Medical Savings Accounts (MSAs) — Custodian Responsibility and Marketing

The creation of the new Medical Savings Account (MSA) has generated a great deal of interest on the part of many small employers. Eligibility for an MSA is limited to employees of small employers who participate in a high-deductible health care plan. Contributions are based on a percentage of the health care plan's annual deductible limit. Distributions from the MSA that are used for medical expenses that are not covered by insurance will not be subject to tax. Distributions used for nonmedical reasons on a percentage of the health care plan's annual deductible limit. Contributions are based on a percentage of the health care plan's annual deductible limit. The most common questions we get from potential MSA custodians and trustees. The MSA custodian/trustee's responsibilities are for determining MSA eligibility, contribution amounts, and taxation of distributions. Recent IRS Notices and the release of the MSA reporting forms have clarified these issues.

A bank's responsibility in administering an MSA is perhaps even less complicated than what is faced with IRAs. To begin with, the issues of MSA eligibility and contributions will be examined. An MSA custodian or trustee is not responsible for determining whether or not an individual is eligible for an MSA. This determination will fall on the individual and to some extent the individual's employer. There is virtually no way an MSA custodian/trustee could determine when an individual does or does not meet the eligibility requirements for an MSA. As such, the determination will fall on the individual. The MSA forms we have designed clearly place this responsibility on the accountholder.

MSA contribution amount determination is again the responsibility of the individual. Again, it would be impossible for the custodian/trustee of an MSA to determine what contribution could be made to an MSA for an individual. The MSA custodian/trustee's responsibility with MSA contributions will be to report the amount of any MSA contributions. The new IRS Form 5498-MSA illustrates the fairly simple MSA contribution reporting an MSA custodian/trustee faces. It asks for the following information:

Box 1 asks for the total MSA contributions made for the year by the individual. This box does not include contributions made to an MSA by the individual's employer.

Box 2 asks for the total MSA contributions made in 1997 either by the employer or the individual.

Box 3 asks for the total MSA contribution made in 1998, for 1997, either by the employer or the individual.

Box 4 asks for the amount of any rollover contribution to the MSA in 1997.

Box 5 asks for the December 31, 1997 fair market value of the MSA.

With these reporting requirements, the MSA custodian/trustee will only have to document, administer and report the amount of any contributions, the date made, and the source of the contributions. It will be critical that the custodian/trustee ascertain the source of the contribution. Is this coming from the individual, or from the individual's employer? Employer contributions to a person's MSA will only appear on the 5498-MSA in Boxes 2 or 3 and then again Box 5 as part of the fair market value. The source will also be important as the individual cannot contribute to the MSA in any year their employer does.

Responsibility relating to rollover contributions is quite simple — it will be the individual's responsibility for compliance with the MSA rollover rules. We are strongly recommending that the MSA custodian/trustee get an MSA rollover form signed by the individual where the individual will certify compliance with the rules. To summarize, contribution responsibility for MSAs will be quite similar to that for IRAs. The custodian/trustee will need to ascertain...
IRS Issues 1997 MSA Form 1099-MSA

Instructions to Recipient
Distributions from a medical savings account (MSA) are reported to recipients on Form 1099-MSA.

The payer is not required to compute the taxable amount of any distribution. An MSA distribution is not taxable if you used it to pay qualified medical expenses or you rolled it over to another MSA. However, see Box 2 below. If you did not use the MSA distribution for qualified medical expenses or you did not roll it over, you must include the distribution in your income, and you may owe a 15% penalty. If the accountholder died during the year, see Pub. 502, Medical and Dental Expenses. Box 1—Shows the amount you received this year. The amount may have been a direct payment to the medical service provider or distributed to you. See the instructions for your income tax return for information about how to report this amount.

Box 2—Shows the earnings on any excess contributions you withdrew by the due date of your income tax return. If you withdrew the excess, plus any earnings, by the due date of your income tax return, you must include the earnings in your income in the year you received the distribution even if you used it to pay qualified medical expenses. This amount is included in Box 1.

