Virginia ABLE Account Deduction Guidelines

Introduction

During the 2016 Session, the Virginia General Assembly enacted budget language (Item 3-5.11 of the 2016 Appropriation Act (House Bill 30, Chapter 780)) that established an individual income tax deduction for contributions to a Virginia Achieving a Better Life Experience ("ABLE") account effective for taxable years beginning on or after January 1, 2016. Under the federal Achieving a Better Life Experience Act of 2014, Congress authorized states to establish tax-advantaged ABLE savings trust accounts to assist individuals and families in saving for the qualified disability expenses of individuals who are disabled or blind prior to age 26. House Bill 2306 (2015 *Acts of Assembly*, Chapter 311) and Senate Bill 1404 (2015 *Acts of Assembly*, Chapter 227) established Virginia ABLE savings trust accounts to be administered by the Virginia College Savings Plan ("Virginia529"). On December 19, 2016, Virginia529 opened the first ABLE savings trust account program, called the "ABLEnow program." For additional information about establishing or making contributions to an ABLE savings trust account under ABLEnow, please visit the program website, www.able-now.com .

These guidelines are published by the Department of Taxation ("the Department") to provide guidance to taxpayers regarding the deduction for ABLE Act contributions. These guidelines are not rules or regulations subject to the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 et seq.) and are being published in accordance with the Tax Commissioner's general authority to supervise the administration of the tax laws of the Commonwealth pursuant to *Va. Code* § 58.1-202. As necessary, additional information regarding the individual income tax deduction will be published and posted on the Department's website, www.tax.virginia.gov.

These guidelines represent the Department's interpretation of the relevant laws. They do not constitute formal rulemaking and hence do not have the force and effect of law or regulation. In the event that the final determination of any court holds that any provision of these guidelines is contrary to law, taxpayers who follow these guidelines will be treated as relying on erroneous written advice for purposes of waiving penalty and interest under *Va. Code* §§ 58.1-105, 58.1-1835, and 58.1-1845. To the extent there is a question regarding the application of these guidelines, taxpayers are encouraged to write to the Department and seek a written response to their question.

General Overview

Effective for Taxable Year 2016, Virginia allows an individual income tax deduction for the amount contributed during the taxable year to an ABLE savings trust account entered into with Virginia529. The amount of the deduction on any individual income tax return in any taxable year is generally limited to $2,000 per ABLE savings trust account . If the contribution by any person to an ABLE savings trust account exceeds $2,000, the remainder may be carried forward and deducted in future taxable years.

However, a contributor to an ABLE savings trust account who has attained age 70 is not subject to the annual $2,000 limitation. Such contributor is allowed a deduction for the full amount contributed to an ABLE savings trust account, less any amounts previously deducted.

For the purposes of all examples in these Guidelines, assume that the ABLE savings trust account is an account entered into with Virginia529 that is set up for the benefit of a designated beneficiary, as defined under federal tax law.

Contributors Eligible to Claim the Deduction

The deduction may be claimed by an individual who makes a contribution during the taxable year to an ABLE savings trust account entered into with Virginia529. An individual is considered a contributor entitled to claim this deduction to the extent he contributes money to an ABLE savings trust account, regardless of whether he is listed as the owner of the savings trust account. To be eligible for the deduction, the contributor must own the assets contributed prior to making the contribution.

Example 1:

Taxpayer A filed a Taxable Year 2016 Virginia income tax return, claiming a deduction for contributions made to an ABLE savings trust account. The contributions were derived from cash in Taxpayer A's bank account. Because Taxpayer A owned the assets that were contributed to the ABLE savings trust account, Taxpayer A would be considered to be the contributor and would be eligible to claim the deduction for contributions made to the ABLE savings trust account for Taxable Year 2016.

Example 2:

Parent made contributions to a custodial account created under the Uniform Gift to Minors Act ("UGMA") or the Uniform Transfer to Minors Act ("UTMA") for the benefit of Son. Subsequently, some of the assets contained in the custodial account were used to make contributions to an ABLE savings trust account, also set up for the benefit of Son.

Because the contributions made to the ABLE savings trust account were made from Son's UGMA/UTMA account, Son was the owner of the assets contributed to the ABLE savings trust account. Parent did not own the assets for which the contributions were disbursed and, therefore, would not be eligible to claim the deduction for such contributions. Rather, Son would be considered to be the contributor, and he would be eligible to claim the deduction for contributions made to his ABLE savings trust account for the taxable year.

