15,000 in 2018).⁸⁷

The term “member of the family” is defined more broadly in IRC § 529 than in IRC § 529A. For ABLE Accounts under IRC § 529A, a member of the family is limited to a sibling or stepsibling of the participant,⁸⁸ whether by adoption or by birth.⁸⁹ For 529 Accounts under IRC § 529, a member of the family includes not only a sibling or stepsibling, but also a spouse or first cousin of the designated beneficiary of the 529 Account as well as a child (or descendant a child), parent (or ancestor of a parent), stepparent, aunt, uncle, niece, nephew, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, sister-in-law, or any spouse of one of the foregoing relations.

As mentioned above, in 2018 the General Assembly excluded a rollover from a 529 Account to an ABLE Account from North Carolina's recapture tax on prior tax deductions for contributions to a 529 Account.⁹⁰ For taxable years 2006 through 2013, a contribution to an NC 529 Program account was deductible from North Carolina state income tax, up to a maximum of \$2,500 per year for individuals and \$5,000 for couples.⁹¹ The recapture tax is intended to recapture the amount of deducted contributions that are not used for qualified educational expenses under IRC 529.

Distributions: Gross income

Distributions from an ABLE account are includible in the gross income of the participant (as the owner of the account) unless the distributions are used for (A) “qualified disability expenses” (QDEs);⁹² (B) Medicaid recapture payments (as described above);⁹³ or (C) for the rollovers discussed above in *Rollovers from ABLE accounts*.⁹⁴

What is a QDE?

⁸⁷ IRC § 529(c)(3)(C)(i)(III).

⁸⁸ IRC § 529A(e)(4), which refers to IRC § 152(d)(2)(B).

⁸⁹ IRC § 529A(e)(4) incorporates the rule of IRC § 152(f)(1)(B).

⁹⁰ North Carolina Session Law 2018-5 (S.B. 99), Section 38.1.(h), which amended N.C.G.S. § 105-153.5(c)(7).

⁹¹ North Carolina Session Law 2006-66 (S.B. 1741), Section 24.12. North Carolina Session Law 2013-316 (H.B. 998), Section 1.1.(b).

⁹² IRC § 529A(c)(1)(B).

⁹³ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-3(b)(4).

⁹⁴ IRC § 529A(c)(1)(C).

As discussed above, qualified disability expenses (QDEs) are broadly defined as *any* expenses that are both (1) related to the participant’s disability or blindness; and (2) for the benefit of the participant.⁹⁵ Examples 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, [and] funeral and burial expenses.”⁹⁶

QDE compliance

As discussed above, the compliance burden regarding categorizing and documenting QDEs is on participants, and by extension on any parents, guardians, and agents who manage ABLE accounts on behalf of participants.

What amount is includible in gross income?

Unless otherwise excludible pursuant to IRC 529A, the amount of distributions includible in gross income is calculated pursuant to IRC 72.⁹⁷ For the purpose of applying IRC 72:

- Distributions, earnings, and QDEs are aggregated for the taxable year; and
- The allocation of the total distribution amount for a year between total earnings and total contributions (or investment in the ABLE account) is calculated as of the end of the year.⁹⁸

Only the portion of distributions attributable to earnings – and not contributions, which are made on an after-tax basis – is includible in gross income.⁹⁹ Earnings includible in gross income for a taxable year are the product of total distributions and the earnings ratio,¹⁰⁰ which is defined as the ratio of “earnings attributable to the account” for the year to the “total account balance” at the end of the year, where the total account balance is adjusted for distributions from and contributions to the account during the year.¹⁰¹

As mentioned above, to the extent that distributions are used for QDEs, they are excludible from gross income. “Used for QDEs” means that total distributions for a taxable year do not exceed QDEs for the year.

If distributions during a tax year are spent partially, but not entirely, on QDEs (*i.e.*, total distributions for the year exceed total QDEs), then the portion of the distributions attributable to earnings is includible in gross income; however, such earnings are reduced by the proportion of distributions spent on QDEs to total distributions. In other words, the portion of the earnings that are includible in gross income are reduced by the proportion of total distributions represented by QDEs (*i.e.*, includible earnings = total earnings x (QDEs/total distributions)).

Distributions: Additional income tax

⁹⁵ IRC § 529A(e)(5).

⁹⁶ *Id.*

⁹⁷ IRC 529A(c)(1)(A).

⁹⁸ IRC 529A(c)(1)(D).

⁹⁹ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-3(a)

¹⁰⁰ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-3(c).

¹⁰¹ Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015), § 1.529A-1(a)(8).

Any amount of a distribution that is includible in gross income is also subject to an additional tax of 10% of the includible amount, except in the following situations:

1. Upon the death of a participant, a distribution to the participant's estate or to a beneficiary of the participant's will; and
2. Earnings on returned excess contributions.

Distributions: Gift and GST taxes

Distributions to participants are not treated as taxable gifts, presumably regardless of the amount of the total distributions in a year. Furthermore, gift and generation-skipping transfer (GST) taxes do not apply to a change in the designated beneficiary from the participant to an eligible individual who is a "member of the family" of the participant.

SUMMARY OF DOCUMENTATION

Tax forms

- IRS Form 4598-QA (ABLE Account Contribution Information). Sent to the IRS and the participant.
- IRS Form 1099-QA (Distributions from ABLE Accounts). Sent to the IRS and the participant (or other person (*e.g.*, for return of excess contributions)).

Enrollment and management

- Guardianship, power of attorney, or birth certificate (parent of adult child) for those acting on behalf of a participant.
- SSI/SSDI verification letter or disability diagnosis from a physician

QDEs

- Documentation to support a participant's amount of QDEs for a taxable year

ADDITIONAL RESOURCES

Statutes

- Pub.L. 113-205 (H.R. 647): Achieving a Better Life Experience Act
- Internal Revenue Code Section 529A (26 U.S.C.A. § 529A): Qualified ABLE Programs
- N.C.G.S. Chapter 147, Article 6f (§ 147-86.70, *et. seq.*): Achieving a Better Life Experience Program Trust

Proposed Regulations

- Federal Register, Vol. 80, No. 119, 35602 (June 22, 2015): Proposed Regulations
- IRS Notice 2015-18: Qualified ABLE Programs
- IRS Notice 2015-81: Section 529A Interim Guidance Regarding Certain Provisions of Proposed Regulations Relating to Qualified ABLE Programs
- IRS Notice 2018-58: Guidance on Recontributions, Rollovers and Qualified Higher Education Expenses under Section 529
- IRS Notice 2018-62: Guidance on the Contribution Limits Applicable to ABLE Accounts

ABLE National Resource Center

- Website: www.ablenrc.org
- Center's comparison tool for ABLE programs across the country:
www.ablenrc.org/state_compare

NC ABLE Program

- Department's website: www.nctreasurer.com/able
- Enrollment website (including a link to the plan disclosure document):
NC.SaveWithABLE.com

Ascensus (recordkeeper for the NC ABLE Program):

- Telephone number: (888) 627-7503
- Website: www2.ascensus.com/individuals/save-with-an-able-account

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