Box 3—These codes identify the distribution you received:
1—Normal distribution
2—Excess contributions
3—Disability
4—Death
5—Prohibited transaction

Payers, Please Note—Specific information needed to complete this form and other forms in the 1099 series is given in the 1997 Instructions for Forms 1098, 1099, 5498 and W-2G. A chart in those instructions gives a quick guide to which form must be filed to report a particular payment. You can order those instructions and additional forms by calling 1-800-TAX-FORM (1-800-829-3676).

Furnish Copy B of this form to the recipient by February 2, 1998. File Copy A of this form with the IRS by March 2, 1998.

IRS Issues 1997
MSA Form 8851
See the sample form enclosed with this newsletter.

Form 8851—A trustee of a medical savings account (MSA) must file Form 8851, Summary of Medical Savings Accounts, to report the number of MSAs established and other information. See Form 8851 for details.
MSA—Continued from page 2

would seem to us that there should be a
two-fold marketing effort. To begin with,
the financial institution should let its
customers know that it offers MSAs.
Those financial institutions that are
offering MSAs early on will see
substantial activity due to the fact that
many institutions have not yet decided
whether or not to offer them, and others
have decided that they won't. We have
had comments from numerous
individuals around the country that relate
some difficulty in finding a financial
institution that has or will have these
available. This should make it easier for
financial institutions that are offering
MSAs to get these deposits. The trick will
be to let people know you offer the MSA.
This could be done through a statement
mailing to existing customers, through
print, radio, or TV media in your local
markets. With the relative lack of MSA
custodian/trustees, the later could prove
quite effective.

We would also recommend a strong
marketing effort be aimed at small
employers. As eligibility for an MSA is
limited to employees of employers with
50 or fewer employees, a concentrated
effort should be made to aim marketing at
this type of employer. The employer
needs to be made aware of MSAs. Part of
the eligibility requirement is participation
in a "high-deductible health care plan." If
the employer offers health insurance to its
employees, it would have to fall under the
parameters for a "high-deductible plan"
in order for employees to have an MSA.
Demonstrating the cost savings an
employer will realize by using this type of
high-deductible plan can go a long way
towards getting the MSA deposit
accounts. Additionally, demonstrating the
tax benefits of an MSA for both the
employer and the employee will make
these attractive to many employers. In
many banks, marketing towards
employers can be a very targeted effort. In
many cases, your personnel will know
who the customers are the owners of a
small business or are self-employed.
These are the people that need to be made
aware of how MSAs work and of the fact
that your institution offers them.
Mailings, phone calls or personal visits to
these people who are already bank
customers should prove effective. This
makes the marketing effort more focused
and less expensive.
Tied to marketing to the small
employer is an effort towards marketing
to tax preparers, CPAs, attorneys, and
insurance agents. When these tax
professionals see the benefits of an MSA
to their small employer clients, many will
recommend the adoption of a high-
deductible plan coupled with the MSAs
for the employees. We are seeing a
dramatic increase in the number of
insurance people working with banks in
this area. On a number of occasions we
have had insurance agents who sell the
high-deductible health plans call us to ask
for the names of banks in their area who
will offer the MSA deposit account.
Working closely with these people will,
in our opinion, dramatically increase your
MSA deposits. Marketing to these people
may be as simple as letting them know
you offer MSAs. This can be done through
a targeted mailing effort to these
professions, through personal phone calls
to these types of professionals in the
bank's community, and possibly through a
seminar aimed at these professionals.
The key again is letting them know you
have MSAs available.

IRS Issues 1997 MSA Form 5498-MSA and 8851

Instructions to Participant
The information in boxes 1 through 5 is submitted
to the Internal Revenue Service by the trustee of
your medical savings account (MSA) to report
regular or rollover contributions made to your
MSA and the value of your MSA.

Generally, contributions you make to your MSA are
deductible. However, if your employer makes a
contribution to one of your MSAs, you cannot
deduct this contribution, and you will have
an excess contribution.

Box 1—The amount shown is the contribution
you made in 1997 and through April 15, 1998, for
1997. You may be able to deduct this amount on
your 1997 income tax return. See the instructions
for your income tax return for information about how to
report distributions and rollovers.

Box 2—The amount shown is the total employer
deductions made in 1997 to your MSA.

Box 3—The amount shown is the total

Box 4—This is the amount of any rollover you
made to this MSA in 1997 after a distribution from
another MSA. See the instructions for your
income tax return for information about how to
report distributions and rollovers.

