THE ESTATE PLANNER

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MANAGING YOUR RESIDUARY ESTATE

How an HSA can benefit your estate plan

Financial power of attorney

To spring or not to spring?

Estate Planning Red Flag

You're attempting to create your estate plan with DIY tools

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Managing your residuary estate

Even with a comprehensive estate plan, it's likely you'll have some assets in a residuary estate. Like the sediment at the bottom of your glass after you finish a fine wine, an estate plan may also leave some residue.

This residue takes the form of assets left over after your executor has paid the estate's debts, taxes and other expenses and distributed specific bequests of money or property. To avoid unintended consequences, include instructions in your will about how your residuary estate should be distributed.

How is a residuary estate created?

A residuary estate may be created intentionally or unintentionally. Why would someone do so intentionally? Most people accumulate a lot of assets, both large and small. Providing for the distribution of every asset — including all household furnishings, vehicles, electronics, clothing and jewelry — may not be desirable. You may want to make specific bequests of certain valuable heirlooms, such as leaving a diamond necklace to your daughter. But it isn't necessary — or even possible in many cases — to specify a recipient for all your "stuff."

To ensure that your assets are distributed according to your wishes, consider including a residuary clause in your will.

Some assets may unintentionally end up in your residuary estate. This can happen if you inadvertently leave an asset out of your will or trust. Failure to name a beneficiary for assets such as life insurance policies or payable-on-death bank accounts can cause those assets to end up in your residuary estate. Another possibility is that the beneficiary of an asset dies before you and you neglect to name a contingent beneficiary.

Unlike the sediment in the wineglass, the residuary estate isn't something to discard. In fact, assets in your residuary estate can be highly valuable — sometimes even more valuable than the other parts of the estate.

If your will doesn't designate one or more beneficiaries for your residuary estate, that portion of your estate will likely go through probate. In this case, the probate court will determine how those assets should be distributed according to your state's intestate succession laws. In other words, those assets will be distributed as if you died without a will. (See "Understanding the laws of intestate succession" on page 3.)

How should your residuary estate be managed?

To avoid unintended consequences and ensure that your assets are distributed according to your wishes, consider including a residuary clause in your will. This clause provides for your estate's residue to be distributed to one or more beneficiaries, which may include family members or other loved ones, or even charitable organizations.

Understanding the laws of intestate succession

If you fail to leave instructions for the disposition of your residuary estate, those assets will likely be distributed according to your state's laws of intestate succession. Every state has intestacy laws that determine who'll inherit your property if you die without a will, trust or other legally binding document that provides for the distribution of your assets.

These laws vary from state to state, but generally they establish the order of priority under which assets will be transferred if you don't have a will or trust or if your estate plan fails to provide for those assets. A typical sequence is your:

- Surviving spouse,
- Biological and/or adopted children,
- Grandchildren,
- Surviving parents,
- Siblings,
- Siblings' descendants (nieces and nephews), and
- Grandparents' descendants (aunts and uncles).

If none of these heirs exist, your assets may be transferred to the state.

Keep in mind that "nonprobate" assets generally don't pass via intestate succession. This includes property held in a trust as well as life insurance policies, payable-on-death bank accounts and retirement accounts that go to a named beneficiary.

The residuary clause should be designed carefully to avoid unintended consequences or conflicts among your heirs. The size of the residuary estate may vary widely and its value may fluctuate dramatically over time. Suppose you name one of your children as beneficiary of your residuary estate. If that portion of your estate grows unexpectedly large, that child may end up with a larger share of your estate than his or her siblings. A better approach may be to allocate a specific percentage of the residue to each beneficiary.

Another option, if you have a trust, is to create a pour-over will. A pour-over will ensures that your trust is properly "funded" by providing that any leftover or overlooked assets are automatically poured (transferred) into the trust when you die. This ensures that all your assets are distributed according to the terms of your trust and that nothing is left to the devices of the probate court or the laws of intestate succession.

Any questions?

As you're putting together your estate plan, ask your estate planning advisor about managing your residual estate. There are several options for handling your estate's residue, but overlooking these assets isn't one of them. Failure to provide instructions for the disposition of your residuary estate can lead to undesirable — and in some cases, disastrous — consequences.

