Does the ABLE Act Enable the Wealthy and Disable the Poor?

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ABSTRACT

The Achieving a Better Life Experience (ABLE) Act of 2015 establishes 529A plans which provide special needs individuals with a new option to plan for their financial needs. In the past, advisors would use first- and third-party special needs trusts (SNTs) for the financial planning needs of those with disabilities. Although the resources under the ABLE Act are important, this article suggests that the ABLE Act is not a replacement for traditional SNTs and could inadvertently create unintended situations where lower net worth individuals are subject to a regressive "death tax" that provides less, rather than more, assets for the benefit of the intended beneficiary.

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Overview of the ABLE Act

A new innovation for providing for the care of special needs individuals is the Achieving a Better Life Experience (ABLE) Act which is enacted as law under 26 USC 529A (IRC Sec. 529A). The ABLE Act was developed similar to 529 college savings plans with provisions for the benefit of those with special needs and was enacted into law in 2014. Through the ABLE Act, Congress encourages the saving of private funds to care for special needs beneficiaries outside of traditional special needs trusts (SNTs).[1] Similar to traditional 529 plans, the ABLE Act allows post-tax contributions to be made to the beneficiary's account with tax-exempt growth; however, exceptions do exist. For example, the growth may be taxable when distributions are made from the account if the ABLE Act requirements are not met or for payment of nonqualified expenses.

To qualify, individuals creating an ABLE 529A account must establish it for "the purpose of meeting the qualified disability expenses for the designated beneficiary of the account."[2] Qualified disability expenses under IRC Sec. 529A(e)(5) 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." Additionally, the beneficiary must have been disabled or

legally blind before the age of 26, and have a disability that has lasted, or will last for a minimum of 12 months. The beneficiary must also have documentation signed by a physician, defined under 42 USC Sec. 1861 (cited by IRC Sec. 529A) confirming the individual's medical condition.

The primary financial constraints of ABLE accounts limit options for individuals with special needs. Unlike traditional 529 college savings plans, ABLE account contributions are limited to the IRS annual tax exclusion for gifts, which is currently $14,000 a year[3] with no catch-up capabilities. Any amount over $14,000 is subject to a 6 percent tax.[4] Additionally, the beneficiary can make investment decisions twice a year, giving it far less flexibility and greater exposure to market risk than SNTs which permit the trustee to make investment decisions as needed.[5] Furthermore, upon the death of a beneficiary, the balance of the ABLE account is used to pay back all the assistance received from the state.[6] For example, Medicaid benefits received by the beneficiary would be paid back to the state upon the death of the special needs individual. However, an account can be transferred to another beneficiary, but only to a sibling or step-sibling who has a qualified disability.[7]

Review of Third-Party SNTs

Prior to the enacting of the ABLE Act, estate planning for clients with special needs traditionally consisted of an SNT to provide funds for the care and well-being of individuals with special needs. SNTs in turn may be either first- or third-party trusts, which have important distinctions for funding and estate planning options. Barr et al. provide a succinct summary of the differences:

> A first-party SNT must be irrevocable and for the sole benefit of a beneficiary under age 65 who is "disabled" within the meaning of 42 U.S.C. §1382c(a)(3)(A) of the Social Security Act when the SNT is established and funded. On the death of the beneficiary, any assets then remaining in a first-party SNT are subject to a "payback" in favor of all state Medicaid agencies that have provided medical assistance to the beneficiary during his lifetime equal to the total amount of such benefits, even if the payback exhausts the remaining assets of the SNT. In contrast, "third-party" SNTs are funded with assets that do not belong to the beneficiary. Third-party SNTs are not subject to any of the foregoing restrictions and limitations other than that the beneficiary must not be able to revoke or terminate the SNT, nor have the legal authority to direct the use of the SNT assets for [the] SNT beneficiaries support and maintenance…. First-party and third-party SNTs that are fully compliant with relevant federal and state laws, and properly administered by the trustee, will not disqualify the SNT beneficiary from receiving any means-tested government benefits, such as Medicaid and Supplemental Security Income (SSI), for which the beneficiary would otherwise be eligible for as a result of his disabilities.[8]

For purposes of comparison, this article refers to third-party SNTs which require more due diligence among estate planners due to their complexities than do ABLE plans. However, SNTs also offer more flexibility than ABLE plans. Foremost of these, is their greater sources for funding and their exemption from Medicaid recapture.

