

Montana Medical Care Savings Accounts (MSAs)

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A Medical Care Savings Account (MSA) can provide a reduction in Montana state income tax. This MontGuide explains who is eligible, what expenses are allowed, and how to set up an MSA.



MontGuide

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THE MONTANA MEDICAL CARE SAVINGS ACCOUNT

Act allows Montanans to save money for medical expenses and long-term health care and reduce their state income taxes at the same time. Unfortunately, only 1.2 percent of Montana tax filers took advantage of an MSA in 2006 and 2007.

While the term “medical care savings account” implies a savings account, a checking account or certificate of deposit are also permitted. The account holder can designate an account as a “Montana medical care savings account” at a financial institution (bank, savings bank, credit union, or mutual fund company.)

An MSA must be separate from other accounts and only the account holder can have access to the funds. Joint accounts for MSAs are not allowed. In other words, spouses must establish separate MSAs.

The money that is deposited in an MSA is not subject to Montana income taxation while in the account or if used for eligible medical expenses for the account holder or his or her dependents. If an account holder does not use money deposited in his or her MSA during the year deposited, it remains in the account and earns interest that is free from Montana taxation. The money in the MSA then can be used for eligible medical care expenses in future years. Any money used in the reduction of income in one year cannot be deducted from income in a future year.

Who is eligible for an MSA?

All resident taxpayers are eligible to establish a Montana MSA even if they have another health care plan provided by their employer or a Section 125 (Flexible Spending Account) or a Federal Health Savings Account (HSA). A taxpayer does not have to be in a high deductible plan at work to be eligible for an MSA. An MSA could be considered as a health care risk management tool for Montanans regardless of their type of employment. An

MSA cannot be established for a minor child under 18. However, a parent's account can be used for eligible expenses for a minor child.

What are the limits on contribution amounts?

The maximum amount that can be used to reduce Montana taxable income is limited to \$3,000 annually for each taxpayer. A person can also put less than \$3,000 in an MSA. As long as the money is left in the MSA (or withdrawn for eligible medical expenses), it is not subject to state income taxation. *The amount that is used to reduce income for state income tax purposes is the total deposited in the MSA during the tax year* – not the amount withdrawn for eligible medical care expenses. A similar reduction is not allowed in income for federal tax purposes.

Example 1: Barbara, a county employee, established an MSA at a local bank and deposited \$3,000 in the account on January 31, 2009. During the year, she had \$2,000 in eligible medical expenses. On Barbara's Montana Individual Income Tax Return, her taxable income of \$29,000 is reduced by her \$3,000 MSA deposit, not the \$2,000 she withdrew for eligible medical expenses.

The remaining \$1,000 in Barbara's MSA will continue to earn interest and is available to be withdrawn for eligible medical care expenses in future years. However, Barbara can not use the remaining \$1,000 as a reduction of income in 2010. Barbara's Montana adjusted gross income for 2009 is \$26,000 ($\$29,000 - \$3,000 = \$26,000$). Her Montana income tax will be computed based on \$26,000, less allowable deductions. However, Barbara's federal income tax will be computed on her federal adjusted gross income of \$29,000, less any allowable deductions.

Example 2: Donna and Jim, a married ranching couple, each established separate MSAs and deposited a total of \$6,000 (\$3,000 in Jim's and \$3,000 in Donna's).

Their combined income of \$46,000 is reduced by \$6,000 to \$40,000 ($\$46,000 - \$6,000 = \$40,000$). Their Montana income taxes will be computed based on \$40,000, less allowable deductions. However, Donna and Jim's federal income taxes will be computed on their federal adjusted gross income of \$46,000, less any allowable deductions.

How much will I save on state income taxes?

A Montana taxpayer's adjusted gross income is reduced by the amount annually contributed to the MSA account. The maximum amount can be up to \$3,000 for single filers and up to \$6,000 total for two MSAs for joint filers. As a result of a reduction in income, there is a reduction in the Montana income tax that is due. The amount of reduction in Montana income taxes depends on the account holder's tax bracket. For information on tax rates, go to www.mt.gov/revenue.

To figure *approximately* how much your Montana income tax would be reduced, multiply the amount deposited in your MSA account by the tax rate for your taxable income. For example, in 2009 Montanans who had adjusted gross income of \$15,400 and above were in the 6.9 percent tax bracket.

