

ABLE Accounts: Tax-Free Earnings for Disabled Individuals

A little known federal law provides for tax-advantaged savings



Christopher M. Zehner
CFP®, CDFA®
Senior Financial Advisor

Christopher Zehner is a Senior Financial Advisor in the Erie, Pennsylvania office of HBKS Wealth Advisors (HBKS®). He specializes in comprehensive financial planning and investment advisory services. Mr. Zehner's keen attention to detail has allowed him to help high-net-worth families achieve their financial and estate planning goals.

Mr. Zehner began his financial services career in 2000 and became a part of HBKS in 2001. He earned his Bachelor of Science Degree in Business Administration from Slippery Rock University and is a CERTIFIED FINANCIAL PLANNER® and a CERTIFIED DIVORCE FINANCIAL ANALYST®.

If you have a disability or are a parent or guardian to someone who is disabled, you might be able to save and invest to cover the related expenses in a tax advantaged way. A 2014 federal law allows for ABLE accounts, where the disabled person is the beneficiary and account owner, but anyone can make contributions to the account in an amount up to the annual gift tax exclusion limits. The income earned by the investments in the account is not taxed as long as the proceeds are used to pay for disability related expenses.

Qualifying expenses include:

- Housing costs, including rent and mortgage payments
- Home improvement and modification
- Transportation, including purchase or modification of a vehicle
- Health care and related services, including insurance premiums, therapy, and equipment
- Personal assistance
- Assistive technology
- Education, including tuition, books, and supplies
- Employment training and support
- Financial management and administration

The law was enacted, at least in part, to address an issue that arises when someone applies for Medicaid, Supplemental Security Income (SSI) or other public benefits that require them to have \$2,000 or less in countable assets. It exempts the money in ABLE accounts from the \$2,000 limit. As a result, account holders can accumulate substantial savings and investment earnings in addition to their public benefits in ABLE accounts, providing some security against future

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expenses. However, when an ABLE account exceeds \$100,000, SSI payments are suspended until the account balance falls back below the \$100,000 level.

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Among the tax benefits associated with ABLE accounts, earnings accumulate tax deferred at the federal level and are tax free when they are withdrawn if used to pay qualified expenses. However, any withdrawn earnings not used for a qualified expense may be subject to ordinary income tax and a 10 percent federal penalty.

While the ABLE Act is a federal law, it is administered by states, similar to how states administer 529 college plans. Like those plans the participant can be a resident of one state and enroll in another state's program. The nuances of the programs differ from state to state; for example, some states follow in the federal path and do not tax ABLE account earnings and some offer other tax incentives. Each state sets its own lifetime contribution limit, the same as the state's maximum for Section 529 college savings plan contributions. And if an account owner who has been receiving Medicaid dies, a state can file a claim against the account balance for medical expenses paid during the period the ABLE account was open. As well, different plans come with different investment options. So it is best to consult with your financial advisor and examine your options before opening an account.

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