

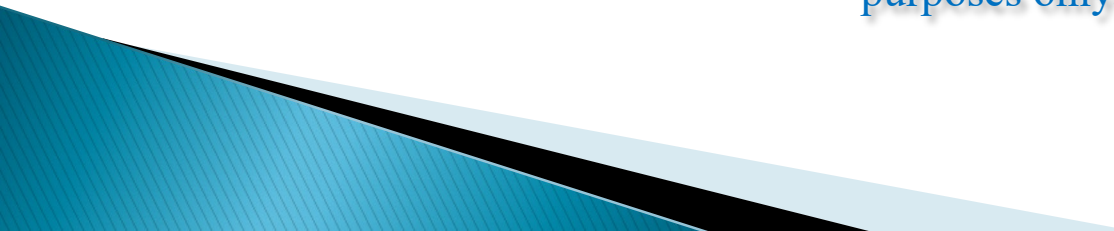
**THE “NEW” ALABAMA QUALIFIED DISPOSITIONS IN TRUST ACT:
DRAFTING A DOMESTIC ASSET PROTECTION TRUST FOR
YOURSELF (FINALLY!)**

September 17, 2026

GULF COAST ESTATE PLANNING CONFERENCE

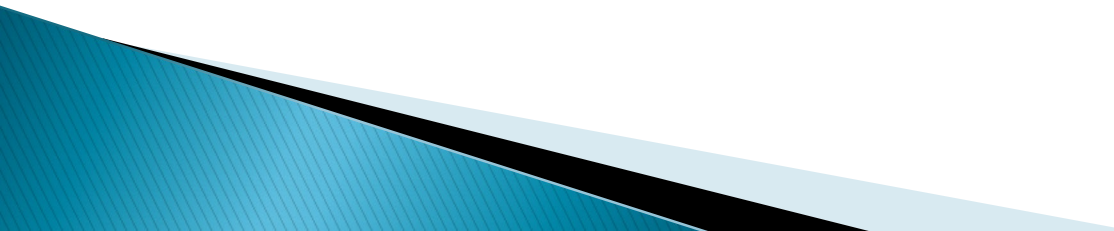
J. Robert Turnipseed
Armbrecht Jackson LLP

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WHAT IS IT? DOMESTIC ASSET PROTECTION TRUSTS

❖ The Qualified Dispositions in Trust Act

- Prior to 2021, Alabama provided few options for creditor protection, where the person seeking the protection wanted to keep an interest in the assets.
 - On April 18, 2021, Alabama finally provided a way—the Alabama Qualified Dispositions in Trust Act.
 - Allowed for the creation of what is called a “Domestic Asset Protection Trust,” which is an irrevocable trust designed for the benefit of the Grantor.
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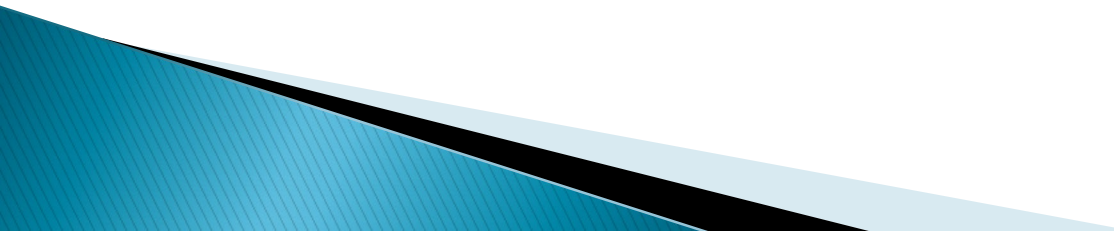
WHAT IS IT? DOMESTIC ASSET PROTECTION TRUSTS

❖ Difference From Other Trusts

- **Revocable Trust**—standard estate planning technique, mainly to avoid probate and allow Grantor to keep benefits of assets. Provides no creditor protection. Can be amended or revoked at will by the Grantor. Ignored for tax purposes (except by certain local tax officials for homestead exemption purposes!)
- **Third Party Trust**—created for the benefit of someone other than the Grantor. Can provide protection of assets from creditors, except for fraudulent transfers. Usually not amendable or revocable (at least without a lot of hassle). Tax treatment varies widely (can be taxed at either the individual or trust level, or even to the Grantor).