Example 3: Nina, a high school teacher, reduced her Montana taxable income of \$34,500 by the \$3,000 she deposited in her MSA at a local credit union in 2009. Because she earns above \$15,400, she is in the 6.9 percent Montana income tax bracket. Her deposit reduces the amount of her 2009 Montana income tax due by approximately \$207 ($\$3,000 \times .069 = \207). To be eligible for a state income reduction of \$3,000 for the 2010 tax year, Nina must deposit \$3,000 between January 1 and December 31, 2010.

Example 4: Rob and Sheila, owners of a downtown business, deposited \$3,000 each in an MSA at a local savings bank. The deposits lowered their Montana taxable income by \$6,000. They are in a 6.9 percent Montana state income tax bracket, which means their income is taxed at the rate of 6.9 percent (tax tables change yearly). Their MSA deposits saved them approximately \$414 in state taxes ($\$6,000 \times .069 = \414).

Eligible medical care expenses that are paid with MSA funds cannot be deducted elsewhere on the Montana income tax return.

A person's medical expenses cannot be deducted on the federal income tax return unless they exceed 7.5 percent of federal adjusted gross income.

Example 5: Ben and Bethany have an adjusted gross income of \$45,000. Any medical expenses they could deduct on their federal return must be above \$3,375 ($\$45,000 \times 0.075 = \$3,375$). Because their medical expenses are \$3,100, they are not allowed a deduction on their federal return. However, because Ben and Bethany established Montana MSAs with a \$3,000 deposit each, they are able to reduce their Montana taxable income by \$6,000 even though their withdrawals for eligible medical care expenses totaled \$3,100.

How much interest will my MSA earn?

Money in an MSA can earn interest just like money deposited in other savings, checking, and investment accounts at financial institutions. The rate of interest is determined by the financial institution where the MSA is established. Interest earned and investment gains on an MSA are not subject to Montana income tax if left in the account or if withdrawn for eligible medical expenses.

Example 6: Doug, a young farmer, contributed \$3,000 annually in his MSA for three years. He had no medical expenses that exceeded his health insurance allowances during those years. His MSA earned interest of \$45 in the first year, \$90 the second year and \$135 the third year. None of the interest income was subject to Montana income taxation because Doug left the earnings in his MSA. However, Doug's \$135 interest earnings on the MSA are subject to federal income taxation.

Which is best...an MSA, FSA or HSA?

An MSA is not like the federal medical care flexible spending account offered by some employers where you either "use it or lose it" or the Health Savings Account (HSA) that is deducted from federal adjusted gross income. The amount placed in a Montana MSA can only be used to reduce Montana income. The amount placed in a Federal Health Care Savings Account (HSA) can be used to reduce state and federal income. However, there are eligibility requirements that are outlined in detail in the *MontGuide Health Savings Accounts (MT200704HR)* from your local Extension office.

The amount placed in a *flexible spending account* (FSA) can be used to reduce both state and federal income. The challenge is a Montanan typically has to decide a year ahead of time how much to expect in medical expenses that will not be covered by health insurance. Any amount not used is lost, thus the "use it or lose it" phrase is often attributed to FSAs.

Example 7: Becky decided to set aside \$333 per month (\$4,000 during the year) in her FSA. Unfortunately she had used up all \$3,000 by July because of uncovered physical therapy expenses. From July December she had another \$3,000 in eligible medical expenses. She opened an MSA to cover these expenses and was able to reduce her Montana income by a total of \$6,000 (\$4,000 for the FSA + \$2,000 for the MSA = \$6,000). However, Becky's federal income was only reduced by \$4,000 that was set aside in her FSA.

How do I report my MSA?

The amount of an MSA deposit is entered as a reduction on the Montana Individual Income Tax Return. For example, on Form 2M for the year 2008, the amount deposited between January 1 and December 31, 2008 was entered on line 32 (this line number could change from year to year).

MSA earnings are reported on the financial institution's 1099 form that is sent to the account holder and to the Internal Revenue Service (IRS). Some financial institutions send a 1099 form for each MSA. Others may include the MSA interest and investment gains in a total with other interest and investment accounts. Closely examine the 1099 so you deduct only the appropriate amount on the MSA contribution line on the Montana Individual Income Tax form. Remember, the MSA interest earnings must be declared on the federal income tax return.

What are eligible medical care expenses?

Money withdrawn from an MSA is not subject to Montana income tax if used for either of two basic purposes:

1. Paying eligible medical care expenses of the account holder or his or her dependents.

The Montana Department of Revenue accepts eligible medical care expenses as defined under the Internal Revenue Code Section 213 (d). They are the same expenses that are allowed as itemized deductions for federal income tax purposes such as:

- medical insurance premiums
- prescription drugs
- insulin
- medical, dental, and nursing care
- eyeglasses
- crutches
- hearing aids
- transportation for medical care
- certain lodging expenses

A complete listing of eligible medical care expenses for a Montana MSA is available in IRS Publication 502, "Medical and Dental Expenses." The list may be printed from the IRS Web site at www.irs.gov.

