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MEDICAL CARE SAVINGS ACCOUNTS

By: Matt W. Zeigler, Esq.

With little fanfare, Governor Engler signed into law on July 31, 1994, the Medical Care Savings Account Act, Public Act 289, 1994.

Legislative History It is a common observation that one root cause of the high rate of increase in the cost of health care, and in the price of insurance to cover health care expenses, is the lack of cost consciousness by consumers. Consumers of health care, it is said, are often "spending someone else's money" or at least do not perceive the money they are spending as their own because they are relying on insurance. This means, the argument goes, that there are few incentives to seek out less expensive services and products and few incentives to decide to forego care entirely in marginal cases. The result is over-utilization of the health care system and a lack of price discipline, together leading to ever-increasing expenditures on health care. Among some who emphasize this point-of-view, one new proposal deemed encouraging is the "medical care savings account," sometimes known as a "medical IRA" or "medisave" account. The basic elements of this concept are a high-deductible, catastrophic health insurance policy and money set aside in a tax-free savings account to pay smaller bills and deductibles. One form of this would have an employer switch from its current health insurance to a high-deductible catastrophic policy and deposit the saving into a tax-free account for an employee's use. If the employee did not use the money in a given year, it would be withdrawn. (Early withdrawals of money, however, would be subject to penalty.) The money also could be allowed to accumulate, in anticipation of special health care expenses or to be used to purchase health insurance if the employee lost his or her job. In other words, the money in the medical savings accounts would belong to the employees to use as they saw fit and would be portable from one employer to another or to self-employment.¹

So, how would you, as an Employer, like to put away up to \$1,000 each year on a pre-tax basis to pay for uncovered medical expenses for your employees? And how would you, as an employer, like to set up a program that would allow your employees to put away up to an additional \$2,000 each year to pay for uninsured medical costs?

Contributions. The idea is simple: an employer adopts a written program to provide a health coverage policy, certificate, or contract or self-insured health plan called a Medical Care Savings Account Program, (a Savings Account). There are three different Plans that were created by the statute which include:

PLAN A:

- The purchase of health insurance coverage with a higher deductible for the benefit of its employees and/or dependents; and

¹ Commentary from House Legislation Analysis Section.

- the employer contributes an amount, but not less than \$1,000 on behalf of an employee, which is all or part of the premium differential or savings realized by the employer as a result of the purchase of the insurance policy with the higher deductible (which presumably cost less than the previous medical insurance policy with the lower deductible). The employee can, in addition, contribute, an amount, up to \$2,000 per year to the Savings Account. The legislation anticipates that the new plan would have a higher deductible in the range of at least \$1,000 to \$3,000 per year.

PLAN B:

- If an employer did not previously have a health insurance plan, the establishment of the Savings Account consists of:
- the purchase of health insurance coverage with a high deductible for the benefit of its employees and/or dependents; and
- the employer may contribute an amount, which is up to the deductible amount under the new Plan. In addition to the deductible amount, the employee may contribute an amount equal to the difference between the amount of the deductible (contributed by the employer) and the statutory limit of \$3,000². For example, if the employer were to establish a plan with a family deductible of \$500, then the employee could salary defer an additional \$2,500 for medical expenses.

PLAN C:

- An employee ("Account Holder") establishes a medical insurance plan, for him or herself and his or her dependents;
- Medical insurance coverage is purchased with a deferred amounts for the benefit of him or herself and his or her dependents; and
- The employee contributes an amount, but not more than \$3,000 to pay for the cost of the benefits.

Contributions, however made, can be accumulated in the Savings Account from year to year, without current taxation, until disbursed, as outlined below.

What Medical Expenses Are Covered? The medical expenses which are eligible to be paid for from the Savings Account are those which are allowed to be treated as deductions under the Internal Revenue Code, Section 213(c), which include expenses for the diagnosis, cure, mitigation, or for the prevention of disease, transportation for essential medical care, and insurance premiums for medical treatment. Eligible medical expenses include those of the employee and his or her dependents. The statute prevents double dipping, so that medical expenses otherwise covered by insurance, worker's disability, auto insurance, self-insured plans, or another policy of insurance, would not be paid for from the Savings Account.

Who Can Set Up One of these Savings Accounts? After the employer sets up the Program, the funds can be deposited into any account set up by a financial institution, any licensed insurance company,

² This \$3,000 limit would be adjusted annually based on the consumer price index. The 1994 limit is \$3,000.

any licensed broker dealer, any licensed third party administrator, any licensed certified public accountant, the employer that has a self-insured health plan as defined under ERISA, or the employer that adopts a Medical Care Savings Account Program. The statute creates a fiduciary duty between the person holding the funds and the employee, just like all of the other retirement plans and other employee benefit funds.

Self-employed individuals are also eligible to set up a Savings Account for themselves.

Withdrawals and Disbursements. In addition to the payment of eligible medical expenses, an employee may withdraw the funds from the Savings Account one time each year on the last day of the plan year of the account administrator, be it the employer, bank, insurance company, etc. Those amounts when disbursed, would be subject to ordinary income taxation in the year of withdrawal. There is an early withdrawal penalty of 10% when money is withdrawn at any other time during the plan year which is not used to pay for medical expenses.

Portability is provided between successive employers when both the employee and the new employer agree to accept the funds from that employee's prior employer. Otherwise, the employee's accumulated funds may remain in the first employer's Savings Account until disbursed.

Tax Implications. The tax facts are that the employee would be entitled to a reduction in taxable income up to \$3,000 each year to the extent included in adjustable gross income. Any interest earned on the amounts accumulated would also not be included in taxable income. The Michigan tax consequences are that for the amount deferred into the Savings Account will have a tax credit of 3.3%. So, the amounts deferred will be subject to a 1% income tax in Michigan.

On the Federal level, until such time as these Savings Accounts are adopted by the US Congress, there is no federal tax savings. The adopter of a Savings Account must inform the employees of the tax implications of these accounts, just as sponsors of the tuition assistance programs routinely do on an annual basis, or when the tax consequences change.

Conclusion. Michigan adopted this Act with a sunset provision set to be repealed on January 1, 1999. During this time the Commissioner of Insurance is to study the impact that these Savings Accounts have on cost savings to medical consumers in the State and report their findings to the State Legislature.

Adopting a written program to permit the employees to pay for their own first line medical care will certainly achieve a profound awareness of the cost of delivery for these services. The statute is a step in the direction of cost containment when the consumers start asking and comparing these expenses. However, without federal tax savings on these accounts, the race to adopt such a program will be slowed.

A tax savings of 3.3%, and perhaps more in the future, is an incentive to employers to reduce their health care premium dollars with a goal of current tax savings to employers and employees, the ultimate consumers of medical care.