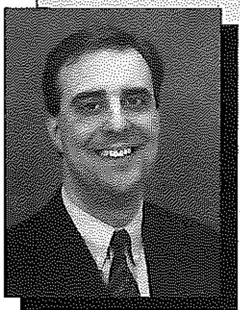

SCOTT M. STEVENS *is vice president, sales and marketing, for United Chambers Life. He has been with the company for ten years and is directly responsible for new product development and market planning.*

Stevens acquired his bachelor of science degree in marketing and economics from the State University of New York–College at Oswego, and is pursuing his masters in business administration from North Central College. His specific expertise includes: product development and enhancement, corporate communications, market research and analysis, and medical savings accounts. Stevens' previous responsibilities involved recruiting, hiring, and training independent insurance agents, general agents, and local chambers of commerce nationwide.

Stevens can be reached by telephone at 630-505-3100, extension 8494; by fax at 630-577-2932; or e-mail at ***sstevens@aclic.com.***

MSAs: Big Benefits For Small Business

In August 1996, the great health care debate finally reached consensus in The Health Insurance Portability and Accountability Act. As part of this act, the government established a four-year "pilot project" allowing employees of small business to establish tax-free, interest-bearing medical savings accounts. Free enterprise and consumerism triumphed over more socialistic, restrictive proposals that were supported by few. The real winner was the American health care consumer; in particular, those persons employed by small business.

Exactly What is an MSA?

The federal government defines an MSA as, "a tax exempt trust or custodial account established for the purpose of paying medical expenses in conjunction with a high deductible health plan."[1] Similar to other government sanctioned savings programs such as individual retirement accounts (IRAs) and flexible spending accounts (FSAs), the MSA creates tax incentives for individuals to set aside funds for a specific purpose.

Under an MSA, individuals enrolled in a high deductible plan may make tax-free contributions to an account created primarily for the purpose of paying for qualified medical expenses. Or, eligible employers may make contributions on behalf of their employees. MSA contributions can be made by the employee or the employer, but not both. Any unused funds are allowed to accrue, tax-deferred. The maximum annual contribution that can be made is equal to 65 percent of the health plan deductible amount in the case of single coverage, and 75 percent of the health plan deductible amount for a family. Contributions only can be made for the number of months that an individual is insured by a qualifying high deductible plan. Individuals also cannot contribute more than their income in any one month.

Qualifying High Deductible Plans

In order to take advantage of the tax-favored status and benefits associated with MSAs, an individual must maintain health insurance coverage through a qualifying high deductible health plan. According to the federal government, such a plan must meet the following requirements.

1. Individual annual deductibles must be at least $1,500 and cannot exceed $2,250.
2. Family annual deductibles must be at least $3,000 and cannot exceed $4,500.
3. Annual out-of-pocket maximums including deductibles, but excluding premiums, cannot exceed $3,000 for individuals and $5,500 for families.

The premiums savings inherent in high deductible plans, versus lower deductible or copay plans, can be used to help fund the MSA. Consider the following example.

Bob Smith is a 40 year old, married, self-employed carpenter in Naperville, Illinois. The premium for a copay plan through a local HMO is $466 per month. The premium for a $2,250 MSA/high deductible plan offered is $153 per month. If Bob elects the $2,250 deductible plan, he saves $313 each month. He can invest the premium difference in his MSA, earning tax-deferred interest, and in less than eight months, will have enough money to cover his deductible, if necessary.

Once the MSA is adequately funded, an individual has a "100 percent plan." MSA funds are used to pay for the up-front expenses applied against the high deductible; then, the high deductible plan pays for any significant health care expenses. In effect, the high deductible plan is a "safety net."

Other Uses of MSA Funds

MSA funds can be used to pay for qualified medical expenses, as defined under Section 213 of the IRS tax code, even if they are not covered by the high deductible health plan. For example, most health plans exclude coverage for certain items (e.g., acupuncture, vitamins, contact lenses). *(Note: You can request a list of qualifying medical expenses by contacting the IRS at (800) TAX-FORM.)* The government assesses a 15 percent tax, in addition to regular income tax, on the use of MSA funds for ineligible expenses. However, at age 65, the 15 percent penalty no longer applies to otherwise ineligible disbursements.

MSA funds can also be used, tax-free, to pay premiums for:

- Long term care insurance.
- COBRA coverage.
- Health insurance while an individual is receiving unemployment compensation.