If you are covered under Social Security (or if you are a government employee who paid Medicare tax), you are enrolled in *Medicare A*. The payroll tax paid for Medicare A is not an eligible medical expense. If you are not covered under Social Security (or were not a government employee who paid Medicare tax), you can voluntarily enroll in Medicare A. In this situation, the premiums paid for Medicare A are eligible medical care expenses.

Medicare B is supplemental medical insurance. Premiums paid for Medicare B are eligible medical care expenses for a Montana MSA.

Medicare D is a voluntary drug coverage insurance. Premiums paid for Medicare D are eligible medical care expenses for a Montana MSA.

The deductible amount and co-payments that are not covered by other types of health insurance are treated as eligible medical expenses.

2. Purchasing long-term care insurance or a long-term care annuity for the long-term care of the MSA account holder or his or her dependents.

The Montana Department of Revenue also accepts as eligible medical care expenses the purchase of long-term care insurance for the account holder and his or her dependents or the purchase of a long-term care annuity.

What expenses are not eligible?

Money held in an MSA *may not* be used to pay any medical expenses that are reimbursable under some other type of insurance coverage.

Example 8: Keri, a state employee, had \$2,945 in medical expenses with all but \$100 covered by her health insurance policy. She cannot withdraw \$2,945 from her MSA as eligible medical care expenses because that was the amount already reimbursed to Keri by her health insurance company. However, she can withdraw the \$100 deductible that she paid for eligible medical expenses that were not covered by her health insurance policy.

Other types of reimbursable items that do not qualify as eligible medical care expenses under the Montana MSA law include: medical expenses payable under an automobile insurance policy; workers' compensation insurance policy or self-insured plan; Federal HSA payment; Section 125 (Flexible Spending Account FSA) or medical expenses covered under a health coverage policy, certificate, or contract.

Who are eligible dependents?

Money in an MSA can be used to pay eligible medical care expenses not only for the account holder, but also the taxpayer's eligible dependents. Under the Montana MSA Act eligible dependents are defined as:

- the spouse of the account holder;

Example 9: Shirley, a city employee, was seriously ill with \$6,000 in non-covered medical expenses. She can use \$3,000 of her husband's MSA to pay her medical expenses as well as \$3,000 from her MSA.

- a child of the account holder;

Example 10: Joel and Tara's daughter was seriously ill with over \$6,000 in non-covered medical expenses. Joel and Tara can use their MSAs (\$3,000 each) to pay their daughter's medical expenses.

- however, the child must be younger than 19 years of age, or
- younger than 23 years of age and enrolled as a full-time student at an accredited college or university, or
- legally entitled to subsistence, education, medical care, or other care necessary for the health, guidance, or well-being of the child who is not otherwise emancipated, self-supporting, married, or a member of the armed forces of the U.S., or
- mentally or physically incapacitated to the extent that the child is not self sufficient.

Individuals who have legally adopted a child can also establish MSAs and use the funds to pay for eligible medical care expenses for that child.

Who can administer my MSA?

Montana law provides that an MSA can be administered by the individual account holder (self-administered) or by a registered account administrator. Almost all Montana MSAs are self-administered. Regardless of the type of administration selected, the account holder in all circumstances is required to maintain documentation to verify that MSA funds are used exclusively for eligible medical expenses.

Self-Administered Account Holders. Montana law allows an individual to self-administer his or her MSA. The MSA may be established with a financial or other approved institution (e.g., banks, savings banks, credit unions, mutual fund companies, and so on).

A self-administered MSA must be kept separate from all other accounts. It must be maintained specifically for eligible medical expenses for the individual account holder or any eligible dependents.

A self-administered account holder must file a Medical Care Savings Account annual reporting form (available from the Department of Revenue and on page 7 of this Montguide) with his or her Montana income tax return. The form is available online at www.mt.gov/revenue. Click: Forms & Resources>Downloadable Forms for Current Tax Year. Then under Individual Income Tax forms, click: MSA.

What are the charges for an MSA?

Ask the institution if they have any type of maintenance or service fees for MSAs. For example, one financial institution charges a \$1 fee per withdrawal for each one in excess of six per month. Another institution does not charge a service fee if the account holder maintains a \$300 minimum balance. If the account holder drops below the \$300 minimum, there is a fee of \$2 during each month the balance is below the minimum.