WHAT IS IT? DOMESTIC ASSET PROTECTION TRUSTS

❖ History of Domestic Asset Protection Trusts

- First State to Pass an Act—Alaska in 1997.
 - Alabama became the 20th State to pass a version of the Act in 2021. Joined Mississippi and Tennessee in our area. We were the last jurisdiction to pass such an Act.
 - The state acts vary widely, with some providing maximum protection to Grantors (notably Nevada, Alaska and South Dakota), and with other states making compromises in the drafting process to exclude certain types of creditors.
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THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

- General Rule—Section 19-3B-505(a)(2):
“[W]ith respect to an irrevocable trust, a creditor or assignee of the grantor may reach the maximum amount that can be distributed to or for the grantor’s benefit.”
- This general rule allowed creditors and assignees the power to invade trust principal through a process of attachment, to the extent the grantor is due distributions.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

A. New Rules under the Act

- The Act provides that for “qualified dispositions,” the interest of the Grantor is not subject to a process of attachment issued against the beneficiary, and may not be taken in execution under legal process directed at that beneficiary, the trustee, the trust estate, or any part of income of the trust estate.
- The Act further provides that the principal and income of the trust shall be applied by the Trustee solely for the benefit of the beneficiary, free, clear, and discharged of all obligations of the beneficiary.
- No claims against Trustees, advisors, or attorneys.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

B. Exceptions: Voidable / Fraudulent Conveyances

- Creditors can bring an action under § 5 and 6 of the Alabama Avoidable Transfers Act (Ala. Code §§ 8-9B-5 and 8-9B-6).
- For claims of a creditor that arise after the qualified disposition has been made, they must prove actual intent to hinder, delay or defraud the creditor.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

B. Exceptions: Voidable / Fraudulent Conveyances

- The statute of limitations on the fraudulent transfer claim is as follows:
 - a. Two years after the qualified disposition was made; or
 - b. If the claim was fraudulently concealed, the earlier of one year after the qualified disposition was or could reasonably have been discovered by the claimant, and the time allowed under statute of limitations under §8-9B-10.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

B. Exceptions: Preexisting liens

- Under Section 19-3E-5(j), valid liens that attach to property before a qualified disposition will survive the transfer, and the trustee takes title to the property subject to the lien and to any agreements that created or perfected the lien.
- Grantor and creditor can enter written agreements regarding said dispositions, and any transfers that violate that agreement will not be considered a qualified disposition.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

B. Exceptions: Child Support

The Act provides that transfers can be avoided for outstanding child support. It specifically excludes from the definition of a qualified disposition any “disposition to the extent that, at the time of the disposition, the transfer is in arrears on child support obligation by more than 30 days.”

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

B. Exceptions: Spousal Claims / Divorce

- The Act specifically provides that trust assets are not considered real or personal property of the beneficiary and are not the beneficiary's marital asset and may not be awarded to a beneficiary spouse if the following rules apply:
 - (1) The beneficiary made the qualifying disposition more than thirty days before marriage;
 - (2) The beneficiary and spouse agree that the subdivision of the Act applies to the qualified disposition; or
 - (3) The beneficiary and spouse agree that the property is not considered marital property, is not considered part of the trust beneficiary's estate, and may not be awarded to the spouse in a judgment of divorce.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

B. Exceptions: Spousal Claims / Divorce

- Furthermore, the amount in the trust cannot be considered in calculating alimony.
- Substitute for a prenuptial agreement. 30 day rule.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

C. Rights of Trustee and Beneficiaries for Avoided Qualified Dispositions: Section 19-3B-7

- Present value of the debt
- Good Faith of Trustee—lien on property for fees and costs.
- Good Faith of beneficiary—keeps prior distributions.
- Creditor has burden of proof to show lack of good faith.
- Subsection (f) allows for conversion of an existing trust into a DAPT.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Creditor Protection**

So what can a creditor do once a qualified disposition has been avoided?

