



MontGuide

Montana Medical Care Savings Accounts (MSAs) for the 2018 Tax Year

by Marsha A. Goetting, Ph.D., CFP®, CFCS, Professor and Extension Family Economics Specialist, Montana State University-Bozeman; Keri D. Hayes, MSU Extension Economics Publications Assistant

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.

MT199817HR Reviewed 1/19

THE MONTANA MEDICAL CARE SAVINGS ACCOUNT

Act allows Montanans to save money for medical expenses and long-term health care while reducing their state income taxes.

While the term "medical care savings account" implies a savings account, a checking account or certificate of deposit is also permitted. Stocks, bonds, and mutual funds are allowed investments for an MSA. Individuals should consider how liquid the account will be at the time they expect to need the money for eligible medical expenses.

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 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 anyone else he or she chooses. An account holder has until January 15 to make a withdrawal for an expense **paid** in the prior tax year.

If an account holder does not use money placed in his or her MSA during the year deposited, it remains in the account and earns interest that is free from Montana income taxation, as long as the funds are used for eligible medical 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 age 18 and older 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 health insurance plan to be eligible

for an MSA. An MSA cannot be established for a minor child under age 18. However, parents' MSAs can be used for eligible expenses for a minor child as well as children over the age 18.

Who is eligible to use my MSA?

Formerly funds in an MSA could only be used by an account holder for his or her parents, spouse or children. The 2017 Montana Legislature passed a law that changed those rules.

As of January 1, 2018, money in an MSA can be used to pay eligible medical care expenses not only for the account holder, but also **ANYONE** he or she chooses.

What are the limits on contributions to an MSA?

The maximum amount used to reduce Montana taxable income was limited to \$3,000 annually from 1997 to 2017 for each taxpayer. The amount increased to \$3,500 annually in 2018 and \$4,000 annually in 2019. After December 31, 2019, the MSA contribution limit will be increased by the Consumer Price Index and rounding the resulting figure to the nearest \$500 increment.

A person can also put less than the limit 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 can be used to reduce income for state income tax purposes is the total amount deposited in the MSA during the tax year* – not the amount withdrawn for eligible medical expenses. A similar reduction in income, however, is not allowed for federal income tax purposes. Montana has no limitation on the amount of funds and interest that may be accumulated tax-free within an MSA.

All examples within this MontGuide utilize the MSA limit for the 2018 tax year of \$3,500.

Example 1: Barbara, a county employee, established an MSA at a local bank and contributed \$3,500 in the account on January 31, 2018. During the year, she had \$2,000 in eligible medical expenses. On Barbara's Montana Individual Income Tax Return, her taxable income of \$39,000 is reduced by her \$3,500 MSA contribution, not the \$2,000 she withdrew for eligible medical expenses.

The remaining \$1,500 in Barbara's MSA will continue to earn interest and is available to be withdrawn for eligible medical expenses in future years. However, Barbara can not use the remaining \$1,500 as a reduction of income in a future tax year. Barbara's **Montana** adjusted gross income for the present tax year is \$35,500 ($\$39,000 - \$3,500 = \$35,500$). Her Montana income tax will be based on \$35,500, less allowable deductions. However, Barbara's **federal** income tax will be computed on her federal adjusted gross income of \$39,000, less any allowable deductions.

Example 2: Donna and Jim, a married ranching couple, established separate MSAs in 2018 and contributed a total of \$7,000 (\$3,500 in Donna's and \$3,500 in Jim's).

Their Montana adjusted income of \$46,300 is reduced by 7,000 to \$39,300 ($\$46,300 - \$7,000 = \$39,300$). Their Montana income taxes will be computed based on \$39,300, less allowable deductions. However, Donna and Jim's federal income taxes will be computed on their federal adjusted gross income of \$46,300, 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. The maximum amount can be up to \$3,500 for single filers and up to \$7,000 total for two MSAs for married couples (2018). 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 rate (the highest rate is 6.9% in 2018). For information about future Montana tax rates, go to <https://mtrevenue.gov/taxes/individual-income-tax/individual-tax-rates/>.

To determine *approximately* how much your Montana income tax would be reduced, multiply the amount deposited in your MSA by the tax rate for your taxable income. For example, in 2018 Montanans who had adjusted gross income of \$17,900 and above had a 6.9 percent tax rate.

