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ESTATE TAX PLANNING AND THE OFTEN-OVER-LOOKED POWER OF THE "MED-ED EXCLUSION"

The current federal gift and estate tax rate is 40% and once an individual uses his or her lifetime exemption (currently $11.58 million and scheduled to drop to about half of that in 2026, perhaps sooner in light of election results) tax planning becomes difficult and complex. The only simple solutions are making charitable gifts and using the annual gift tax exclusion that allows an individual to make gifts of $15,000 per year to as many people as desired, provided there are no strings attached to the gift. For people with large estates, this well-known annual exclusion is an important, albeit modest, tool to whittle away at their taxable estates while providing support or a small windfall to family and friends.

But there is another—often overlooked—strategy for reducing a taxable estate. Internal Revenue Code Section 2503(e) excludes the direct payment of another's medical and educational expenses from federal gift tax. Importantly, that direct payment is similarly excluded from another transfer tax designed to prevent high-net worth individuals from skipping over generations in an effort to reduce estate taxes, known as the generation-skipping transfer, or GST, tax. Grandparents can therefore take advantage of the IRC 2503(e) exclusion for the benefit of their children, grandchildren and even great-grandchildren without giving rise to federal estate or GST tax.

This so-called "Med-Ed Exclusion" has traditionally proven valuable for individuals who already take advantage of the $15,000 annual exclusion and have used their lifetime exemptions. They are able to make additional tax-free gifts by making tuition payments directly to their grandchildren's college or private school. But what about medical care? For individuals with good health insurance, the payment of medical expenses on another's behalf may not seem like a tax-planning opportunity at first glance, but the definition of medical care is extremely broad, and includes amounts paid for "the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body."[1] In addition, the unlimited exclusion from the gift tax includes amounts paid for medical insurance on behalf of any individual.[2]

The definition encompasses everything from preventative medicine and in-patient services to seeing eye dogs and beyond. But the breadth of the medical exclusion can be made all the more

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1 Treas. Reg. §25.2503-6(b)(3)
2 The unlimited exclusion from gift tax does not apply to amounts paid for medical care that are reimbursed by the donee's insurance.

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powerful as an estate planning tool when you look toward some of the innovative developments that have been taking place in private medicine today.

For example, consider private medicine that provides comprehensive, full service, year-round care for a fixed annual fee, like Private Medical—a family-office style medical practice currently operating in New York and California. Their membership to proactive, evidence-based medicine includes a personal relationship with a primary care physician, a 5-person care team, state of the art testing and access to a global community of experts. A family member could make the perhaps otherwise unaffordable fixed payment on behalf of his or her children, grandchildren and even extended family or friends without incurring gift or GST tax, and in turn, the beneficiaries would receive proactive, highly personalized medical care at no personal cost. Individuals could also prepay for their grandchildren for 10+ years or arrange for multi-year family plans. These prepayment or multi-year payment options should also qualify for the tax exclusion. The IRS has approved the prepayment of tuition expenses under the same IRC section as long as the payments were not refundable.

For high-net worth clients, estate tax planning often consists of chipping away at the problem using charitable and annual exclusion gifts, as well as complex trust structures. The Med-Ed Exclusion offers another simple and effective tax solution enhanced by overall health benefits.

If you have any questions about how the direct payment of medical or education expenses applies to your situation, **please contact your attorney for advice.**