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IRS Releases Final ABLE Account Regulations

The Internal Revenue Service has issued final regulations for Achieving a Better Life Experience (ABLE) accounts. These accounts can help eligible individuals (known as designated beneficiaries) save for qualified disability expenses without ruining their eligibility for governmental aid.

These final regulations combine two previously issued sets of proposed regulations. The IRS published the first set of proposed regulations in 2015 following the passage of the ABLE Act. The IRS published the second set in 2019 after enactment of the Tax Cuts and Jobs Act of 2017 (TCJA) and the Protecting Americans from Tax Hikes (PATH) Act of 2015, both of which made significant changes to ABLE accounts.

Highlights of Final Regulations

The final regulations address many comments received on the 2015 and 2019 proposed regulations and confirm and clarify several provisions. The most important provisions of the final regulations are described below.

Qualified ABLE Programs

Qualified ABLE programs may use private contractors. To help reduce administrative costs, the 2015 proposed regulations suggested that qualified ABLE programs should have one or more Community Development Financial Institutions (CDFIs) perform certain administrative duties. The final regulations clarify that, in addition to contracting with a CDFI, a qualified ABLE program may also contract with a private contractor to provide program services.

Final regulations are similar to 529 plan rules. To help simplify administration and to reduce costs, the IRS designed the final regulations, where possible, to resemble the rules that apply to Internal Revenue Code (IRC) Sec. 529 qualified tuition programs. Each ABLE program, however, has some flexibility when implementing the final regulations.

Two or more states may maintain a qualified ABLE program. The final regulations provide that two or more states may form a consortium to jointly maintain a qualified ABLE program. The consortium is treated as the program of each participating state.

States may limit program only to state residents. IRC Sec. 529A originally required states to allow ABLE accounts only for designated beneficiaries who are residents of that state or of a state contracted to provide a qualified ABLE program. The PATH Act removed this requirement, so the final regulations also eliminate all references to a residency requirement and to a "contracting state." The final regulations clarify, however, that a state program could still impose a residency requirement.

ABLE Accounts

Establishment and signature authority. The final regulations clarify that designated beneficiaries—*if* they are legally competent—may delegate another person to establish an ABLE account or to take action with the ABLE account. For designated beneficiaries without legal capacity, the final regulations contain an expanded hierarchy of individuals who may establish an ABLE account or exercise signature authority over an ABLE account. The designated beneficiary's agent under a power of attorney has top priority. If the designated beneficiary does not have an agent, then the ordering rule grants authority to the following individuals (listed in order): conservator or legal guardian, spouse, parent, sibling, grandparent, or representative payee (individual or organization).

ABLE programs may accept a certification (under penalties of perjury) that an individual has signature authority and that no other person with a higher priority is willing to serve. To provide more flexibility, the final regulations now allow ABLE accounts to have co-signatories that work either jointly or independently.

Successor designated beneficiaries. Designated beneficiaries may name a successor designated beneficiary. This is an individual who will receive the account assets as of the designated beneficiary's death. The final regulations confirm that a qualified ABLE program can require that any successor beneficiary be not only the designated beneficiary's sibling, but also an individual eligible for an ABLE account.

Determining eligibility. The final regulations provide a new disability certification safe harbor to determine whether an individual is eligible to establish an ABLE account. The safe harbor contains seven criteria for a designated beneficiary (or an individual with signature authority) to certify under penalty of perjury that the designated beneficiary meets the qualified ABLE program's eligibility requirements.

Like the 2015 proposed regulations, the final regulations apply the "marked and severe functional limitations" definition to the disability standards. The final regulations also clarify that the disability standards under IRC Sec. 529A apply regardless of a designated beneficiary's engagement in substantial gainful activity.

The final regulations confirm that designated beneficiaries generally must recertify their eligibility each year. But qualified ABLE programs may adopt a different method of confirming continued eligibility, such as deeming the annual certification to have been provided in certain circumstances (e.g., in clear cases of permanent disability). Designated beneficiaries who have a change in eligibility status because they are no longer disabled do not have to terminate the ABLE account. Instead, they can maintain the account in case they become eligible again. The final regulations clarify that any expenses incurred while designated beneficiaries are ineligible will not be considered qualified disability expenses. An otherwise compliant program will not cease to be a qualified ABLE program merely because a designated beneficiary fails to report a change in status.

Only one ABLE account allowed. A designated beneficiary cannot maintain multiple ABLE accounts. But if additional accounts are opened, the final regulations now allow two ways to fix this error to avoid jeopardizing a designated beneficiary's eligibility for public benefits. First, all contributions to the additional account must be returned to the contributor(s) under the excess contribution rules. Alternatively, the ABLE accounts must be consolidated into one account and any excess contributions must be returned to the contributor(s). Either of these remedies must be completed by the designated beneficiary's tax return due date, plus extensions, for the year in which the additional ABLE account was established.

Although designated beneficiaries cannot have more than one ABLE account, the final regulations confirm that designated beneficiaries can have multiple subaccounts under one primary account. For example, the signatory on the ABLE account might control all the investments while someone else is given authority to distribute assets from a cash subaccount created for the purpose of paying day-to-day expenses.