Example 3: Single Person: Nina, a high school teacher, reduced her Montana taxable income of \$34,500 by the \$3,500 she contributed to her MSA at a local credit union during 2018. Nina has a 6.9 percent Montana income tax rate. Her deposit reduces the amount of her 2018 Montana income tax due by approximately \$241.50 ($\$3,500 \times .069 = \241.50). To be eligible for the maximum state income reduction for the 2019 tax year, Nina must deposit up to \$4,000 between January 1 and December 31, 2019.

Example 4: Married Couple: Rob and Sheila, owners of a downtown business, deposited \$3,500 each in an MSA at a local bank in March 2018. The deposits lowered their Montana taxable income by \$7,000. They have a 6.9 percent Montana state income rate (tax tables change yearly). Their MSA deposits saved them approximately \$483 in Montana income taxes ($\$7,000 \times .069 = \483).

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

A person's medical expenses not covered by health insurance cannot be deducted on the federal income tax return unless they exceed 7.5 percent of federal adjusted gross income in 2018; 10 percent in 2019 and thereafter.

Example 5: Ben and Bethany have an adjusted gross income of \$45,000. Any medical expenses they could deduct on their federal return in 2018 must be above \$3,375 ($\$45,000 \times 0.75 = \$3,375$). Because their medical expenses not covered by health insurance is \$3,100, they are not allowed a deduction on their federal return. However, because Ben and Bethany established Montana MSAs in 2018 with a contribution of \$3,500 each, they are able to reduce their Montana taxable income by \$7,000 even though their withdrawals for eligible medical expenses totaled \$3,100.

How much will I save on federal income taxes?

Nothing. The amount deposited to a Montana MSA is not eligible for a reduction in income on the federal tax return. However, if a person has medical expenses that exceed 7.5 percent of federal adjusted gross income in 2018; 10 percent in 2019 and itemizes using Schedule A, that amount can be used.

Example 6: David had medical expenses of \$10,000 of deductible eligible expenses during the year. He used \$3,500 of his MSA to pay his eligible medical expenses. He can claim \$6,500 as additional medical care expenses on his Montana tax return. ($\$10,000 - \$3,500$

= \$6,500). On this federal tax return he can only claim the amount exceeding 7.5 percent of his federal gross income in 2018.

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. The interest earned and the investment gains on an MSA are not subject to Montana income tax if they are left in the account or if they are withdrawn for eligible medical expenses. MSA earnings must be declared on the Federal income tax return.

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

An MSA is not like the federal medical care flexible spending account (FSA) 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, up to the annual limit, can only be used to reduce Montana income. The amount placed in a Federal Health Care Savings Account (HSA) can be used to reduce both state and federal income. The eligibility requirements are outlined in detail in the MontGuide *Health Care Savings Accounts* (MT200704HR), available from your local Extension office.

The amount placed in a *flexible spending account* (FSA) can also 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. However, as of 2015 and thereafter, up to \$500 in an FSA can be rolled over to the next year.

Example 7: Becky decided to set aside \$200 per month (\$2,400 during the year) in her FSA. Unfortunately she had used up all \$2,400 by July because of uncovered physical therapy expenses. From July to December she had another \$3,500 in eligible medical expenses. She opened an MSA to cover these expenses and was able to reduce her Montana income by a total of \$5,900 (\$2,400 for the FSA + \$3,500 for the MSA = \$5,900 in 2018). However, Becky's federal income was only reduced by the \$2,400 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 2, Schedule II for the year 2017, the amount deposited between January 1 and December 31,

2017 was entered on line 18 (*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, your MSA interest earnings must be declared on the federal income tax return.

The MSA form has been simplified so that it is easier to calculate and report your allowable exclusion. A worksheet (MSA-Worksheet) is also available to help you track deposits, earnings and withdrawals. In 2018, the optional worksheet information will be incorporated into a form that has yet to be created. The Penalty Calculation is also included on the Form that will be available from the Department of Revenue.

For the tax year 2018 and beyond, account holders will be required to report a beginning and ending balance.

What are eligible medical expenses?