In some cases, a taxpayer may ask or direct that a third party make a contribution to an ABLE savings trust account on his behalf. Because of Virginia's conformity to federal tax law, Virginia will look to federal law to determine whether the person considered to have made the contribution is the taxpayer or a third party acting on his behalf. However, that person may only claim the deduction if he is an individual.

Example 3:

Spouse A filed a Taxable Year 2016 Virginia income tax return, claiming a deduction for contributions made to an ABLE savings trust account. Spouse A filed his Virginia income tax return using the married, filing separately, status. His wife, Spouse B, made such contributions from her separate bank account to the ABLE savings trust account. Spouse A asserts that he may claim the deduction because his wife made the contribution on his behalf due to his illness.

Under federal income tax law, Spouse B's contribution generally will not be recast as a contribution by Spouse A. Because Virginia conforms to the federal tax treatment, Spouse B (and not Spouse A) would generally be entitled to the deduction on her Virginia income tax return.

Example 4:

Taxpayer A transferred cash to a trust that is a "grantor trust" for federal income tax purposes. Subsequently, the grantor trust contributed $1,000 of cash to an ABLE savings trust account.

Under federal income tax law, the income and deductions attributable to a grantor trust are generally reported by the grantor on his income tax return. See *I.R.C.* § 671. Therefore, Taxpayer A would generally be entitled to the deduction on his Virginia income tax return.

Example 5:

Taxpayer A transferred cash to a trust that is not a "grantor trust" for federal income tax purposes. Subsequently, the trust contributed $1,000 of cash to an ABLE savings trust account.

Under federal income tax law, the income and deductions attributable to a non-grantor trust are not generally reported by the grantor on his income tax return. Therefore, Taxpayer A would generally not be entitled to the deduction on his Virginia income tax return. Since the trust is not an individual, it is not entitled to claim the deduction either.

Example 6:

Taxpayer A was a resident of Virginia who died in Taxable Year 2016. Pursuant to his will, Taxpayer A directed that his estate contribute $1,000 of cash to a specified ABLE savings trust account.

Under federal income tax law, the income and deductions attributable to an estate are not generally reported by the decedent individual on his income tax return. Therefore, Taxpayer A would generally not be entitled to the deduction on his Virginia income tax return. Since the estate is not an individual, it is not entitled to claim the deduction either.

Computing the Deduction for Contributors Under Age 70

For a contributor to an ABLE savings trust account who has not attained age 70, the amount of the deduction on any individual income tax return in any taxable year is limited to $2,000 per ABLE savings trust account. If the contribution to an ABLE savings trust account exceeds $2,000 in a taxable year, the remainder may be carried forward and deducted in future taxable years until the ABLE savings trust contribution has been fully deducted.

Example 7:

Taxpayer A contributed $2,000 to an ABLE savings trust account during Taxable Year 2016 for the benefit of Son. Taxpayer A also contributed $2,000 to a separate ABLE savings trust account during Taxable Year 2016 for the benefit of Daughter. Taxpayer A will be entitled to claim the full $4,000 deduction for his contributions on his Taxable Year 2016 Virginia income tax return.

Example 8:

Taxpayer A and Taxpayer B, who file Virginia income tax returns as single individuals, each contributed $2,000 to the same ABLE savings trust account during Taxable Year 2016. Each taxpayer will be entitled to deduct $2,000 on his or her Taxable Year 2016 income tax return.

Example 9:

Taxpayer A contributed $10,000 to an ABLE savings trust account during Taxable Year 2016 for the benefit of Son. On Taxpayer A’s Taxable Year 2016 Virginia income tax return, he claimed a deduction of $2,000 for his contribution and carried forward the remaining $8,000. During Taxable Year 2017, he changed the designated beneficiary of the ABLE savings trust account to Daughter, who was also an eligible individual. Taxpayer A can continue to carry forward the remaining balance and claim a deduction of $2,000 on his Taxable Year 2017 Virginia income tax return. This is true, even though the ownership of the account changed during the taxable year.

Computing the Deduction for Contributors Age 70 and Over

A contributor to an ABLE savings trust account who has attained age 70 is not subject to the annual $2,000 limitation. A contributor is considered to have attained age 70 for the taxable year if he has attained age 70 on or before December 31 of that taxable year. Such contributor is allowed a deduction for the full amount contributed to an ABLE savings trust account up to his total Virginia taxable income for the taxable year, less any amounts previously deducted. To the extent that a contribution exceeds a contributor's Virginia taxable income, the contributor may carry forward the remainder to future taxable years.