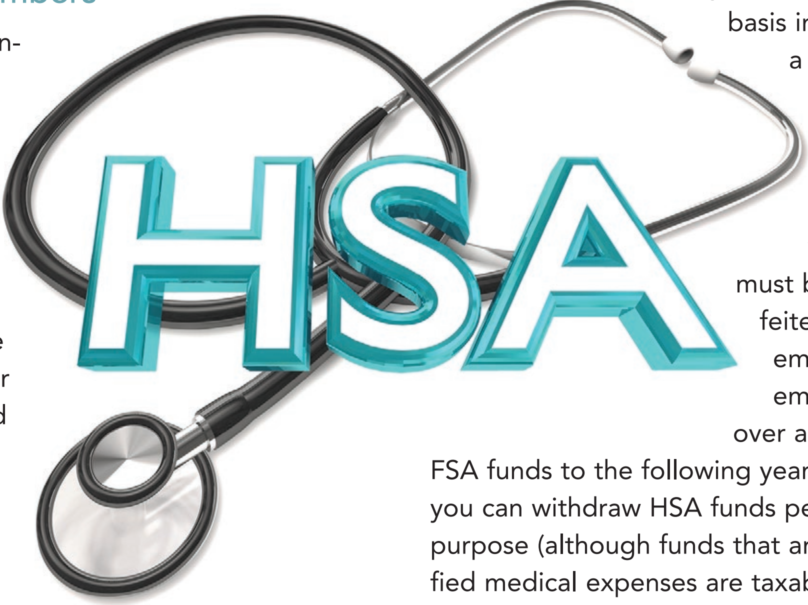
How an HSA can benefit your estate plan

A Health Savings Account (HSA) can positively affect your estate plan. How? In addition to serving as a viable option to reduce health care costs, an HSA's funds grow on a tax-deferred basis. In fact, an HSA is similar to a traditional IRA or 401(k) plan in that it's a tax-advantaged savings account funded with pretax dollars.

Funds can be withdrawn tax-free to pay for a wide range of qualified medical expenses. Bear in mind that withdrawals for nonqualified expenses are taxable and, if you're under age 65, subject to penalties.

HSAs by the numbers

To provide these benefits, an HSA must be coupled with a high-deductible health plan (HDHP). For 2025, an HDHP is a plan with a minimum deductible of $1,650 ($3,300 for family coverage) and maximum out-of-pocket expenses of $8,300 ($16,600 for family coverage). In addition, you must not be enrolled in Medicare or covered by any non-HDHP insurance (a spouse's plan, for example). Once you enroll in Medicare, you can no longer contribute to an HSA, but you can continue to withdraw funds to pay for qualified expenses.



Currently, the annual contribution limit for HSAs is $4,300 for individuals with self-only coverage and $8,550 for individuals with family coverage. If you're 55 or older, you can add another $1,000. Typically, contributions are made by individuals, but some employers contribute to employees' accounts.

Reducing health care costs

HSAs can lower health care costs in two ways by 1) reducing your insurance expense, HDHP premiums are substantially lower than those of other plans, and 2) allowing you to pay qualified expenses with pretax dollars.

In addition, any funds remaining in an HSA may be carried over from year to year, continuing to grow on a tax-deferred basis indefinitely. This is a huge advantage over health care Flexible Spending Accounts (FSAs), where the funds must be spent or forfeited. (Note that employers may allow employees to carry over a certain amount of FSA funds to the following year. When you turn 65, you can withdraw HSA funds penalty-free for any purpose (although funds that aren't used for qualified medical expenses are taxable).

To the extent that HSA funds aren't used to pay for qualified medical expenses, they behave much like an IRA or a 401(k) plan.

Benefiting your estate plan

Unlike traditional IRA and 401(k) plan accounts, HSAs need not make required minimum distributions once you reach age 70½. Except for funds used to pay qualified medical expenses, the account balance continues to grow on a tax-deferred basis indefinitely, providing additional assets for your heirs. The tax implications of inheriting an HSA differ substantially depending on who receives it, so it's important to consider your beneficiary designation.

> *Unlike traditional IRA and 401(k) plan accounts, HSAs need not make required minimum distributions once you reach age 70½.*

If you name your spouse as beneficiary, the inherited HSA will be treated as his or her own HSA. That means your spouse can allow the account to continue growing and withdraw funds tax-free for his or her own qualified medical expenses. If you name your child or someone else other than your spouse as beneficiary, the HSA terminates and your beneficiary is taxed on the account's fair market value.

