



**House  
Legislative  
Analysis  
Section**

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## MEDICAL CARE SAVINGS ACCOUNT

**Senate Bill 926 (Substitute H-1)  
First Analysis (6-9-94)**

**Sponsor: Sen. John Pridnia  
Senate Committee: Commerce  
House Committee: Insurance**

### ***THE APPARENT PROBLEM:***

It is a common observation that one root cause of the high rate of increase in the cost of health care, and in the price of insurance to cover health care expenses, is the lack of cost consciousness by consumers. Consumers of health care, it is said, are often "spending someone else's money" or at least do not perceive the money they are spending as their own because they are relying on insurance. This means, the argument goes, that there are few incentives to seek out less expensive services and products and few incentives to decide to forego care entirely in marginal cases. The result is over-utilization of the health care system and a lack of price discipline, together leading to ever-increasing expenditures on health care. Among some who emphasize this point-of-view, one new proposal deemed encouraging is the "medical care savings account," sometimes known as a "medical IRA" or "medisave" account. The basic elements of this concept are a high-deductible, catastrophic health insurance policy and money set aside in a tax-free savings account to pay smaller bills and deductibles. One form of this would have an employer switch from its current health insurance to a high-deductible catastrophic policy and deposit the savings into a tax-free account for an employee's use. If the employee did not use the money in a given year it could be withdrawn and be subject to taxation. (Early withdrawals of money, however, would be subject to penalty.) The money also could be allowed to accumulate, in anticipation of special health care expenses or to be used to purchase health insurance if the employee lost his or her job. In other words, the money in the medical savings accounts would belong to the employees to use as they saw fit and would be portable from one employer to another or to self-employment. (Similar plans could also be created by individuals on their own without an employer-employee relationship.) This kind of benefit plan is already possible, and is being marketed, notably by Golden Rule Insurance Company, but without tax exemption for the contributions to the accounts.

Legislation is being promoted at the national level to provide the necessary special tax treatment. Proposals also are being made at the state level for exemptions from state tax.

### ***THE CONTENT OF THE BILL:***

Senate Bill 926, together with House Bill 4878, would provide for tax-exempt medical care savings account programs. House Bill 4878 would create a new act, the Medical Care Savings Account Act, to describe the features of such an account. The act would be repealed effective January 1, 1999. Senate Bill 926 would provide the tax exemption. (For additional relevant information on the nature of the accounts, see the House Legislative Analysis Section analysis of House Bills 4878 and 4879, dated 10-12-93. The proposal has been altered somewhat since that analysis to include accounts established on behalf of individuals who are not employees. House Bill 4878 [S-7] refers to three kinds of accounts: those set up by employers that previously had provided another form of health coverage; those established by employers that had not previously provided health coverage; and those established by or for "resident individuals.")

Senate Bill 926 would amend the Income Tax Act (MCL 206.30) to provide for a deduction from taxable income for contributions made to such an account and interest earned on those contributions.

Specifically, the bill would allow a taxpayer to deduct from taxable income, to the extent included in adjusted gross income, the amount of a contribution made on behalf of the taxpayer to a medical care savings account under the Medical Care Savings Account Act proposed in House Bill 4878. Interest earned on such an account would also be deducted from taxable income. The bill would specify that the maximum deduction would be limited to: twice the maximum contribution allowed under House Bill 4878 for a couple filing

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jointly, if each person has a medical care savings account and neither is covered by a health insurance policy (other than the qualified higher deductible plan that is part of a medical savings account plan); or, the maximum contribution allowed under House Bill 4878 for taxpayers filing singly or for those who did not qualify under the provision described above. Contribution limits in House Bill 4878 (S-7) would be \$3,000 for the 1994 tax year, to be adjusted annually based on increases in the consumer price index. Amounts withdrawn, to the extent not included in adjusted gross income, would be added to taxable income, as would interest earned or any penalty imposed on an account in the case of an early withdrawal.

Senate Bill 926 and House Bill 4878 are tie-barred to one another, and would apply to tax years beginning after 1993.

### ***FISCAL IMPLICATIONS:***

A Senate Fiscal Agency analysis of a slightly different version of the bill said the following about the estimated costs of the tax exemption. The reduction in state revenue would be in the area of \$60 million if it was assumed that every potentially eligible household would take maximum advantage of the proposal. The reduction would be about \$25 million if it was assumed that only households that itemize deductions would participate. The SFA opines, however, that without a federal tax exemption for these plans, "it would seem extremely unlikely that a household would forego the significantly higher federal marginal tax offset on current employer-based health insurance premiums just to gain the bill's state tax credit." (6-1-94)

### ***ARGUMENTS:***

#### ***For:***

The bill is part of a package that would provide an additional option for employers who want to provide health care coverage to their employees and, at the same time, offer a means to restrain health care costs by providing incentives for health care consumers to be cost conscious. Under this proposal, employers could switch to cheaper high-deductible health insurance coverage and put some or all of the savings into a special savings account for use by an employee in paying for uncovered medical expenses. The money going into the employee's account would be exempt from the state income tax while in the account or if spent for

legitimate purposes. For example, a company might purchase a policy with a \$3,000 deductible and put \$3,000 into each employee's account. The account would be under the control of the employee. Money unused at the end of the year could be withdrawn and treated as income for tax purposes, or it could be retained in the account. (There would be an additional penalty for early withdrawals.) The package, as currently written, would also permit any individual to establish a medical care savings plan and enjoy a tax deduction. This would make employees and other individuals with such accounts more aware of how their health care dollars were being spent and would encourage more cost-conscious behavior in determining whether to seek care, how much care to buy, and from whom.