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

1. Paying eligible medical expenses of the account holder or anyone he or she chooses.

The Montana Department of Revenue accepts eligible medical 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
- Medicare A premiums: If you are not covered under Social Security (or were not a government employee who paid Medicare tax) and you voluntarily enroll in Medicare A, the premiums paid for Medicare A are eligible medical expenses for a Montana MSA.
- Medicare B premiums
- Medicare D premiums
- prescription drugs
- insulin
- medical, dental, and nursing care
- eyeglasses
- crutches
- hearing aids
- transportation for medical care

- certain allowable lodging expenses
- deductible amount and co-payments that are not covered by other types of health insurance
- premium paid for family leave insurance
- Family leave expenses are covered under Montana law but the administrative rules that determine the calculation have not been issued. As stated in the statute, an expense, calculated monthly, includes approximating wages lost while caring for parents, spouse, or children for the purposes allowed under the Family Medical Leave Act of 1993. A family leave expense is calculated by multiplying the hourly wage that the caregiver would have been paid by the number of hours that would typically be spent working but were instead spent caring for parents, spouse, or children. The hourly wage for a person paid a salary is the gross annual wage divided by 2,087.

A listing of eligible medical expenses for a Montana MSA is available in IRS Publication 502, "Medical and Dental Expenses." The publication may be printed from the IRS website at <http://www.irs.gov/pub/irs-pdf/p502.pdf>.

2. Purchasing long-term care insurance or a long-term care annuity for the long-term care of the MSA holder or anyone he or she chooses.

The Montana Department of Revenue also accepts the purchase of long-term care insurance as eligible medical expenses for the account holder or to anyone he or she chooses or the purchase of a long-term care annuity.

What expenses are not eligible for an MSA?

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

Example 8: Amy established an MSA at a local bank and deposited \$3,500 in the account on January 10, 2018. During the year, she had medical expenses of \$1,400. Her insurance covered 40 percent of medical expenses ($\$1,400 \times 0.40 = \560). The amount not covered by insurance was \$840. She decided to utilize her MSA to pay for the balance of \$840 in medical expenses. Amy now has \$2,660 left in her MSA to carry over to the next year ($\$3,500 - \$840 = \$2,660$). On her 2018 Montana tax return Amy may reduce her Montana income by \$3,500, the total amount she contributed into her MSA.

In 2019, Amy didn't contribute any money into her MSA, since she felt the \$2,660 in the MSA would cover any additional medical expenses not covered by

insurance in 2019. Because Amy didn't contribute any money to her MSA in 2019, she does not receive any deductions on her 2019 Montana income tax return.

Other types of reimbursable items that do not qualify as eligible medical 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.

If you are covered under Social Security (of if you are a government employee who paid Medicare taxes), you are enrolled in Medicare A. The payroll tax paid for Medicare A is not eligible medical expenses for a Montana MSA.

Who administers my MSA?

Montana law provides that an MSA can be administered by the individual account holder (self-administered), or 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, etc).

A self-administered MSA must be kept separate from all other accounts. The account must be maintained specifically for eligible medical expenses for the individual account holder or anyone he or she chooses.

A self-administered account holder must file a Medical Care Savings Account annual reporting form (available from the Department of Revenue) with his or her Montana income tax return. The worksheet is not required to be filed.

Are there fees to establish and maintain 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. The maintenance fee is not subject to taxes or penalties.

Some institutions provide free checking for MSAs for depositors age 50 and older.

What types 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 10 percent penalty collected by the Department of Revenue on the amount withdrawn unless the withdrawals fall under one of the four exception rules:

1. An MSA 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, to the extent the funds were excluded on a prior tax return.
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, unless the account passed to a beneficiary.
3. The transfer of funds from one MSA to another MSA 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.

Example 10: 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 MSA so he can use the funds for eligible medical expenses.

Example 11: 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 the credit union to write her a check. Then she deposited the \$2,000 to the MSA she has established at the bank.

4. You can reimburse yourself from your MSA for eligible medical expenses you paid, even if the expenses were incurred during the year before you established the account. You have until December 31 to withdraw funds from your MSA to reimburse yourself for funds withdrawn from your MSA for eligible medical care expenses.

Example 12: Jack took a ski trip between Christmas and New Years. During his vacation he fell and broke his ankle. At the emergency room he was asked to pay the minimum co-pay for his health insurance. Because he didn't have access to his MSA, he paid from his checking account. He has until December 31 to make a qualified withdrawal from his MSA for the expense of the co-payment.

Penalties. Self-administered account holders who make withdrawals from an MSA that were not used to pay qualifying medical expenses must report the amount on the form available from the Department of Revenue. The money withdrawn is considered ordinary income for Montana income tax purposes.

What happens to my MSA when I die?

If an account holder dies, Montana law provides a legal procedure for distributing the money in the MSA. If the deceased person's MSA is with an account administrator, he or she is responsible for distributing the principal and accumulated interest in the account to the estate of the account holder or to a designated payable-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.