It's possible to designate your estate as beneficiary, but in most cases that's not the best choice, because a beneficiary other than your estate can avoid taxes on qualified medical expenses paid with HSA funds within one year after death. When the estate is the beneficiary, the entire value of the HSA is taxable to you on your final income tax return. This presents a planning opportunity, particularly if you're in a lower tax bracket than the beneficiary or beneficiaries of the HSA.

A win-win

Opening and contributing to an HSA offers tax-advantaged options that can help reduce health care costs and provide estate planning benefits. Contact your estate planning advisor for details.

Financial power of attorney

To spring or not to spring?

A financial power of attorney (POA) can be a critical component of your estate plan. It appoints a trusted representative (often called an agent) to make financial decisions on your behalf in the event you're unable to do so.

Without a POA, if you become incapacitated because of an accident or illness, your loved ones won't be able to manage your finances without going through the lengthy and expensive process of petitioning the court for guardianship or conservatorship. To ensure that financial decisions or tasks don't fall through the cracks, consider executing a financial POA, also known as a POA for property. This document authorizes your agent to manage your investments, pay your bills, file tax returns and otherwise handle your finances, within the limits you set.

Springing vs. durable POA

One important decision you'll need to make is whether your POA should be "springing" — effective when certain conditions are met — or nonspringing (also known as "durable") which is effective immediately.

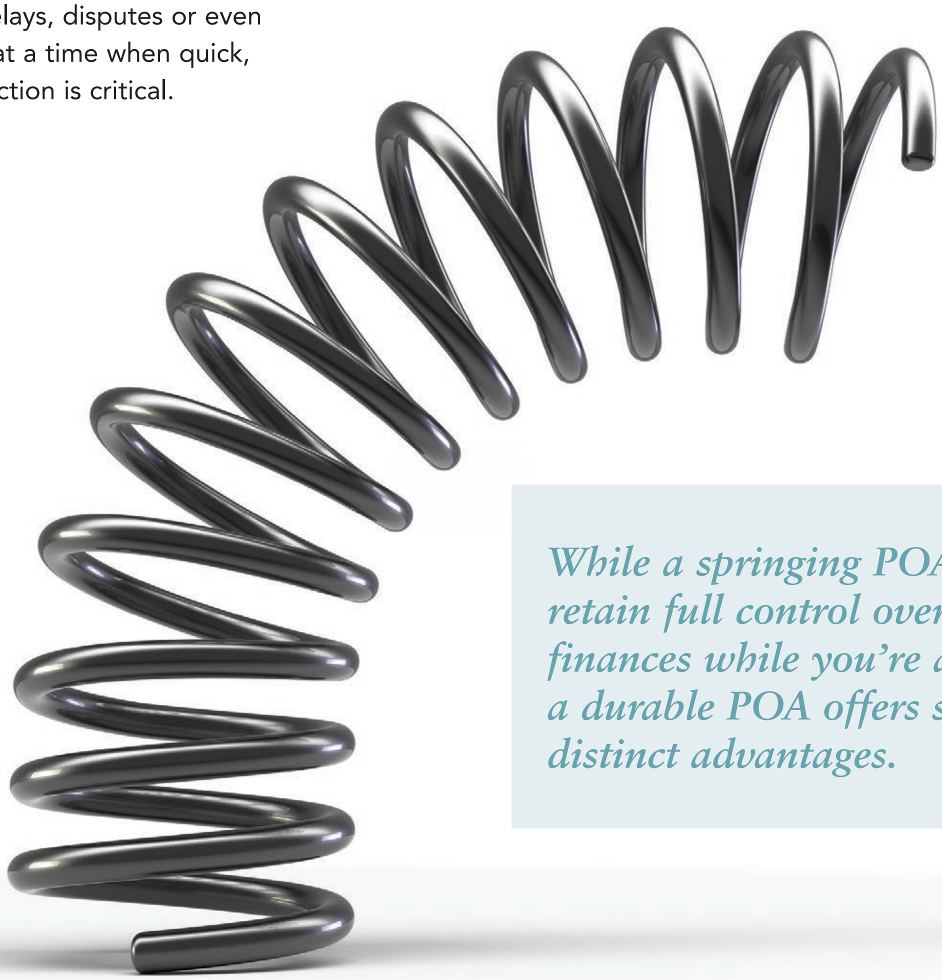
A springing POA activates under certain conditions, typically when you become incapacitated and can no longer act for yourself. In most cases, to act on your behalf, your agent must present a financial institution or other third party with the POA as well as a written certification from a licensed physician stating that you're unable to manage your financial affairs.

