DESCRIPTION OF TENTATIVE AGREEMENT RELATING TO MEDICAL SAVINGS ACCOUNTS ("MSAs")

Prepared for the Use of the Conferees
for the Revenue Provisions of H.R. 3103
(The "Health Coverage Availability and Affordability Act of 1996")

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of the

JOINT COMMITTEE ON TAXATION

July 26, 1996

JCX-43-96

Introduction

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary of the principal features of a tentative agreement relating to the tax treatment of medical savings accounts ("MSAs") in connection with the conference on H.R. 3103 (the "Health Coverage Availability and Affordability Act of 1996"). H.R. 3103, as passed by the House of Representatives, permitted all individuals covered under a high deductible health plan to make contributions to MSAs. The Senate-passed version of H.R. 3103 did not contain specific provisions relating to MSAs.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Tentative Agreement Relating to Medical Savings Accounts*, JCX-43-96 (July 26, 1996).

Description of Tentative Agreement Relating to
Medical Savings Accounts ("MSAs")

Availability of MSAs

- Beginning in 1997, MSAs are available to employees covered under a qualified employer-sponsored high deductible health plan if the employer employed, on average, no more than 50 employees during the preceding or the second preceding year. Also beginning in 1997, MSAs are available to self-employed individuals who are covered under a high deductible plan.

- In order to have an MSA, an otherwise eligible individual must be covered under a qualified high deductible health plan and not covered under any other health plan (other than plans providing certain incidental health coverage).

- Contributions can be made both by the employer and the employee, but an individual is not eligible to make contributions for a year if the employer makes contributions for that year.

- If a small employer ceases to be a small employer, it remains an eligible employer until it has more than 200 employees. After that, only employees of the employer who already have an MSA can continue to make contributions to the MSA.

Cap on taxpayers utilizing MSAs

- The number of taxpayers benefiting annually from an MSA contribution is generally limited to 750,000. In determining whether the cap has been exceeded, MSAs of individuals who were not previously insured are not taken into account. For 1997, individuals are permitted to establish MSAs if they are in the qualifying group of self-employed individuals or employees working for employers with 50 or fewer employees.

- After December 31, 2000, generally no new contributions may be made to MSAs except by or on behalf of self-employed individuals who previously had MSA contributions and employees (including new employees or employees who did not previously have an MSA) employed by an employer that made contributions to an MSA on behalf of any employees during 1997-2000. In addition, if the employer did not make MSA contributions, employees of an otherwise eligible employer could establish new MSAs and make new contributions if participation standards were met for employees covered under a high deductible plan in the year 2000. Self-employed individuals who made contributions to an MSA during the period 1997-2000 also may continue to make contributions after 2000.

Tax treatment of and limits on contributions

- Employer contributions are excludable and individual contributions are deductible.
- The maximum annual contribution is 65 percent of the deductible under the high deductible plan in the case of individual coverage and 75 percent of the deductible in the case of family coverage.

Comparability rule for employer contributions

- If an employer provides high deductible health plan coverage coupled with an MSA and makes employer contributions, the employer must make available the same contribution of behalf of all employees with comparable coverage during the same period. No special restrictions are imposed on the ability of the employer to offer different plans to different groups of employees, and no special requirements are imposed with respect to self-employed individuals who own a company.

Definition of high deductible plan

- A high deductible plan is a health plan with an annual deductible of at least $1,500 and no more than $2,250 for an individual and at least $3,000 and no more than $4,500 in the case of a family.
- The maximum out-of-pocket expenses with respect to allowed costs (including the deductible) must be no more than $3,000 in the case of an individual and no more than $5,500 in the case of a family. (All dollar amounts are indexed for increases in the CPI beginning after 1998.)
- High deductible plans must disclose cost-sharing and related information as required by the Secretary of the Treasury. The NAIC would be encouraged to develop standards for high deductible plans that States could adopt.

Tax treatment of MSAs

- Earnings on amounts in an MSA are not currently includible in income.
- Distributions from an MSA for medical expenses are generally excludable from income. In any year in which an MSA contribution is made, withdrawals are excludable from income only if used for the medical expenses of someone covered by a high deductible plan.

- Distributions not used for medical expenses are includible in income. Such distributions are also subject to an additional 15-percent tax unless made after age 65, death, or disability.

- Upon death, any remaining MSA balance would be includible in the decedent's gross estate, under rules similar to those applicable to individual retirement arrangements.

Measuring the effects of MSAs

- Treasury will regularly evaluate whether high deductible plans purchased in conjunction with MSAs are providing meaningful health coverage and will make reports to the Congress.

- Treasury will monitor MSA participation and the cost of the Federal Government of such participation during the 1997-2000 period and report on such participation to the Congress.

- An independent organization with expertise in health care matters will be requested to prepare a study regarding the effects of MSAs in the small group market on adverse selection, health costs, use of preventive care, consumer choice, and other relevant issues.