Advisors must carefully consider the requirements of a third-party beneficiary SNT when evaluating clients with special needs. SNTs are a variation of supplemental or third-party trusts which are designed to provide additional benefits to special needs individuals while ensuring that the beneficiary remains entitled to Supplemental Security Income (SSI)[9] and Medicaid.[10] For example, SNT assets can be used for expenses not covered by Medicaid, such as housing and recreational activities, while maintaining government assistance. However, to ensure government assistance is not affected, SNTs require that the trustee remain in complete control of the assets of the trusts and the trustee is the only individual who can make distributions. Ad-

ditionally, cash disbursements from the SNT, if paid directly to the beneficiary, will lead to an equal reduction in public assistance received by the beneficiary. Finally, the SNT can be amended or revoked, but not by the beneficiary, otherwise the beneficiary will lose government assistance.[11] Due to the need of balancing government assistance with additional resources of an SNT, complexities arise. As Kitces states:

> [p]lanning for special needs beneficiaries is highly complex, a mixture of making challenging care decisions and managing limited resources. Many families will try to save assets on behalf of a special needs beneficiary to provide further support, but if not coordinated properly, can actually disqualify the beneficiary from Federal and state aid programs, including SSI and Medicaid.[12]

Because of these intricacies, the creation of a SNT requires advice from financial planners experienced in special needs planning, including consultation with an attorney who has experience drafting SNTs. For many families, this expense adds to the costs of hiring an experienced trustee and as a result may not be feasible.

When to Select an ABLE 529A Plan or a Third-Party Beneficiary SNT

ABLE plans now offer financial planners and clients an additional option when planning for the care of clients with special needs. However, it is of vital importance that planners and clients recognize the differences between ABLE plans and SNTs when addressing the needs and resources available to beneficiaries with special needs.

ABLE plans differ from SNTs in many ways. Medicaid recapture after the death of the beneficiary doesn't apply to SNTs unlike ABLE plans.[13] The assets in a SNT can be used not only for the beneficiary but also can be given to family members after the death of the beneficiary or to others. Under this provision, the Medicaid pay-back provisions of ABLE plans are avoided and other beneficiaries can secure the financial benefits of funds remaining in the SNT.

A benefit of SNTs is there are no annual contribution limits. However, ABLE plans limit annual contributions to $14,000 per year which is the annual gift tax exclusion allowed by the Internal Revenue Service.[14] Additionally, ABLE plans disqualify recipients from SSI once the account balance exceeds $100,000. SNTs have no such restriction.[15]

The benefits of ABLE plans are that contributions are post-tax and capital appreciation grows tax-free. SNT's capital appreciation is taxed and this can cause additional costs for tax filing purposes. ABLE plans are administratively less complex and the added administrative costs associated with SNTs could be less advantageous to low-income beneficiaries who do not expect to reach the $100,000 limit of ABLE plans.

How to Choose: Three Scenarios for Deciding between ABLE Accounts and SNTs

Whether to select an ABLE plan over a supplemental special needs trust, or consider doing both, ultimately depends on the amount of contributions that will be used to fund the respective accounts. There are situations, depending on the needs and financial resources available to the beneficiary, where an ABLE plan or an SNT, or both, could be used to the benefit of a special needs beneficiary. The following is one such scenario supporting the appropriateness of establishing an ABLE account.

Scenario 1— 529A ABLE Plan for the Beneficiary

- The beneficiary is a member of a family that doesn't expect to meet the $100,000 limit over the lifetime of the beneficiary.
- Projected annual withdrawals and Medicaid benefits will meet the needs of the beneficiary with special needs.

Under this scenario, it is assumed the beneficiary meets the requirements of an ABLE account, was disabled before the age of 26, and has a life expectancy of 40 due to his or her disability. The ABLE plan will be funded with $7,000 per year, for a total of 14 years,

leaving approximately a $98,000 balance in the plan upon the death of the beneficiary. This remaining balance is subject to Medicaid recapture, including both any remaining after-tax contributions and any tax-free growth. Prior to death, disbursements to the beneficiary of the ABLE account are tax free provided they pay for qualified disability expenses. Under this scenario, the beneficiary obtains the benefits of the ABLE plan and can also utilize Medicaid to care for their needs. Furthermore, the balance of the account will most likely not exceed $100,000 which triggers the elimination of possible SSI for the beneficiary.

However, SNTs are suitable in other situations. Assume the special needs individual was disabled before age 26 and meets the requirements of the ABLE Act, but has a severe disability and a long life expectancy. Consequently, a third-party SNT would be the optimal choice for estate planning. This leads to a second scenario where an SNT is an option for financial planners.

