

Part IV. Items of General Interest

Medical Savings Accounts

Announcement 99-95

PURPOSE

Sections 220(i) and (j) of the Internal Revenue Code provide that if the number of Medical Savings Account (MSA) returns filed for 1998 or a statutorily specified projection of the number of MSA returns that will be filed for 1999 exceeds 750,000, then October 1, 1999, is a “cut-off” date for the MSA pilot project. The Internal Revenue Service (IRS) has determined that the applicable number of MSA returns filed for 1998 is 32,371 and that the applicable number of MSA returns projected to be filed for 1999 is 44,784 (after reduction in each case for statutorily specified exclusions, such as the exclusion for previously uninsured taxpayers). Consequently, October 1, 1999, is not a “cut-off” date and 1999 is not a “cut-off” year for the MSA pilot project.

BACKGROUND

The Health Insurance Portability and Accountability Act of 1996 added section 220 to the Code to permit eligible individuals to establish MSAs under a pilot project effective January 1, 1997. The pilot project has a scheduled “cut-off” year of 2000, but may have an earlier “cut-off” year if the number of individuals who have established MSAs exceeds certain numerical limitations. See sections 220(i) and (j).

If a year is a “cut-off” year, section 220(i)(1) generally provides that no individual will be eligible for a deduction or exclusion for MSA contributions for any taxable year beginning after the “cut-off” year unless the individual (A) was an active MSA participant for any taxable year

ending on or before the close of the “cut-off” year, or (B) first became an active MSA participant for a taxable year ending after the “cut-off” year by reason of coverage under a high deductible health plan of an MSA-participating employer.

Section 220(j)(2)(A) provides that the numerical limitation for 1999 is exceeded if the number of MSA returns filed on or before April 15, 1999, for taxable years ending with or within the 1998 calendar year, plus the Secretary’s estimate of the number of MSA returns for those taxable years which will be filed after April 15, 1999, exceeds 750,000. For this purpose, section 220(j)(2)(A) provides that a tax return is an MSA return for a taxable year if any exclusion is claimed under section 106(b) or any deduction is claimed under section 220 for that taxable year. Section 220(j)(2)(B) provides, as an alternative test, that the numerical limitation for 1999 is also exceeded if the sum of 90 percent of the MSA returns for 1998 plus the product of 2.5 and the number of MSAs for taxable years beginning in 1999 that are established during the portion of 1999 preceding July 1 (based on reports by MSA trustees and custodians), exceeds 750,000.

Under section 220(j)(3), in determining whether any calendar year is a “cut-off” year, the MSA of any previously uninsured individual is not taken into account. In addition, section 220(j)(4)(D) specifies that, to the extent practical, all MSAs established by an individual are aggregated and two married individuals opening separate MSAs are to be treated as having a single MSA for purposes of determining the number of MSAs.

A total of 36,638 tax returns reporting an excludable or deductible contribution to an MSA for the 1998 taxable year were filed by April 15, 1999. Of this total, 8,749 taxpayers were reported as being previously uninsured. It has been estimated that an additional 5,839 tax returns reporting MSA contributions for the 1998 taxable year have been or will be filed after April 15,

1999, including 1,357 taxpayers who were previously uninsured. Accordingly, it has been determined that there were 42,477 (36,638 plus 5,839) MSA returns for 1998. Of this total, 10,106 (8,749 plus 1,357) were for taxpayers reported as being previously uninsured. As a result, 32,371 (42,477 minus 10,106) MSA returns count toward the applicable statutory limitation for 1998 MSA returns of 750,000.

Based on the Forms 8851 filed on or before August 1, 1999 by MSA trustees and custodians, it has been determined that 11,727 taxpayers who did not have MSA contributions for 1998 established MSAs for 1999 during the portion of 1999 preceding July 1. Of this total, 4,468 taxpayers were reported by trustees and custodians as previously uninsured, and therefore are not taken into account in determining whether 1999 is a “cut-off” year. In addition, 963 taxpayers were reported by trustees and custodians as excludable from the count because their spouse also established an MSA, and 36 taxpayers had more than one account. Accordingly, the applicable number of MSAs established from January 1, 1999 through June 30, 1999, is 6,260 (11,727 minus (4,468 plus 963 plus 36)). The alternative limitation for 1999 (90 percent of the applicable number of MSA returns for 1998 plus the product of 2.5 and the number of applicable MSAs established from January 1, 1999 through June 30, 1999) is 44,784 (90 percent of 32,371 plus 2.5 times 6,260), which is less than the statutory limit of 750,000. Thus, 1999 is not a “cut-off” year for the MSA pilot project by reason of either the 1998 MSA returns test of section 220(j)(2)(A) or the alternative test of section 220(j)(2)(B) of the Code.

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