- Section 19-3E-8(g): provides that “on avoidance of a qualified disposition to the extent permitted under subsection (a), the sole remedy available to the creditor is an order directing the trustee to transfer to the transferor the amount necessary to satisfy the transferor’s debt to the creditor at whose instance the disposition has been avoided.”
- Point—they can then seize the funds through regular process against the Transferor.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Formation requirements**

- General requirements for establishment of a trust under the UTC apply (written instrument signed by Grantor, funding with assets, relinquishment of control, definite beneficiary, etc...)
- But the trust must meet the additional requirements of the Act to qualify as a domestic asset protection trust in Alabama.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ Qualified Disposition Defined

- **Disposition**—defined by 19-3E-2. Very broad definition.
- **Qualified disposition**--A disposition of property to one or more trustees, at least one of whom is a qualified trustee, which is governed by a trust instrument, including, but not limited to, a trust instrument as modified by an irrevocable written election described in subsection (f) of Section 19-3E-5, under which the transferor has no more rights, powers, or interests than those permitted by Section 19-3E-4.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Qualified Trustee**

- Defined in 19-3b-2(19). Not the transferor!!!
- Includes the following:
 - a. Is an individual who is a resident of this state, or is an organization that is authorized by the law of this state to act as a trustee and whose activities are subject to supervision by state regulatory bodies;

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Qualified Trustee**

b. Maintains or arranges for custody in this state of some or all of the property that is the subject of the qualified disposition and administers all or part of the trust in this state.

c. Whose usual place of business, where some of the records pertaining to the trust are kept, is located in this state or, if the person does not have such a place of business, who is a resident of this state.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ Qualified Trustee

- Trust officers—note that for a corporate trustee, the place of business is where the primary trust officer is located!
- Note—can have other nonqualified trustees, but must have at least one that is a Qualified Trustee.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ Qualified Trustee

- Successor Trustees? Addressed in Ala. Code § 19-3B-8.
- Can provide successor in the trust instrument, or apply to the Court for appointment.
- Vacancy won't DQ the trust, but have to have successor appointed within a “reasonable time.”

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Use of Advisors/Directed Trusts**

- Yes! The Act allows for “advisors” to be utilized in the administration of a Trust. Effectively allows for creation of a “directed trust.”
- What kinds of things can an “advisor” be given control over?
 - (1) Investments
 - (2) Distributions
 - (3) Removal or appointment of trustees

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Qualified Affidavit**

- Requires transferor to provide affidavit at time of the transfer of property to the trust, stating as follows:
 - (1) The transferor has full right, title, and authority to transfer the property to the trust.
 - (2) The transfer of the property to the trust will not render the transferor insolvent.
 - (3) The transferor does not intend to defraud a creditor by transferring the property to the trust.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Qualified Affidavit**

(4) The transferor does not know of or have reason to know of any pending or threatened court actions against the transferor, except for those court actions identified by the transferor on an attachment to the affidavit.

(5) The transferor not involved in any administrative proceedings, except for administrative proceedings identified on an attachment to the affidavit.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Qualified Affidavit**

(6) The transferor is not currently in arrears on a child support obligation by more than 30 days.

(7) The transferor does not contemplate filing for relief under the Bankruptcy Code, 11 U.S.C. §§ 101 to 1532, inclusive.

(8) The property being transferred to the trust was not derived from unlawful activities.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Permitted Powers of Transferor**

- Act allows for the Transferor to retain certain powers over the Trust, listed in Section 19-3E-4.
- Subsection (a) provides that “any agreement or understanding that purports to grant or permit the retention of any greater powers or rights is void.” What does this mean?

