Medical Savings Accounts

Announcement 98–88

PURPOSE

Sections 220(i) and (j) of the Internal Revenue Code provide that if the number of medical savings account (MSA) returns filed for 1997 exceeds 600,000, then October 1, 1998, is a "cut-off" date for the MSA pilot project. If a statutorily specified projection of the number of MSA returns that will be filed for 1998 exceeds 750,000, then October 1, 1998, will also be a "cut-off" date for the MSA pilot project. The Internal Revenue Service (I.R.S.) has determined that the applicable number of MSA returns filed for 1997 is 26,160, and that the applicable number of MSA returns projected to be filed for 1998 is 50,172 (after reduction in each case for statutorily specified exclusions, such as the exclusion for previously uninsured taxpayers). Consequently, October 1, 1998 is not a "cut-off" date and 1998 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 1998 is exceeded if the number of MSA returns filed on or before April 15, 1998 for taxable years ending with or within the 1997 calendar year, plus the Secretary's estimate of the number of MSA returns for those taxable years which will be filed after April 15, 1998, exceeds 600,000. Section 220(j)(2)(B) provides, as an alternative test, that the numerical limitation for 1998 is also exceeded if the sum of 90 percent of the sum determined under section 220(j)(2)(A) for 1998 plus the product of 2.5 and the number of MSAs for taxable years beginning in 1998 that are established during the portion of 1998 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 35,887 tax returns reporting MSAs for the 1997 taxable year were filed by April 15, 1998. Of this total, 13,311 taxpayers were reported as being previously uninsured. It has been estimated that an additional 5,781 tax returns reporting MSA contributions for the 1997 taxable year have been or will be filed after April 15, 1998, including 2,197 taxpayers who were previously uninsured. Accordingly, it has been determined that there were 41,668 (35,887 plus 5,781) MSA returns for 1997. Of this total, 15,508 (13,311 plus 2,197) were for taxpayers reported as being previously uninsured. As a result, 26,160 (41,668 minus 15,508) MSA returns count toward the applicable statutory limitation for 1997 MSA returns of 600,000.

Based on the Forms 8851 filed on or before August 1, 1998 by MSA trustees and custodians, it has been determined that 13,034 taxpayers who did not have MSA contributions for 1997 established MSAs for 1998 during the portion of 1998 preceding July 1. Of this total, 2,180 taxpayers were reported by trustees and custodians as previously uninsured, and therefore are not taken into account in determining whether 1998 is a "cut-off" year. In addition, 166 taxpayers were reported by trustees and custodians as excludable from the count because their spouse also established an MSA, and 37 taxpayers had more than one account. Accordingly, the applicable number of MSAs established from January 1, 1998 through June 30, 1998, is 10,651 (13,034 minus (2,180 plus 166 plus 37)). The alternative limitation for 1998 (90 percent of the applicable number of MSA returns for 1997 plus the product of 2.5 and the number of applicable MSAs established from January 1, 1998 through June 30, 1998) is 50,172 (90 percent of 26,160 plus 2.5 times 10,651), which is less than the statutory limit of 750,000. Thus, 1998 is not a cut-off year for the MSA pilot project by reason of either the 1997 MSA returns test of section 220(j)(2)(A) or the alternative test of section 220(j)(2)(B) of the Code.

Questions regarding this announcement may be directed to Felix Zech in the Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622-4606 (not a toll free number).