While a springing POA lets you retain full control over your finances while you're able, a durable POA offers some distinct advantages:

- A durable POA takes effect immediately, allowing your agent to act on your behalf for your convenience, not just when you're incapacitated. For example, you might ask your agent to conduct a business or real estate transaction on your behalf while you're traveling abroad.
- If you do become incapacitated, a durable POA allows your agent to act quickly on your behalf, to handle urgent financial matters without the need for a physician to certify that you've become incapacitated. With a springing POA, the physician certification requirement can lead to delays, disputes or even litigation at a time when quick, decisive action is critical.
- Durable POAs may also be advantageous for elderly individuals, who are mentally capable of handling their affairs but prefer to have assistance.

Durable POAs have one important disadvantage. That is, some people are uncomfortable with a POA that takes effect immediately because they're concerned that their agents may be tempted to abuse their authority or commit fraud. However, if you can't fully trust an agent with an immediate POA, it's even riskier to rely on them when you're incapacitated and unable to protect yourself.

In light of the advantages of durable POAs and the potential delays caused by springing POAs, the best approach is to grant a durable POA to someone you trust completely, such as your spouse or one of your children. If you'd like added security, consider asking your attorney or another trusted advisor to hold the durable POA and deliver it to



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the designated agent only when you instruct them to do so or you become incapacitated.

Keep your POAs fresh

Although this article has focused on financial POAs, similar considerations apply to health care POAs (also known as health care proxies). To ensure that your wishes are carried out, it's advisable to prepare and sign financial and health care POAs as soon as possible and to let your loved ones know where to find them.

It's also a good idea to sign new POAs periodically. Financial institutions and health care providers may hesitate to honor POAs that are years or decades old.

ESTATE PLANNING RED FLAG

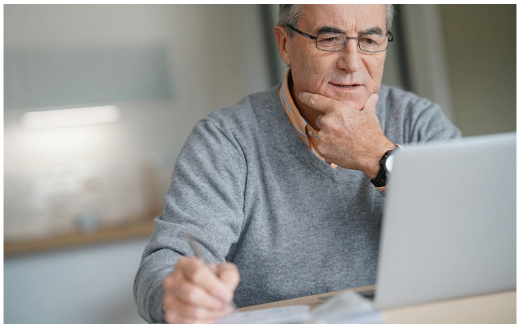
You're attempting to create your estate plan with DIY tools

Interested in trying to prepare your own estate plan? There are resources available to assist you, such as online services, computer software and how-to books. Do-it-yourself (DIY) estate planning may save you hundreds or even thousands of dollars up front.

If your estate is modest in size, your assets are solely in your name, and you intend to leave them to your spouse or other closest surviving family member, an online service may be a cost-effective option. However, in all but the simplest cases, the risk of unintended results or costly disputes often outweighs any initial savings.

Part of the problem is that online services can help you create individual documents. The good ones can even help you comply with applicable laws, such as ensuring the right number of witnesses to your will. However, they can't help you create an estate *plan*. Putting together a plan means determining your objectives and coordinating a collection of carefully drafted documents designed to achieve those objectives. And in most cases, that requires professional guidance.

For example, let's suppose John's estate consists of a home valued at $750,000 and a mutual fund with a $750,000 balance. He uses a DIY tool to draft a will, leaving the home to his daughter and the mutual fund to his son. This arrangement appears fair. But suppose that, by the time John passes away, he has sold the home and reinvested the proceeds in his mutual fund. Unless he amended his will, his daughter would end up with nothing, effectively disinheriting her. An experienced estate planning advisor would have anticipated such contingencies and ensured that John's plan treated both children fairly, regardless of the specific assets in his estate.



DIY tools tend to fall short when a decision demands a professional's experience rather than mere technical expertise. For example, an online service might make it easy to name a guardian for your minor children, but it can't help you evaluate the many characteristics and factors that go into selecting the best candidate.

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