Supporters of this approach point to other benefits as well. It works against the bias that all dollars to pay for health care need first be sent to insurance companies or similar entities in premiums. It eliminates the relatively high administrative costs to insurance companies associated with small medical bills. Further, it tends to promote healthier lifestyles and provide incentives to reduce health risks. Employees and others who have these accounts will know they can benefit financially by staying healthy. The exemption from the state income tax will provide additional incentive for the creation of these plans. Proponents say they are fairly confident of a federal income tax exemption for the accounts in the near future as well.

#### ***Response:***

It ought to be made clear that contributions to medical care savings accounts by employers are not now exempt from federal income tax and would be treated as income to the employees. Without this federal exemption, this approach may not be attractive.

#### ***Against:***

A number of concerns have been raised. One is that approaches of this kind could discourage more comprehensive reform. By itself, this concept cannot address the many problems associated with the current health care insurance system, such as selection biases, cost-shifting, administrative inefficiency, and ever-increasing costs.

The medical care savings account concept could lead to a segregation of insureds or employees by health risk. If employees are offered a choice between a comprehensive plan and a savings

account plan, those with fewer health problems will tend to choose the latter, due to the financial incentives, while those with more health problems would take the comprehensive coverage. This will make any comprehensive coverage more expensive (since the cost is likely to be based on the experience of the group as a whole). Further, if employees were allowed to switch plans annually, it could lead to people using the comprehensive plan in years when medical expenses were anticipated and taking the savings account in other years, further segregating by risk. Instead, reform of health care coverage should focus on greater pooling of risks and more affordable coverage for all state residents.

Also, the concept could lead to an increase in uncompensated care for hospitals and other providers, to the extent that those with large deductibles are unable to cover all of their costs (due to underfunded or inadequate savings accounts). Some in the health field caution that, while this approach is to be applauded for its emphasis on cost consciousness and personal responsibility by health care consumers, there are better ways to reduce costs due to unhealthy behavior and wastefulness. Insurers and similar entities can do so, without risk segregation, through benefit plan designs, co-payments, designation of eligible providers and facilities, caps on annual out-of-pocket expenses, and other means.

It is also fair to ask whether health care consumers have the information, or the time and means, that they need to be "cost conscious" about health care decisions.

***Response:***

It is not clear that the plans envisioned by this legislation would lead to an increase in uncompensated care. They would, in some cases, replace policies that already have various deductibles and co-pays anyway. Companies that go to the trouble of initiating such plans will likely fund them properly, and the accounts grow over time. Also, the proposal permits interest-free loans (or advances) to employees by employers to cover shortfalls, with the loan to be paid back out of future installment payments by the employer to the account. This may encourage some employers who cannot now afford health care benefit plans to establish one, which would, if anything, reduce problems of uncompensated care. While this approach is not the sole and exclusive solution to health care financing, it is a positive step.

***Against:***

It should be noted that the bills do not require that all savings to employers from switching plans go into a medical care savings account, only that "all or part" of the premium differential must go into an account, without any minimum specified. Also, there are no standards for the "higher-deductible" policies as regards the scope of coverage. Plans of this kind do not emphasize preventive medicine or "wellness" approaches, which some people believe lead to greater eventual savings to the system. Also, there is the danger that employees will be tempted, if they have other pressing financial needs or problems, to withdraw the money from the account and incur the tax penalty, and then not be able to pay for needed treatment. Further, one could ask, what the need (and justification) is for a tax exemption for these accounts.

***Response:***

Granting some flexibility to employers on the amount to be deposited in a medical savings account would permit some companies to offer these plans who otherwise could not afford to. A shared contribution plan between employer and employee would be better than not having a benefit plan and would be better than many of the other low-cost alternatives that provide deductibles and co-pays. The tax exemption allows contributions to a medical care savings account by an employer to be treated equally with payment for insurance to an insurance company, and thus counteracts that bias.

***Against:***

With a tax deduction available to any individual who establishes a medical care spending account (accompanied by a high deductible catastrophic policy), the state stands to lose revenue. Under the original proposal, the expectation was that no revenue would be lost because the dollars flowing into the new accounts would be dollars that otherwise would be sent to insurance companies by employers on behalf of employees.

***POSITIONS:***

A representative of the National Federation of Independent Business testified in support of the bill. (6-9-94)