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Permitted Powers of Transferor**

- Includes such things as the following:
 - (1) Directing investments;
 - (2) Vetoing distributions;
 - (3) Special power of appointment at death;
 - (4) Right to income;
 - (5) Right to income in charitable trust, or right to release interest in favor of charity;

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Permitted Powers of Transferor**

- (6) Right to income of GRAT or GRUT;
- (7) Receipt or use of principal, if due to trustee or advisor acting under discretionary trust provision or support provision;

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Permitted Powers of Transferor**

- (8) Right to remove or replace trustee;
- (9) Using real property;
- (10) Right to income taxes;
- (11) Payment of deceased transferor estate debts; and
- (12) Right to minimum required distributions from retirement account.

THE ACT—ALA. CODE § 19-3B-101 et seq

❖ **Jurisdiction/Venue**

- Covered by Ala. Code § 19-3B-3.
- Jurisdiction—circuit courts or any probate courts exercising equity jurisdiction
- Venue—order of priority established in 19-3B-3(c)

TAX ISSUES

ESTATE AND GIFT TAX ISSUES

- ❖ Completed gift? Possibly. Retained control over the trust property is the key issue on this--will cause inclusion under IRC Section 2036. For example, Grantor cannot have the following powers:
 - No reservation of veto power.
 - No testamentary general power of appointment.
 - No mandatory distributions, including mandatory reimbursement of income taxes. IRC 2036(a)(1); see also Rev. Rul. 2004-64.
- ❖ Are discretionary distributions by Trustee enough to cause Estate Tax inclusion? No, but IRS will closely scrutinize the trust instrument and circumstances for a DAPT. See, e.g., PLR 200944002. Cannot have any “understanding,” either express or implied, that an interest or right in property would later be conferred back to the donor.
- ❖ Point—careful drafting is required for a DAPT to avoid estate tax inclusion!

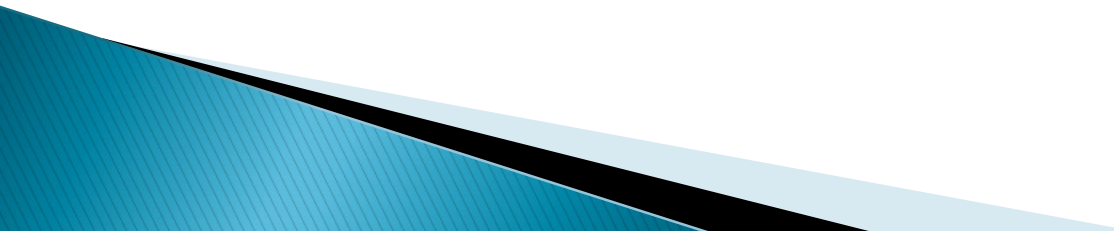
TAX ISSUES

INCOME TAX ISSUES

- ❖ Potential for Grantor Trust Treatment—minimizes income tax.
 - Grantor Trust: IRS considers the grantor being the owner of the trust assets for income tax purposes, meaning income is taxed to the Grantor directly, at his or her tax rates, instead of taxed at fiduciary income tax rates. IRC § 671.
 - How to make the trust a “grantor” trust? Requires Grantor to retain certain powers outlined in IRC §§ 674 through 677.
 - E.g., power to substitute assets, testamentary power of appointment, power to vote or direct voting on stock, power to direct investments, power to borrow without adequate security or interest...
- ❖ Non-Grantor Trust—trust income tax rates apply. Trust hits maximum tax rates (37%) when income is > \$15,650, plus potential 3.8% net investment tax for undistributed net income.

TAX ISSUES

BEST OF BOTH WORLDS? COMPLETED GIFT AND GRANTOR TRUST RULES? Intentionally Defective Grantor Trust? Can you do this with a DAPT?