Box 5—This is the fair market value of your
account at the end of 1997.

You are not required to attach a copy of Form
5498-MSA to your income tax return. Keep this
form for your records.

For more information about MSAs, see Pub.
502, Medical and Dental Expenses.

Trustees, Please Note—
Specific information needed to complete this form
and forms in the 1099 series is given in the 1997
Instructions for Forms 1099, 1098, 5498, and
W-2G. You can order these instructions and
additional forms by calling 1-800-TAX-FORM
(1-800-829-3676).

Furnish Copy B of this form to the participant
by June 1, 1998.

File Copy A of this form with the IRS by June 1,
1998.
Question: May the unrelated business income tax rules apply to self-directed IRAs?

Answer. Yes. In general, Code sections 511-514 set forth the rules for unrelated business income tax. The general concept is that a tax preferred entity (IRA, nonprofit corporation, etc.) should pay tax if it is involved in a business or trade which is unrelated to the primary reason for its existence. The unrelated business tax is just that, a tax. It is not a disqualifying event. If an IRA takes on debt for some investment reason, the unrelated business income tax most likely will be owed. An IRA is generally required to pay income tax on its unrelated business taxable income to the extent such income exceeds $1,000 per year. The form to be filed is the Form 990-T.

Question: Is the mandatory withholding rate for IRAs 10% or 20%?

Answer. The general rules for IRAs are that an IRA custodian must withhold 10% of the distribution amount unless the IRA accountholder instructs you to not have any amount withheld or he or she instructs to withhold more. The IRA accountholder could instruct you to withhold 20%, 30%, 50% or any percentage. All distributions from a qualified plan which are eligible to be rolled over are subject to a mandatory 20% withholding rate. The fact that the distribution amount is less than $200 does not mean there is no duty to withhold at the rate of 20%.

Question: We have an IRA accountholder who made an excess contribution of $400 per year for tax years 1993, 1994 and 1995. She wants us to pay her the $1,200 plus the related income. She called the IRS and they told her to withdraw the $1,200 plus the related income. We called the IRS and they again told us that we should pay out the related income. Is there a requirement that an IRA accountholder must withdraw the related income when he or she withdraws an excess contribution after the due date? What should we tell her?

Answer. There is no requirement for an IRA accountholder to withdraw any related income when he or she withdraws an excess contribution after the due date. The problem is this — the tax code has one set of rules when an excess contribution is withdrawn before the tax return for that year is due, and another set of rules when an excess contribution is withdrawn after the due date of that year’s tax return. The rules are not the same. There is a requirement to withdraw the income if the withdrawal of the excess is “before” but not if it is “after” the deadline for filing the tax return. The pertinent portion of the Code section 408(d)(5) is set forth below:

Possible Legislation — Continued from page 1

bill would restore the law as it was from 1982-1986 — people would no longer be ineligible to deduct their contributions because they were active participants and their income was too high. This bill also contains the second type of IRA — no deduction, but distributions will not be included in income if certain rules are met. Two members of the House Ways and Means Committee have introduced a similar bill in the House. The two members are William Thomas (R-Cal.) and Richard Neal (D-Mass.).

HOT. President Clinton has contained within his 1998 fiscal budget a proposal which would, over a five- to six-year period, increase the adjusted gross income limits from $35,000 to $70,000 for single individuals, and from $50,000 to $100,000 for married individuals. This would mean more individuals would be eligible to deduct their $2,000 IRA contribution. President Clinton has also proposed that the 10% pre-59 1/2 tax would not apply to distributions used to cover post-secondary education expenses, unemployment expenses and first-time home purchasers.

COLD. Trent Lott (R-Miss.) is the Senate Majority Leader. His position is that increases in the income limits for IRAs will not be included in any final 1997 tax bill. He has stated that there are higher priorities: the $500 per child tax credit, a cut of at least 50% in the capital gains tax rate, and a reduction in federal estate taxes. Senator Lott believes the tax revenues lost by the IRA income limit changes would be too great and therefore he will not support such changes.

Summary

Time again will tell if there will be any tax law change which would restore the IRA deduction. At this time, a slight edge would be given that such a law change will be made.