Example 10:

During Taxable Year 2016, Taxpayer A, who was age 70, contributed $14,000 to an ABLE savings trust account. Taxpayer A is entitled to claim the full $14,000 deduction on his Taxable Year 2016 Virginia income tax return. If Taxpayer A's Virginia taxable income is not sufficient to use the full $14,000 deduction, he may carry forward the remainder and deduct it in future taxable years.

Example 11:

Taxpayer A contributed $10,000 to an ABLE savings trust account during Taxable Year 2016. He contributed $5,000 to the same account during Taxable Year 2017. He was 69 as of December 31, 2016, and attained the age of 70 during Taxable Year 2017.

In Taxable Year 2016, Taxpayer A would be entitled to deduct $2,000. In Taxable Year 2017, Taxpayer A would entitled to carry forward and claim the remaining $8,000 deduction from Taxable Year 2016. In addition, he would be entitled to claim the $5,000 deduction from Taxable Year 2017. If Taxpayer A's Virginia taxable income is not sufficient to use the full $13,000 deduction during Taxable Year 2017, he may continue to carry forward the remaining deduction until the full amount has been claimed.

<u>Recapture of the Deduction</u>

Notwithstanding the statute of limitations on assessments contained in *Va. Code* § 58.1-312, any deduction previously claimed is subject to recapture in the taxable year or years in which a nonqualified distribution is made. For the purposes of applying the recapture provision, any payment made from an ABLE savings trust account is considered a distribution if it meets the applicable federal definition of "distribution." Under Prop. Treas. Reg. § 1.529A-1(b)(6), a program-to-program transfer is not considered a distribution and, therefore, would not trigger recapture of the Virginia deduction.

To the extent that a distribution is made, it will trigger recapture if it is nonqualified. A distribution is nonqualified if the distribution is made for any reason other than to pay qualified disability expenses, as defined in *I.R.C.* § 529A, or the beneficiary's death. No deduction may be recaptured more than once. Recapture must reduce deductions earned but not yet claimed, and deductions carried forward, before the contributor's income must be increased.

As a general rule, a contributor is required to recapture deductions during the taxable year or years in which a nonqualified distribution is made. A contributor who is a nonresident taxpayer is only subject to Virginia taxation to the extent he has Virginia source income. See *Va*. *Code* § 58.1-302. Any amount recaptured is not Virginia source income. Therefore, although a nonresident would be required to recapture the deduction in a year in which a nonqualified distribution takes place, if the nonresident has no Virginia source income during that taxable year, the recapture would not result in a tax liability.

Example 12:

Taxpayer A contributed $6,000 to an ABLE savings trust account during Taxable Year 2016. On Taxpayer A's Taxable Year 2016 Virginia income tax return, he claimed a $2,000 deduction. During Taxable Year 2017, a $1,000 nonqualified distribution from the ABLE savings trust account was made.

Taxpayer A is required to recapture $1,000 of his $2,000 deduction previously claimed. Since he has a carry forward of $4,000 available, Taxpayer A must reduce his total carry forward amount by $1,000. Therefore, he would be entitled to deduct $2,000 in Taxable Year 2017 and $1,000 in Taxable Year 2018.

In cases where there are multiple contributors to the same ABLE savings trust account, a contributor must determine the portion of the nonqualified distribution attributable to him. A contributor's share of the nonqualified distribution is equal to the product of the nonqualified distribution and the following fraction:

- The numerator is the contributor's contributions for all taxable years, minus the contributor's share of nonqualified distributions from all prior taxable years and

- The denominator is total contributions to the account by all contributors for all taxable years minus total nonqualified distributions from all prior taxable years.

Generally, a contributor's recapture amount equals his share of the nonqualified distribution. However, a contributor will not be required to recapture any amount to the extent that such amount would exceed the sum of all deductions previously claimed against his tax liability. If a contributor does not have sufficient information to calculate the amount of his recapture, he must contact the designated beneficiary or an individual with signature authority over the account.

Example 13:

The following taxpayers made contributions to the same ABLE savings trust account in the following amounts:

- Taxpayer A contributed $2,000 during Taxable Year 2016.
- Taxpayer B and Taxpayer C contributed $2,000 in aggregate during Taxable Year 2017.

On his Taxable Year 2016 Virginia income tax return, Taxpayer A claimed a $2,000 deduction for the amount contributed during the taxable year to the ABLE savings trust account.