All too often, individuals do not maintain health insurance coverage while they are "between jobs" because of the cost. MSA funds can be used for this purpose, providing a bridge for employees who have temporarily lost their jobs.

MSAs Create Responsible Consumers with Real Purchasing Power

Senator Phil Gramm once offered this question to ponder: "What do you suppose would happen if the federal government passed a bill which provided government reimbursement for 95 percent of all grocery purchases?" This rhetorical question brings to mind an image of overflowing shopping carts. With "someone else" picking up the bill, consumers have no incentive to be prudent or even responsible for buying goods and services. Consequently, our nation's "health care shopping carts" are overflowing.

According to John Goodman, an economist who first promoted the idea of MSAs in his book ***Patient Power*** (co-authored by Gerald L. Musgrave in 1992), "MSAs encourage consumers to shop the market for the best prices, creating competitive pressures that will drive costs lower."[2] Health care consumers with MSAs have a real incentive to "shop around" because their own money is at stake. Consider the following example.

Richard Norton is one of nine employees at Concord Management, a real estate management firm.[3] Shortly after the company changed to a new plan with an MSA, Richard started asking questions about the cost of his asthma medication. Because he shopped and compared prices, his new prescription costs only one-fourth of what he used to pay. This results in a savings of $750, which Richard can accrue tax-deferred.

Over 75 percent of the cost of medical care incurred by families with members under age 65 is less than $1,000 per year.[4] This means that three quarters of the medical expenses of the "under 65 population" can be paid using MSA funds. Imagine the purchasing power of the typical MSA holder, knowing that many health care expenses can be paid for at the point of service. *Since payment will not be delayed due to administrative processing, this provides a good incentive for health care providers to offer their best prices to these purchasers. MSA health care purchasers will still need to use their purchasing power to avoid significant cost shifting.* For example, one health care consumer, using the *Yellow Pages* to "shop around" for a cholecystectomy (better known as a gall bladder removal), discovered that the cost of the same procedure varied by $500 in the same city.

Cost shifting, over-utilization, mandated benefits, and billing errors have all contributed to the increasing cost of health care. In response, insurers and HMOs have adopted restrictive managed care measures to help control costs. Some of these measures also restrict choice of provider. But, MSAs restore freedom of choice of provider. They also encourage health care consumers to seek quality providers at the most reasonable price.

Everyone wins with the MSA...

- The employer has lower cost health insurance.
- Employees have more control over their health care and the ability to accrue tax-deferred funds.
- Health care providers get paid quicker since basic health care claims do not have to be processed by a claims administrator.
- The economy in general benefits from a more stable medical inflation rate.

MSAs effectively address the main goal of health care reform: *To make health care more affordable and accessible.*

Big Benefits for Small Business

MSAs provide the following five essential benefits for small business.

1. The high deductible health plans sold in conjunction with MSAs typically cost less, thus reducing the basic cost of health insurance.
2. Employee contributions can be deducted (up to allowable maximums) from income at year-end or employer contributions are exempt from payroll related taxes.
3. The MSA earns tax-deferred interest that could build up to the point of supplementing retirement if maintained over time.
4. MSAs provide discretionary funds that can be used to pay for:
   - expenses applied against the health plan deductible,
   - qualifying medical expenses that are not eligible under most health plans, and
   - health insurance "between jobs."
5. MSAs encourage individuals to be more responsible health care consumers and to better manage their own care.

While MSAs are not a new concept (***Forbes*** magazine established MSAs for its employees in 1992), it wasn't until The Health Insurance Portability and Accountability Act that the government authorized tax-favored treatment of MSA funds. Unfortunately, unless amended, the act limits availability of MSAs to 750,000 previously uninsured individuals. As of January 1, 1997, the MSA flood gates swung wide open! So remember, the MSA clock is ticking...and, the tax benefits of the MSA *are only available* for the number of months that the MSA exists.

What are you waiting for? Take advantage of MSAs...big benefits for small business!

[1]"IRS Answers Questions About MSAs," *Daily Tax IRS Documents*, 2 December 1996:2311.
[2]Laura M. Litvan, *Nation's Business*, July 1995, v83 n7:31(2).
[3]Litvan, 31 (2).
[4]Milliman and Robertson, telephone conversation, 30 Jan. 1997. ❑