ABLE accounts vs. Special Needs Trusts

For those of us old enough to remember, there is a classic Sesame Street skit in which Ernie buys some bread for himself to eat, along with a jar of peanut butter for Bert. After some trial and error, they determine that they both benefit from using these foods together.

When Achieving a Better Life (ABLE) accounts made their debut in (2016), a debate—at times fierce—opened on the merits of these special tax-advantaged accounts for individuals with disabilities versus the merits of Special Needs Trusts, which had been the traditional way to shelter assets sheltered so that the beneficiaries with disabilities could obtain or retain Supplemental Security Income (SSI) and/or Medicaid. In general, attorneys, who are needed to draw up special needs trusts, had more doubts about the worth of this new vehicle (the ABLE accounts), while financial planners, who tend to be enthusiastic about tax-advantaged savings platforms, took to them with more enthusiasm. The truth is that both Special Needs Trusts and ABLE accounts can provide financial security to a person with a disability. Each has its strengths and weaknesses and the two vehicles can be used in collaboration to get the best outcome.

When it comes to costs, ABLE accounts are much more economical to set up and administer. A typical annual fee for an ABLE account is $45-60 dollars with additional fees for individual investments, ranging from about 0.19% to 0.4%. In comparison, it can cost several thousands of dollars to have an attorney write a special needs trust. Pooled trusts are cheaper to join, but they can still cost several hundred to a thousand dollars per year before taking the cost of investments into account. Because ABLE accounts are tax-deferred and because properly planned withdrawals are non-taxable (see our previous blog), there are no real tax-preparation costs associated with the accounts.

Speaking of taxes, it is almost impossible to hold an asset within a Special Needs Trust that duplicates the tax deferral and tax-free disbursement of an ABLE account. It is possible to have a third-party Special Needs Trust as the beneficiary of say, a parent’s IRA, but there are complications that may limit the tax benefits. A first-party Special Needs Trust cannot own an IRA or a 401(k) account. So, an ABLE account is basically the only way for a person with a disability who works to build some needed tax-deferred retirement savings. In fact, as mentioned in my previous blog, the IRS recognized this and has increased the ABLE annual contribution limits for people with disabilities, who do work and who do not contribute to their employer plan because such plans are generally countable assets that could preclude SSI and Medicaid eligibility.

Although working ABLE owners have a higher limit, contributions to ABLE accounts **are** limited on an annual basis. A settlement, gift or inheritance larger than $15,000 could only be added to an ABLE account over multiple years. Moreover, contributions can be made only in cash and the account can hold only marketable securities—typically index or mutual funds. An ABLE account cannot own a house or a vehicle in the manner of a Special Needs Trust.

The person with a disability is the legal owner of her/his ABLE account and can do what s/he wants with the money. For people with the capacity to make their own financial decisions, this ownership is a strength of ABLE. For people without that capacity or people who are easily subject to influence, this ownership could be a weakness of the vehicle, particularly since most ABLE accounts have debit cards attached.

Both ABLE accounts and Special Needs Trusts can pay for a wide range of goods and services to improve the quality of life for the person with a disability. There is one notable exception, however. ABLE accounts can pay for the owner’s food and shelter without impacting her/his SSI payment amount. If a Special Needs Trust pays for food and shelter, the payment will then be treated as In-Kind Support and Maintenance (ISM) and the SSI payments will be reduced by up to one-third.

Finally, ABLE accounts are payback accounts, despite the fact that they may contain not only money originating with the owner, but also contributions by parents, siblings or other third parties. When the owner of an ABLE account dies, any money left in the account goes first to pay back Medicaid rather than to designated beneficiaries. This is similar to what happens with a first-party Special Needs Trust, but it is very different from the situation with a third-party Special Needs Trust, where unused funds will go directly to contingent beneficiaries and Medicaid will thus have no claim.

Every one has a different situation and the proportion of “peanut butter” to “bread” will be different for each as they seek to maximize the strengths of both ABLE accounts and Special Needs Trusts as planning tools. Ernie and Bert from Sesame Street learned the value of cooperation, and you can learn how you can get your ABLE account and your Special needs Trust to cooperate with each other too.

© Alexandra Conroy Baig, MBA, CFP®

Companions on Your Journey

phone: 773-297-1556

email: alexandra@companionsonyourjourney.com