ABLE Account Contributions

Contribution rules. All ABLE contributions must be in cash (versus in-kind contributions). Individuals may make contributions by check, credit card, money order, or electronic transfer. The final regulations clarify that after-tax payroll deduction is also allowed.

Transfers and rollovers are not subject to a state's aggregate contribution limit. And if a designated beneficiary's sibling becomes the new designated beneficiary, the new designated beneficiary's annual contribution limit is unaffected (for the year of the change) by the former beneficiary's contributions.

Contributor requirements. Corporations and employers can make ABLE account contributions (including payroll deductions) to employees or employees' family members. But any employer contributions are subject to the rules governing federal taxation of compensation. The final regulations align with Notice 2015-81 by not requiring a qualified ABLE program to obtain a tax identification number (TIN) from a contributor if the program has a system in place to reject contributions that would cause an excess contribution (an amount that exceeds the annual gift tax exclusion amount) or an excess aggregate contribution (an amount that exceeds the state's cumulative limit). If such a system exists and a contributor makes an excess contribution or an excess aggregate contribution, then the ABLE programs must request the contributor's TIN so that the program can properly report the removal of excess.

ABLE Account Distributions

Check and debit card distributions are acceptable. When taking distributions, individuals may use checks or debit cards. These transactions will not be treated as a pledge or loan during the period between the use of the check or debit card and the clearing or settlement of the transaction as long as the ABLE program does not advance funds in excess of the distribution amount.

Distribution timing. In determining whether distributions exceed qualified disability expenses in a year, the IRS focuses on when an expense is paid, not when the designated beneficiary incurred the expense. But to address the reality that sometimes expenses are incurred late in one year—but not billed or paid until the next year—the final regulations contain a grace period. A designated beneficiary may now treat a qualified disability expense paid within 60 days following the end of the designated beneficiary's taxable year as if the distribution had been paid in the immediately preceding taxable year. Such expenses cannot be counted again with respect to the year in which they are paid.

Earnings calculation. To simplify ABLE account administration for distributions, the final regulations apply the same earnings ratio calculation used to determine basis and earnings for 529 plan distributions That is, the calculation of the ratio of account earnings to the total account balance is made as of the date of distribution instead of at year end.

Investment changes. Designated beneficiaries may generally change their ABLE account investments only two times each year. The final regulations confirm that 1) moving funds from an investment fund to a cash fund in order to process a distribution, and 2) automatically rebalancing an ABLE account are not considered investment changes. The final regulations also confirm that the annual investment change limit applies separately to successor designated beneficiaries who acquire the account assets during any year.

The Medicaid factor. Once an ABLE account pays the deceased designated beneficiary's qualified disability expenses (including funeral expenses), the account may be distributed to a state that files a Medicaid reimbursement claim. The final regulations clarify that a qualified ABLE program should not report amounts paid to a state's Medicaid program on Form 1099-QA, *Distributions from ABLE Accounts*. A state's qualified ABLE program will not be jeopardized if the state prohibits its Medicaid agency from filing Medicaid reimbursement claims.

Once the statute of limitations for filing Medicaid claims against a designated beneficiary's estate expires, the qualified ABLE program may distribute the account balance to the successor designated beneficiary or to the designated beneficiary's estate.

Gift and Generation-Skipping Transfer Tax

New take on contributions. Based on comments submitted after the release of the 2015 proposed regulations, the IRS has reconsidered how to treat ABLE accounts—for gift tax and generation-skipping transfer (GST) tax purposes—when the designated beneficiary is changed. Under the *proposed* rule, assets transferred to a different beneficiary would be treated as gifts or GSTs only if they were not previously treated as a gift (e.g., because the designated beneficiary contributed to his own account). The *final* rule considers the entire ABLE account subject to gift tax and GST tax treatment when a new designated beneficiary takes over. This treatment will not apply, however, if the new designated beneficiary is the former designated beneficiary's sibling.

Transition Relief

Transition relief is available for all qualified ABLE programs, including programs that are established after the IRS publishes the final regulations. A qualified ABLE program and each account established under that program will be treated as being compliant with the final regulations during the transition period if the program is established and maintained using a good faith interpretation of IRC Sec. 529A.

A qualified ABLE program and all accounts established under that program must meet the requirements of the final regulations before the later of 1) two years after the regulations are published in the Federal Register, or 2) the first day of the qualified ABLE program's first taxable year beginning after the close of the state's first regular legislative session that begins after the date of publication in the Federal Register. If a state has a two-year legislative session, each calendar year of the session is deemed to be a separate regular state legislature session.

Next Steps

Now that the IRS has simplified contributor reporting requirements, relaxed account establishment requirements, and provided a clear list of who can have authority over ABLE accounts, more individuals may be interested in establishing these types of accounts. Qualified ABLE program administrators should familiarize themselves with the final regulations and make any needed programming changes. They should also update policies and procedures to be compliant with the final regulations. Financial advisors should also become familiar with the new rules in order to help clients who may benefit from having an ABLE account.