Self-Administered Account. The personal representative appointed by the district court is responsible for notifying the financial entity of the death of the MSA account holder. The Personal Representative for the estate may (within one year after the death of the account holder) withdraw funds for eligible medical expenses incurred by the deceased.

An account holder can leave the balance in MSA to anyone he/she wants through a payable on death designation (POD), by will, or if no will the MSA is distributed under the law of intestate succession.

However, only immediate family members can use the funds as an MSA. They can transfer the funds to their own MSA or withdraw funds from the inherited MSA for eligible medical expenses.

If a POD beneficiary is designated on the MSA, the proceeds are directly distributed to that individual.

Example 13: Don named his wife as a POD beneficiary of his MSA with a balance of \$7,000. After his death, his wife can request that the bank transfer the \$7,000 to her MSA without the amount being considered income for Montana income taxation purposes.

What happens to my account if I don't designate a POD Beneficiary?

If a POD beneficiary is not named, 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: In her will, Gayle named her three daughters as beneficiaries of her MSA with a balance of \$9,000. After her death, Gayle's daughters can request that the credit union transfer their share of \$3,000 each to their MSAs without the amount being considered income for Montana income taxation purposes for Gayle's estate or her three daughters.

Example 15: Rick, a bachelor, died without a will. All his relatives live outside Montana. The personal representative of his estate filed a decedent's income tax return and declared the \$20,000 in the MSA as income for Montana income tax purposes.

What happens to my MSA if I become incapacitated?

If an account holder becomes incapacitated, the funds cannot be withdrawn unless a *durable 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 for financial transactions. For additional information request the MontGuide, *Power of Attorney* (MT199001HR), available 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. A Montanan with children in Montana could transfer his/her MSA to his/her children.

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 \$3,500. On the morning of December 30, 2018, he transferred \$3,500 from his regular savings account to establish an MSA. The next day (the last business day of the year), he withdrew \$3,495 from the MSA and placed the funds back into his regular savings account. Matt left \$5 in the account to keep the account active.

Matt can reduce his Montana income by the \$3,500 (2018) 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 \$3,500, the amount he deposited.

Summary

- The Montana Medical Care Savings Account Act allows a Montana taxpayer to establish an MSA and contribute up to \$3,500 annually in 2018; \$4,000 in 2019. After December 31, 2019 the increase is determined by the Consumer Price Index in \$500 increments.
- If principal and earnings are withdrawn for payment of eligible medical expenses or for long-term care of the account holder or anyone else, then the amounts are excluded from Montana state income tax. However, only the earnings are subject to taxation at the federal level.
- Withdrawals from an MSA for any purpose other than eligible medical expenses are treated as ordinary income in Montana and taxed accordingly.
- Withdrawals are subject to a 10 percent penalty unless the withdrawal falls under the exception rules listed on page 5.
- An MSA can be managed by an 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 about 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
- Marsha A. Goetting, Ph.D., CFP®, CFCS
Extension Family Economics Specialist
P. O. Box 172800, Montana State University
Bozeman, MT 59717
Telephone: 406-994-5695
E-mail: goetting@montana.edu

Acknowledgements

This MontGuide has been reviewed by representatives from:

- Montana Independent Bankers Association
- Montana's Credit Unions
- Montana Department of Revenue
- Montana Society of Certified Public Accountants

Disclaimer

This MontGuide is based on Montana law and Administrative Rules in effect as of date of printing. The information presented is for information purposes only and should not be considered as tax or legal advice or be used as such. For answers to specific questions, readers should confer with appropriate professionals (certified public accountants, attorneys, and certified financial planners).



To order additional publications, please contact your county or reservation MSU Extension office, visit our online catalog at <https://store.msuextension.org> or e-mail orderpubs@montana.edu

Copyright © 2019 MSU Extension

We encourage the use of this document for nonprofit educational purposes. This document may be reprinted for nonprofit educational purposes if no endorsement of a commercial product, service or company is stated or implied, and if appropriate credit is given to the author and MSU Extension. To use these documents in electronic formats, permission must be sought from the Extension Communications Coordinator, 115 Culbertson Hall, Montana State University, Bozeman, MT 59717; **E-mail: publications@montana.edu**

The U.S. Department of Agriculture (USDA), Montana State University and Montana State University Extension prohibit discrimination in all of their programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital and family status. Issued in furtherance of cooperative extension work in agriculture and home economics, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, Cody Stone, Director of Extension, Montana State University, Bozeman, MT 59717.