During Taxable Year 2018, a nonqualified distribution from the ABLE savings trust account was made in the amount of $1,000.

The portion of the nonqualified distribution attributable to Taxpayer A is computed as follows:

$$\$1{,}000 \times \frac{\$2{,}000}{\$4{,}000} = \$500.$$

Therefore, Taxpayer A would be required to recapture $500.

Example 14:

The following taxpayers made contributions to the same ABLE savings trust account in the following amounts:

- Taxpayer A contributed $6,000 during Taxable Year 2016.
- Taxpayer B and Taxpayer C contributed $2,000 in aggregate during Taxable Year 2017.

On Taxpayer A's Taxable Year 2016 Virginia income tax return, a $2,000 deduction was claimed. The remainder ($4,000) was carried forward to future taxable years. On his Taxable Year 2017 Virginia income tax return, Taxpayer A claimed a $2,000 deduction.

During Taxable Year 2018, a nonqualified distribution from the ABLE savings trust account was made in the amount of $1,000.

The portion of the nonqualified distribution attributable to Taxpayer A is computed as follows:

$$\$1{,}000 \times \frac{\$6{,}000}{\$8{,}000} = \$750.$$

Taxpayer A is required to recapture $750. Since he has a carry forward of $2,000 available during Taxable Year 2018, Taxpayer A must reduce his total carry forward amount by $750. He is entitled to deduct the remaining $1,250 in Taxable Year 2018.

Example 15:

The following taxpayers made contributions to the same ABLE savings trust account in the following amounts:

- Taxpayer A contributed $6,000 during Taxable Year 2016.
- Taxpayer B and Taxpayer C contributed $2,000 in aggregate during Taxable Year 2017.

Taxpayer A had attained the age of 70 in Taxable Year 2016. On Taxpayer A's Virginia income tax return for Taxable Year 2016 and Taxable Year 2017, no deduction was claimed because his total Virginia taxable income for both taxable years was zero.

During Taxable Year 2018, a nonqualified distribution from the ABLE savings trust account was made in the amount of $1,000.

The portion of the nonqualified distribution attributable to Taxpayer A is computed as follows:

$$\$1{,}000 \text{ X } \frac{\$6{,}000}{\$8{,}000} = \$750.$$

Taxpayer A is required to recapture $750. Since he has a carry forward of $6,000 available, Taxpayer A must reduce his total carry forward amount by $750. He is entitled to deduct the remaining $5,250 in Taxable Year 2018.

Example 16:

Taxpayer A contributed $2,000 to an ABLE savings trust account during Taxable Year 2016. On Taxpayer A's Taxable Year 2016 Virginia income tax return, he claimed a deduction of $2,000 for his contribution. In Taxable Year 2017, a nonqualified distribution of $1,000 was made from the ABLE savings trust account. On Taxpayer A's Taxable Year 2017 income tax return, he reported recapture income of $1,000 for his nonqualified distribution.

During Taxable Year 2018, the following taxpayers contributed the following amounts to the same ABLE savings trust account:

- Taxpayer A contributed $2,000.
- Taxpayer B and C contributed $2,000 in aggregate during Taxable Year 2017.

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On Taxpayer A's Taxable Year 2018 Virginia income tax return, he claimed a deduction of $2,000 for his contribution. During Taxable Year 2019, another nonqualified distribution from the ABLE savings trust account was made in the amount of $1,000. The portion of the nonqualified distribution attributable to Taxpayer A is computed as follows:

$$\$1{,}000 \times \frac{\$4{,}000-\$1{,}000}{\$6{,}000-\$1{,}000} = \$600.$$

Therefore, Taxpayer A would be required to recapture $600.

Claiming the Individual Income Tax Deduction

The individual income tax deduction for contributions to ABLE savings trust account is claimed on a schedule to the Virginia income tax return. If the contributor is a resident of Virginia during the taxable year, the deduction is claimed on Schedule ADJ. Part-year residents of Virginia may claim the deduction on Schedule 760PY ADJ, and nonresidents may claim the deduction on Schedule 763 ADJ. These schedules are available to download from the Department's website (http://www.tax.virginia.gov/). These schedules must be completed and included with the contributor's Virginia income tax return.

Additional Information

These guidelines are available online under the Laws, Rules and Decisions section of the Department's website, located at http://www.tax.virginia.gov/. For additional information, please contact the Department at (804) 367-8031.

Approved:

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