Scenario 2—Third-Party SNT for the Beneficiary

- The expected life span of the individual is long.
- The individual has a disability that requires extensive medical care that will greatly exceed the ABLE Act cap of $100,000; and/or
- Available funding will exceed the $14,000 limit established under ABLE plans.
- The contingent and emerging nature of the above provisions makes the use of discretion by the trustee desirable to address future unknown circumstances.

For example, under this scenario assume the beneficiary has cerebral palsy. The life expectancy of an individual with cerebral palsy can be as high as 70 years old;[16] however, life expectancy depends on the severity of the individual's medical condition.[17] It is noteworthy that Honeycutt et al. state that the costs to support a severely disabled individual with cerebral palsy can be as much as $921,000 above the cost of a nondisabled person.[18]

Under Scenario 2, the beneficiary has a disability that will require additional funds that will greatly exceed the $100,000 limit established by the ABLE Act. If a financial planner utilizes an ABLE plan for an individual who requires significant financial assistance, and the balance exceeds $100,000, SSI is eliminated for the beneficiary until the balance falls below $100,000. Additionally, if an intended beneficiary utilizes an ABLE plan, and dies at an early age while budgeting for a long life, a sizable portion of the funds in the plan could be seized by Medicaid recapture provisions. Consequently, an SNT becomes the most viable option as SNTs will not be affected by the elimination of SSI and Medicaid recapture.

Furthermore, when analyzing Scenario 2, as it pertains to the ABLE Act, a traditional SNT has additional key advantages and much more flexibility. Since a third-party trust is not government sponsored or regulated beyond traditional trust law, there are no limitations on who can be named a beneficiary. However, some advisors warn that naming a charity as a beneficiary may void stretch provisions but this is a concern only if the SNT is the beneficiary of an IRA, 403(b) or qualified plan.[19] A safeguard appears to be naming a beneficiary who is alive at the time the SNT becomes active, even if that person dies before the primary beneficiary.

A significant advantage of an SNT is that discretion is allowed. For example, an SNT may be eligible for a "stretch strategy" whereby an inherited IRA used to fund the SNT can spread the distributions over the expected life span of the beneficiary which may greatly increase the amount of funds available for the care of the disabled person. An ABLE account has no such provision. As long as care is exercised in the drafting of the document, trust assets will not affect the SSI or Medicaid eligibility of the beneficiary, but can pay for expenses beyond those listed as qualified under the ABLE Act. Because there are no limitations on the size of SNTs, donors have the ability to provide a desired standard of living beyond what an ABLE account would allow.[20] Finally, SNTs can be funded by

cash including life insurance proceeds, in-kind contributions and securities which provide greater flexibility for high-net-worth individuals. ABLE accounts must be funded solely by after-tax cash.[21]

Scenario 3—
Using SNTs and ABLE Plans Concurrently

There is the possibility where financial planners and clients may desire to establish both an ABLE plan and an SNT. While there are very limited applications of ABLE accounts functioning as the sole method of planning for clients with special needs, there are several valuable ways ABLE plans can be used in conjunction with SNTs. Applying the same facts from Scenario 2, financial planners can create both an ABLE plan and an SNT and fund the ABLE plan up to the $100,000 limit and utilize the funds before accessing SNT funds. This permits all capital gains in the ABLE plan to be obtained tax-free, and limits Medicaid recapture altogether provided that the ABLE account balance is depleted. In this way, additional tax-free growth supplements the taxable growth in the SNT. Hence, the SNT still grows untouched while the ABLE account is drawn down.

An additional benefit of having both an ABLE account and an SNT established for a beneficiary with disabilities is that if the beneficiary passes away and the ABLE account has funds remaining, only the assets in the ABLE account are subject to Medicaid recapture.[22] SNTs assets would remain untouched and can pass to future beneficiaries designated under the SNT.

Does Combining an ABLE Account and an SNT Enable the Wealthy and Disable the Poor?

One specific issue that financial planners must scrutinize is the Medicaid recapture provision of the ABLE Act and the financial needs of the client. Medicaid rules provide that, "…states are required to seek recovery of payments from the individual's estate for nursing facility services, home and community-based services, and related hospital and prescription drug services."[23] However, while Medicaid provides exceptions in cases of hardship,[24] the ABLE Act requires recapture regardless of hardship.[25]

Financial planners must recognize that the strict recapture rules of the ABLE Act can cause problems for low-income individuals with disabilities who have dependents. For example, consider a disabled single parent who is living solely from SSI and Medicaid and who also has a dependent child. In addition to receiving SSI and Medicaid, the disabled parent, or her friends and family, are contributing funds to an ABLE account for unforeseen future medical contingencies. Upon death of the parent, any remaining ABLE funds are recaptured by the state, leaving the child with nothing.

