



**House
Legislative
Analysis
Section**

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MEDICAL CARE SAVINGS ACCOUNT

House Bill 4878 (Substitute H-4)

House Bill 4879 with committee
amendments

First Analysis (10-12-93)

Sponsor: Rep. Terry London

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 If the employee did not use the money in a given year it could be withdrawn and be subject to taxation.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. 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 BILLS:

The bills, taken together, would provide for a particular kind of tax-exempt medical care savings account program. 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. House Bill 4879 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. The bills are tie-barred to one another. The bills would apply to tax years beginning after 1992.

House Bill 4878 says an employer, "except as otherwise provided by statute, contract, or a collective bargaining agreement," could offer a medical care savings account program to its employees. (The bill also says an employer that did not previously provide health coverage could participate in such a program.) Under the bill, a medical care savings account program would be defined to require the inclusion of the following elements.

-- The purchase by an employer of "a qualified higher deductible health plan" for the benefit of an employee and his or her dependents. (This plan would involve a health policy, certificate, or contract that covered benefits exceeding the "higher deductible", which would mean for 1993 a deductible of not less than \$1,000 and not more than \$3,000, with the amount adjusted annually based on changes in the consumer price index.)

-- The contribution of all or part of the premium differential (i.e., savings from the lower cost policy) into a medical care savings account on behalf of an employee. An employer that had not previously provide health coverage could instead contribute all or part of the deductible. A contribution by either kind of employer could not exceed \$3,000 for 1993, to be adjusted annually based on the consumer price index. The employer would have to inform employees in writing before making any contributions of the federal tax status of the contributions. An employer that made contributions on a periodic installment basis could advance, interest free, an amount necessary to cover expenses that exceed the amount in the savings account if the employee agreed to repay the amount from future installments (or when he or she ceased to be an employee).

-- The administration of the plan by an account administrator. (The bill lists those eligible to be an administrator, including financial institutions, insurance companies, trust companies, persons registered under the Uniform Securities Act, third party administrators, certified public accountants, licensed attorneys, self-insured employers, and employers participating in a medical care spending program.)

The bill specifies that an account administrator could only use the funds in such a medical care savings account to pay the eligible medical expenses of the employee or his or her dependents or to purchase a health coverage policy, if the employee did not otherwise have health coverage. An employee would submit documentation of medical expenses he or she paid in the tax year, and the administrator would reimburse the employee for eligible medical expenses.

Funds from an account could not be used to cover medical expenses of the employee or dependents otherwise covered, including expenses covered by an auto insurance policy, worker's compensation policy or self-insured plan, or another health coverage policy, certificate, or contract.

An employee could withdraw money from the account on the last business day of the administrator's business year without penalty. The amount would be added to taxable income for state income tax purposes. Withdrawals at other times of the year would be subject to a 10 percent penalty to be paid to the Department of Treasury and the

interest earned on the account during the tax year would be added to taxable income in addition to the amount withdrawn. (However, disbursement of assets of an account pursuant to a bankruptcy filing would not be considered a withdrawal and would not be subject to tax or penalty.) Upon the death of an employee, the account administrator would distribute the principal and accumulated interest of an account to the employee's estate.

If an employee left the employ of a participating employer, he or she would have 60 days to transfer the account to a new administrator or request in writing that the account remain with the former employer's account administrator. (That administrator would decide whether to agree to retain the account.) Not more than 30 days after the expiration of the 60 days, if no account administrator had accepted the former employee's account, the former employer would mail a check to the employee for the amount in the account on that day. The amount would be subject to taxation but not the penalty. If an employer joined another employer with a medical savings account program, he or she could transfer the account to the new employer's account administrator.

House Bill 4878 also would require the insurance commissioner to report on or before January 1, 1998, to the standing committees in the House and Senate on insurance and health legislation on the availability of health care coverage under and market share of medical care spending account programs; the results of a survey of employer and employee satisfaction with the programs; and the results of a loss ratio study relative to the programs.

House Bill 4879 would amend the Income Tax Act 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 new act. Interest earned on such an account would also be deducted from taxable income. 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.

FISCAL IMPLICATIONS:

A representative of the Department of Treasury has said the bill has no revenue implications for the state. (10-7-93)

ARGUMENTS:**For:**

The bills 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.) This would make employees 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. Additionally, it would permit people temporarily unemployed to use dollars from their medical savings accounts to purchase insurance coverage while between jobs.

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. There would be no loss of current revenue to the state, since these employer contributions would be new "income" to employees. 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.

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.

POSITIONS:

The Department of Treasury supports the bills. (10-7-93)

The Golden Rule Insurance Company supports the bills. (10-7-93)

The Life Insurance Association of Michigan supports the bills. (10-7-93)

The National Federation of Independent Business supports the bills. (10-7-93)

The Small Business Association of Michigan supports the bills. (10-7-93)

A representative of the Henry Ford Health System testified before the House Insurance Committee to express concerns about the bills. (10-7-93)