- Can be designed as a completed gift for estate and gift tax purposes (which allows any appreciation of assets to escape estate taxation), while also being designed as a “grantor” trust, which will be ignored for federal income tax purposes, meaning that the Settlor will pay the taxes personally each year at a lower marginal rate.
 - How? Retain certain powers under IRC § 674-679 that also match the allowable retained powers for a Grantor in the Act, while also avoiding inclusion under Section 2036 and other estate tax provisions relating to retained power.
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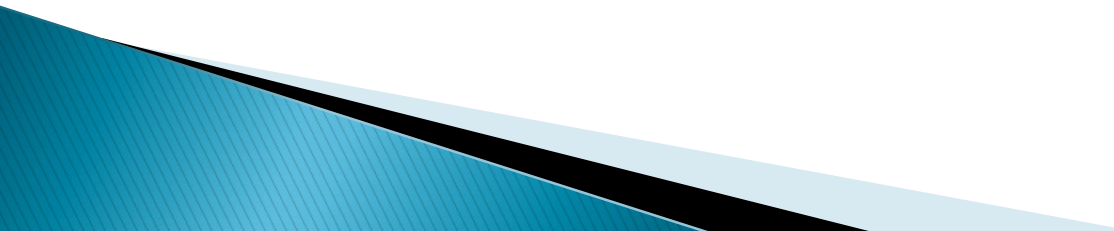
TAX ISSUES

❖ **Planning Point with Alabama Domestic Asset Protection Trusts-- Matching the Retained Powers**

- The kinds of retained powers a Grantor can have to avoid estate tax inclusion and to obtain grantor trust status also have to match the types of allowable retained powers a Grantor can have in an Alabama Domestic Asset Protection Trust. They do not line up perfectly.
- Are there any matches? Yes, including the power to direct investments. But note that the Alabama Act does not include the power to substitute assets, which is a common “bad power” used in IDGTs to qualify for grantor trust status without causing estate tax inclusion.

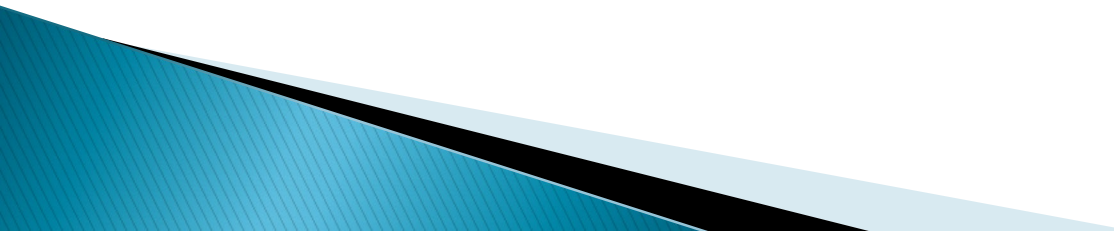
PROS AND CONS OF A DAPT

❖ PROS OF A DAPT

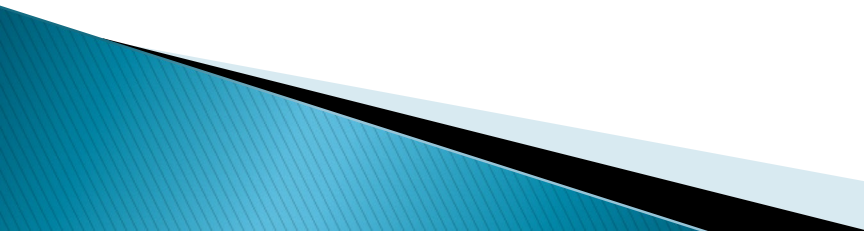
- (1) Retained distributions of income and principal of Grantor
 - (2) Retained powers of Grantor
 - (3) Completed Gift for Estate Tax Purposes
 - (4) Potential for Grantor Trust treatment of income taxes
 - (5) Asset Protection
 - (6) Allowance for Directed Trusts (using advisors to control distributions and investments)
 - (7) Potential Substitution for Prenuptial Agreement
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PROS AND CONS OF A DAPT

