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Authored by

CAROLYN A. REERS
MARY MARGARET COLLEARY

*If you have any questions
about this Advisory,
please contact:*

MICHAEL T. CLEAR
203.363.7675
mclear@wiggin.com

VERONICA R. S. BAUER
561.701.8701
vbauer@wiggin.com

ROBERT W. BENJAMIN
212.551.2602
rbenjamin@wiggin.com

DANIEL L. DANIELS
203.363.7665
ddaniels@wiggin.com

HELEN C. HEINTZ
203.363.7607
hheintz@wiggin.com

DAVID W. KESNER
203.498.4406
dkesner@wiggin.com

CHARLES C. KINGSLEY
203.498.4307
ckingsley@wiggin.com

LEONARD LEADER
203.363.7602
lleader@wiggin.com

VANESSA L. MACZKO
203.363.7667
vmaczko@wiggin.com

THE GIFT OF MEDICAL CARE – THE “MED” OF THE “MED-ED EXCLUSION”

Following up on a prior advisory that we published on “Estate Tax Planning and the Often-Overlooked Power of the ‘Med-Ed Exclusion’” (click [here](#) to read), we offer this update and a deeper dive into the gift of medical care that may have meaningful implications on estate planning strategies for many individuals.

First, by way of background, the current federal gift and estate tax rate is 40% and once an individual uses his or her lifetime exemption (currently \$12.92 million, increasing to \$13.61 million in 2024, and scheduled to decrease significantly in 2026) tax planning becomes difficult and complex.

There are a couple of simple solutions that might come to mind, including making charitable gifts and using the annual gift tax exclusion that allows an individual to make gifts of a certain amount per year (currently \$17,000, increasing to \$18,000 in 2024) 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, friends, or any other individuals they may choose.

But there is another—often underutilized—strategy for reducing your taxable estate. Internal Revenue Code Section 2503(e) excludes the direct payment of another individual’s medical and educational expenses from federal gift tax. This so-called “Med-Ed Exclusion” can prove valuable for individuals who have used their lifetime exemptions, already taken advantage of the annual exclusion, and are looking to further reduce their taxable estates.

Importantly, direct payments under the Med-Ed Exclusion are similarly excluded from another transfer tax designed to prevent high-net worth individuals from skipping over generations in an effort to reduce gift and estate taxes, known as the generation-skipping transfer, or GST, tax. Grandparents can therefore take advantage of the Med-Ed Exclusion for the benefit of their children, grandchildren and even great-grandchildren without giving rise to federal gift or GST tax.

For educational expenses, you are able to make additional tax-free gifts by making tuition payments directly to another individual’s college or private school. *Read more about this and other strategies for funding education expenses [here](#).*

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RANI NEWMAN MATHURA
561.701.8703
rmathura@wiggins.com

ERIN D. NICHOLLS
203.498.4319
enicholls@wiggins.com

CAROLYN A. REERS
203.363.7668
creers@wiggins.com

MATTHEW E. SMITH
203.363.7639
msmith@wiggins.com

KATERYNA BAKHNAK
212.551.2855
kbakhnak@wiggins.com

MARY MARGARET COLLEARY
212.551.2637
mcolleary@wiggins.com

RUTH FORTUNE
203.363.7658
rfortune@wiggins.com

MI-HAE K. RUSSO
212.551.2619
mrusso@wiggins.com

MARISSA A. O'LOUGHLIN
203.363.7674
moloughlin@wiggins.com

KAITLYN A. PACELLI
203.363.7635
kpacelli@wiggins.com

ANDREW S. PHILBIN
203.363.7606
aphilbin@wiggins.com

BETH A. SCHARPF
212.551.2634
bscharpf@wiggins.com

But what about expenses for medical care? While the payment of medical expenses on another's behalf, especially for individuals with good health insurance, may not seem like a tax planning opportunity at first glance, given the cost of medical care today, it can certainly add up and contribute to reducing your taxable estate.

Who can benefit. Like the annual exclusion, gifting under the medical exclusion is permitted without regard to the relationship of the donor and the donee; in other words, it applies to the payment of qualifying medical expenses on behalf of any individual.

How to make payments. Under IRC 2503(e), “qualifying medical expenses” paid on behalf of an individual to any person who provides medical care to such individual will qualify for the exclusion. Payments must be made directly to the health care provider or facility. Reimbursing someone for medical expenses they paid, does not qualify.

EXAMPLE

A was injured in an automobile accident. B, who is unrelated to A, paid A's various medical expenses by checks made payable to the physician. B also paid the hospital for A's hospital bills. These medical and hospital expenses were not reimbursed by insurance or otherwise. Because the medical and hospital bills paid for A were qualifying medical expenses, and since they were paid directly by B to the person and hospital rendering the medical care, the payments would qualify for the exclusion from gift tax under section 2503(e).^[1]

Note, however, that if instead of making the payments directly to the medical service providers, B reimbursed A for the medical expenses which A had previously paid, the payments made by B to A would not qualify and would thus be subject to gift tax.^[2]

What is covered. The definition of “qualifying medical expenses” for someone's medical care 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 or for transportation primarily for and essential to medical care.”^[3] It also includes amounts paid for medical insurance on behalf of any individual directly to the insurance provider. It does not include medical expenses that are reimbursed by insurance, nor does it include medical treatment for cosmetic purposes.^[4]

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¹ Treas. Reg. §25.2503-6(c).

² The payments would be subject to gift tax on the date of the reimbursement, to the extent they and any other gifts from B to A during the same year exceeds the annual exclusion amount.

³ Treas. Reg. §25.2503-6(b)(3).

⁴ Cosmetic surgeries or procedures arising from or related to a birth defect, accident or disease are qualifying medical expenses eligible for the Med-Ed Exclusion.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.

THE GIFT OF MEDICAL CARE – THE “MED” OF THE “MED-ED EXCLUSION”

The breadth of the “Med” of the Med-Ed Exclusion can be made all the more powerful as an estate planning tool when you consider some of the innovative developments that have been taking place in private medicine today.

EXAMPLE

Private Medical, a family-office style medical practice, provides comprehensive, full service, year-round care for a fixed annual fee. The fee includes a personal relationship with a primary care physician, a dedicated care team, state of the art testing and access to a global community of experts. An individual could make the perhaps otherwise unaffordable fixed payment on behalf of his or her parents, 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.

For high-net worth clients, transfer 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 reach out to your Wiggin and Dana attorney for advice.