Some institutions provide free checking for MSAs for depositors age 50 and older. The maintenance fee is not subject to taxes or penalties.

What type of withdrawals can be made without penalty?

The account holder, not the account administrator or financial institution, is responsible for documenting that a withdrawal from an MSA was made for eligible medical expenses.

Withdrawals from an MSA for any purpose other than eligible medical expenses are subject to a Department of Revenue 10 percent penalty on the amount withdrawn unless the withdrawals fall under one of the three exception rules:

- 1) An MSA account holder can withdraw MSA money on the last business day in December, even if the money is not used for eligible medical expenses. However, the amount withdrawn is included as ordinary income for Montana income tax purposes.

Example 11: Thomas, a rancher, established an MSA in March 2009. He did not have any medical expenses during the year so the amount carried over to 2010. On the last business day of the year in 2010, he withdrew \$3,000 from his MSA to use for unexpected repairs on his combine. Thus, his Montana adjusted gross income for 2010 increased by the \$3,000 withdrawal. However, Thomas did not have to pay a 10 percent penalty because the amount was withdrawn on the last business day of the year.

2) A withdrawal upon the death of an account holder is not subject to the 10 percent penalty. The amount withdrawn, however, is added to the decedent's Montana income for the tax year in which the death occurred.

3) The transfer of funds from one MSA account to another MSA account such as a different type of investment (from a savings account to a certificate of deposit within the same financial entity) or a different financial institution (from a savings account in a bank to a savings account in a credit union) is NOT considered a withdrawal and therefore, is not subject to the 10 percent penalty. The account holder will want to make sure that during the transfer process that the funds are not placed, even temporarily, in a regular checking account as this action would result in a taxable transfer and penalty.

Example 12: Warren's MSA funds are in a savings account at his local bank. The MSA has grown to \$12,000. He has decided to transfer \$9,000 to a certificate of deposit MSA so he can earn a higher rate of interest. He requested that the bank directly transfer the \$9,000 to a CD designated as an MSA without the amount being deposited in his regular checking account. He has \$3,000 remaining in his savings account MSA. When the CD matures he can renew it at the prevailing interest rate or he can direct the bank to transfer the balance to his savings account MSA so he can use the funds for eligible medical care expenses.

Example 13: Judy has an \$8,000 balance in her MSA at a local credit union. She has decided to transfer \$2,000 to a local bank. She requested that the credit union directly transfer the \$2,000 to the MSA account she has established at the bank. Judy can then decide which account to use when she has eligible medical care expenses.

Penalties. Self-administered account holders who make withdrawals from an MSA that were not used to pay qualifying medical expenses must complete Form MSA-P. In addition, the penalty must be reported on his or her Montana tax return for the year in which the ineligible withdrawal was made. The form is available online at www.mt.gov/revenue. Click on: Forms & Resources>Downloadable Forms for Current Tax Year. Then under Individual Income Tax forms, click on MSA-P.

What happens to my MSA when I die?

If an account holder dies or becomes incapacitated, Montana law provides a legal procedure for distributing the money in the MSA. If the deceased person's MSA is with an account administrator, the account administrator is

responsible for distributing the principal and accumulated interest in the account to the estate of the account holder or to a designated pay-on-death (POD) beneficiary. This action should be completed within 30 days of the financial entity being furnished proof of the death of the account holder.

If the MSA is self-administered, the MSA is a part of the estate of the deceased account holder. The personal representative who is appointed by the district court is responsible for notifying the financial entity of the death of the account holder.

If a POD beneficiary is designated on the MSA, the proceeds are distributed to that individual. A spouse and lineal descendants of the account holder can transfer the inherited MSA into their MSAs. Stepchildren are considered lineal descendants if that relationship was created before the child's eighteenth birthday.

If a POD beneficiary is not designated, the money in the MSA is distributed according to the account holder's written will or the Montana law of intestate succession if the person had no written will.

Example 14: Don died with his wife as a POD beneficiary of his MSA account that had a balance of \$4,000. His wife can request that the bank transfer the \$4,000 to her MSA without the amount being considered income for Montana taxation purposes.

Example 15: Gayle died with her three daughters as POD beneficiaries of her MSA account with a balance of \$9,000. Gayle's daughters can request that the credit union transfer their share of \$3,000 each to their MSAs.

What happens to my MSA if I become incapacitated?