To some extent, this is a "death tax" in that contributions, if any, remaining in the ABLE account were made on an after-tax basis; their recapture at death amounts in essence to a double taxation. Additionally, the previously tax-free growth remaining in the account is for all intents and purposes now taxed. For a low-income and presumably low-wealth individual, the effect of emptying the estate is essentially a regressive tax in that it has greater negative financial outcomes on that individual than on a person with substantial financial resources.

Since the dependent of the beneficiary cannot inherit the ABLE account (even if they too are disabled) the loss of any potential ABLE account balance may increase the need for the dependent to rely more on public assistance than would otherwise be the case. In this instance the purpose of the ABLE Act is undermined because it creates significant hardship for the dependent child. Further, the effect of recapture defeats the purpose of the ABLE Act which is, "To encourage and assist individuals *and families* (emphasis added) in saving private funds for the purpose of supporting individuals with disabilities to maintain health, independence, and quality of life."[26]

Financial planners must also recognize that managing the assets of affluent clients creates the opposite effect. As discussed in Scenario 3, wealthy individuals

using an ABLE plan, along with an SNT, are provided with a shelter for tax-free growth under the ABLE plan. Financial planners would first use ABLE funds, exhaust the funds so there is no Medicaid recapture of the ABLE account due to the zero balance, while assets in the SNT are not subject to Medicaid recapture. This highlights that while intent of the ABLE Act is to assist low- and middle-income individuals, it also creates a potential added benefit for the affluent.

This is not to say that the beneficiary of an ABLE Act does not receive important benefits. Funds in an ABLE account provide assistance for the beneficiary over and above the limits for eligibility for Medicaid and SSI. However, beneficiaries eligible for such benefits, but without any remaining assets in their estate, would not experience any recapture. Scenario 3 simply points out what is likely an unintended consequence of well-intentioned legislation: that wealthier clients may receive new benefits under the ABLE Act and that low-net-worth clients may forfeit benefits not received in the form of funds remaining in the ABLE account not spent at death, especially any tax-free growth remaining.

Issues for Planners

Implications remain for financial planners, especially for planners who have already established an SNT for their clients. One issue is whether a trustee of an SNT can establish and fund an ABLE account. IRC Section 529A(b)(1) states:

> …the term "qualified ABLE program" means a program established and maintained by a State, or agency or instrumentality thereof-
>
> (A) under which a person may make contributions for a taxable year, for the benefit of an individual who is an eligible individual for such taxable year, to an ABLE account which is established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account.[27]

The Act doesn't state whether a trustee of an SNT can establish a 529A plan. It simply states an ABLE program is established and maintained whereby person(s) can make contributions. However, Franklin notes, "The individual with a disability, or someone on his behalf" may establish the ABLE account which would permit a trustee to establish an SNT.[28]

Another issue for planners concerns the life expectancy of the beneficiary with special needs. ABLE plans are designed similar to 529 college savings plans. However, 529 plans have a specific target date for the beneficiary. For example, if a parent is planning for his or her child's college education and the child is five, it is easy for a planner to determine how many years it takes before the child enters college. For individuals with special needs, projecting life expectancy is not precise. As new medical treatments are developed, it is quite possible that a special needs beneficiary may live longer than expected. If this occurs there may not be enough money in the ABLE plan to cover the costs of providing financial support for the beneficiary assuming there are no ongoing contributions to the ABLE account. Conversely, if the special needs beneficiary dies at an early age, Medicaid recapture becomes the primary concern. Consequently, financial planners must use caution and address life expectancy issues when selecting ABLE plans for their clients.

Among the most significant issue that financial planners face is that only 43 states have enacted, or have proposed legislation, for ABLE plans.[29] This leaves the current status and future prospects of ABLE accounts still largely undecided. Additionally, ABLE accounts must be established for a designated beneficiary in the state where the beneficiary resides, creating another complication for families in an increasingly mobile economy.

Unforeseen issues will also most likely arise in the future. For example, the ABLE Act doesn't address whether an ABLE plan can fall under an SNT. This issue can only be resolved by the Internal Revenue Service or by state laws. Financial planners must take note of the adoption of laws and regulations pertaining to ABLE plans in their respective states. This

will slow the adoption of ABLE plans but ultimately give practitioners more time to learn about the effects of the ABLE Act on special needs planning. ■

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