

## ARCHER MEDICAL SAVINGS ACCOUNTS

For individuals who qualify, Archer MSAs offer a tax-favorable way to set aside funds (or have their employer do so) to meet future medical needs. Archer MSAs were introduced by the Health Reform Act of 1996 and have been available since 1997. The Taxpayer Relief Act of 1997 changed certain rules on coverage, distributions and reporting requirements.

These comments will give you a broad overview of how Archer MSAs work, along with an outline of the qualification requirements.

The idea behind Archer MSAs is somewhat similar to the one behind IRAs (Individual Retirement Accounts), except the goal is to encourage funding for future medical needs as opposed to retirement needs. Here are the key tax-related elements:

1. Contributions you make to an Archer MSA are deductible when made (subject to limitations described below).
2. Earnings on the funds within the Archer MSA are not taxed; and,
3. Distributions from the Archer MSA to cover qualified medical expenses are not taxed. (In this regard, Archer MSAs are more favorable than IRAs, distributions from which are taxed.)

### # WHO IS ELIGIBLE?

In order to be eligible for an Archer MSA, you must be covered by a "high deductible health plan" (discussed below). You must also not be covered by a plan which (1) is not a high deductible health plan, and (2) provides coverage for any benefit covered by your high deductible plan. (It's okay, however, to be covered by a high deductible plan along with separate coverage, through insurance or otherwise, for accidents, disability, dental, vision, or long-term care.)

For 2003, a "high deductible health plan" is a plan with an annual deductible of at least \$1,700 and not more than \$2,500 (for self-only coverage) or at least \$3,350 and not more than \$5,050 (for family coverage). Additionally, annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits cannot exceed \$3,350 for self-only coverage or \$6,150 for family coverage.

A high deductible health plan does not include a plan if substantially all of the plan's coverage is for accidents, disability, dental, vision, long-term care or insurance for a specified disease or illness or insurance paying a fixed amount per day (or other period) of hospitalization.

The plan must be established and maintained by your employer (or spouse's employer) who qualifies as a "small employer," or, if you or your spouse are self-employed, must not be established and maintained by an employer. A small employer, generally, is one employing 50 or fewer employees, on average.

### # DEDUCTION LIMITS

Contributions to an Archer MSA can be deducted for the year up to the total of your monthly limitations for the months you were eligible. The monthly limitation for a month is 1/12 of (1) 65% of the annual deductible under the coverage (for an individual with self-only coverage) or (2) 75% of the annual deductible under the coverage (for an individual with family coverage). For

example, if for the entire year, an individual has family coverage with an annual deductible of

\$4,000, the monthly limitation is  $1/12 \times (.75 \times \$4,000)$  or \$250. The deduction limit for the year would be  $12 \times \$250$  or \$3,000. No other limits apply except the deduction cannot exceed compensation. However, if an individual is entitled to benefits under Medicare, the amount that is allowable as a deduction for an Archer MSA contribution is zero. (Medicare-eligible individuals can choose either the traditional Medicare program or a Medicare+Choice Archer MSA.)

## # EMPLOYER CONTRIBUTIONS

If you are eligible and your employer contributes to your Archer MSA, the employer's contribution is excluded from your gross income, up to the deduction limitation, as described above. However, employer contributions are not excludable if made at the election of the employee under a salary reduction arrangement that is part of a cafeteria plan (i.e., a plan which allows you to elect to use part of your salary towards a variety of benefits). Additionally, the employer must offer to make comparable contributions for all employees with comparable coverage under prescribed requirements.

Note, if an employer makes contributions to your (or your spouse's) Archer MSA which are excludable from gross income, you (or your spouse) cannot deduct any amounts you or your spouse separately contributes to the Archer MSA.

## # OTHER RULES

If the Archer MSA is set up properly, it is generally exempt from taxation, although taxes may apply if contribution limitations are exceeded, required reports are not provided or prohibited transactions occur.

Distributions from the Archer MSA to cover your qualified medical expenses or those of your spouse or dependents are not taxed. Qualified medical expenses for these purposes generally mean those which would qualify for the medical expense itemized deduction. If you withdraw funds from the Archer MSA for other reasons, the withdrawal is taxable. Additionally, an extra 15% tax will apply to the withdrawal, unless it is made after reaching age 65 or in the event of death or disability.

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