If an account holder becomes incapacitated, the funds cannot be withdrawn unless *power of attorney* is given to another individual or unless a *conservatorship* is granted by the district court to another individual.

A *power of attorney* is a written document in which a person gives another person legal authority to act on his or her behalf in financial transactions. For more information request the MontGuide *Power of Attorney (MT199001HR)* from your Extension office.

A *conservatorship* is a court-ordered protective relationship whereby an individual is appointed to manage another person's financial affairs after that person has become unable to do so. An attorney must file a petition with the district court and a judge decides if the person is legally competent to manage his or her finances.

What happens to my MSA if I move from Montana?

If an account holder moves from Montana to another state or country and has unused MSA funds, those unused funds are considered nonqualified withdrawals and must be declared as income on his or her final Montana Income Tax Return on Form 2, Schedule I.

Planning Technique

Montana taxpayers who are not sure if they will have eligible medical expenses during the year can wait until the last business day in December to open an MSA.

Example 16: Matt kept documentation of his medical expenses that were not covered by his health insurance policy throughout the year and found they totaled \$2,225. On the morning of December 30, he transferred \$2,230 from his regular savings account to establish an MSA. The next day (the last business day of the year), he withdrew \$2,225 from the MSA and placed the funds back into his regular savings account. Matt left \$5 in the account because the financial institution had a close-out fee.

Matt can reduce his Montana income by the \$2,225 he deposited into his MSA even though the money was in the account for less than 24 hours. With his Montana tax for the year he files the MSA annual reporting form with an entry of \$2,230. If Matt had withdrawn money from his MSA each time he had an eligible medical expense, he would have been required to enter each transaction on the MSA form.

Summary

- The Montana Medical Care Savings Account Act allows a Montana taxpayer to establish an MSA and contribute up to \$3,000 annually.
- If principal and earnings are withdrawn for payment of eligible medical care expenses or for long-term care of the account holder or a dependent, then the amounts are excluded from state income tax. However, the amount is subject to taxation at the federal level.
- Withdrawals from an MSA for any purpose other than eligible medical expenses are treated as ordinary income and taxed accordingly.

- Withdrawals are also subject to a 10 percent penalty unless the withdrawal falls under the exception rules listed on pages 4 and 5.
- An MSA either can be managed by a registered account administrator or self-administered by the individual account holder. Most accounts in Montana are self-administered.

Further Information

If you have questions or need additional information regarding Montana Medical Savings Accounts, contact:

- Montana Department of Revenue
P. O. Box 5805
Helena, MT 59604-5805
Telephone: 406-444-6900
Toll free: 866-859-2254
www.revenue.mt.gov, at the bottom of the page click: Contact Us
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Acknowledgement

This MontGuide has been reviewed by representatives from:

- Montana Bankers Association
- Montana Credit Union Network
- Montana Department of Revenue
- Montana Society of Certified Public Accountants

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Montana Medical Care Savings Account
Annual Reporting Information for Self-Administered Accounts
15-61-202, MCA

Enter your name here (as it appears on your tax return): _____

Enter your social security number here: _____

Enter the name and address of the financial institution where your Montana medical care savings account is established:

Enter your Montana medical care savings account number here _____

Complete the table below reporting this year's activity to your Montana medical care savings account.

Column A	Column B	Column C	Column D	Column E	Column F
Enter the date of your deposits, earnings, or withdrawals in Column A.	Enter the amount of your deposits to your Montana medical care savings account in Column B.	Enter the amount of interest or other income earned on your Montana medical care savings account in Column C.	Enter your "eligible medical expense" withdrawals in Column D. (See the instructions for the definition of "eligible medical expense".)	Enter your "non-eligible medical expense" withdrawals in Column E. (See the instructions for the definition of "non-eligible medical expense" and the treatment of these withdrawals.)	Balance – Add the amounts in columns B and C, then subtract from this total any amounts reported in Columns D and E. Enter the result in Column F.
1. Enter in column F the balance of your Montana medical care savings account as of January 1 of the tax year. This is the ending balance of your Montana medical care savings account as of December 31 of the prior tax year. If you established your account this year, enter zero here as your beginning balance is established on the date of your first deposit.					
2.					
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11.					
12.					
13.					
14. Enter the column totals on this line.					
If you have an amount entered in line 14, column E enter it here and on Form 2, Schedule I, line 7, or Form 2M, line 25. Complete Form MSA-P (Penalty Calculation) if required.					
Enter the ending balance reported in column F. This is your balance that is carried forward for the next tax year.					



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