❖ **CONS OF A DAPT**

- (1) Costs of administration
 - (2) Loss of control over assets
 - (3) Potential for claims by remainder beneficiaries
 - (4) Higher income taxes for non-grantor trusts
 - (5) Lack of case law / IRS rulings (statute is new!)
 - (6) Alabama's burden of proof for creditors—preponderance of the evidence (most states use clear and convincing evidence standard)
 - (7) Complexity of drafting
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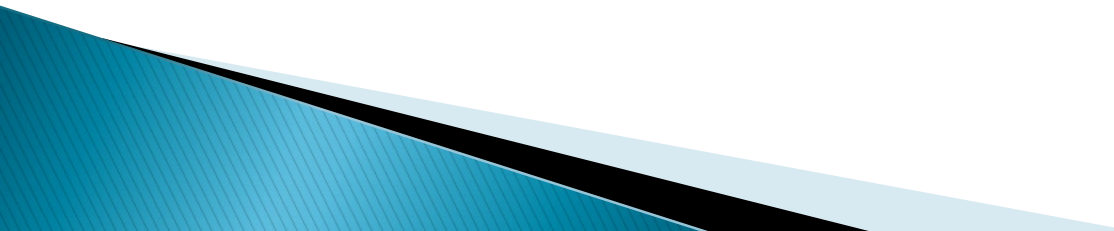
CHOICE OF LAW PROBLEMS

- ❖ Will other states give credit to an Alabama DAPT? Which state's law governs when a creditor sues? The answer depends largely on where the resident resides:
 - Alabama Resident? Most likely, yes.
 - Non-Alabama Resident? Uncertain.
 - ❖ This is the major issue that Courts will face regarding these trusts.
 - ❖ Example—Florida does not have a DAPT statute. The Courts treat these trusts as a violation of state public policy. Under general law, Florida courts will recognize a choice of law clause unless the chosen law contravenes a strong public policy of the forum state.
 - ❖ Key to enforceability—draft the DAPT in the Grantor's state of residence.
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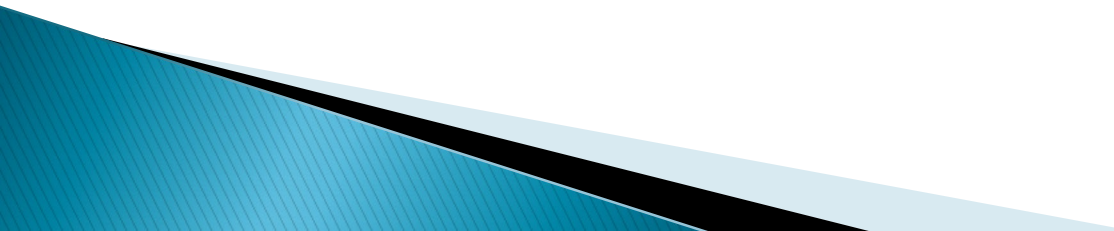
RETIREMENT BENEFITS AS QUALIFIED DISPOSITIONS?

- ❖ Can a Grantor put his 401(k) or IRA into a DAPT?
 - The Act anticipates this. Actually defines “Retirement Benefit” as including such benefits.
 - Retained Power of Transferor? Act provides that the transferor can retain “the right to the actual or potential receipt of a minimum required distribution, as defined in 26 U.S.C. § 4974(b), with respect to a retirement benefit.”
 - Provision in Trust? Use a “conduit trust” provision for retirement benefits, to avoid immediate taxation.
 - Will that cause estate tax inclusion? Yes! So retirement benefits cannot be an asset of the Trust if Estate Tax Planning is a primary goal.

SPENDTHRIFT PROVISION

- ❖ Spendthrift Provision—defined in the Act as “[a] term of a trust which restrains both voluntary and involuntary transfers of a beneficiary’s interest.”
 - ❖ Important to add this provision (as in any other kind of irrevocable trust) to provide maximum protection for creditors.
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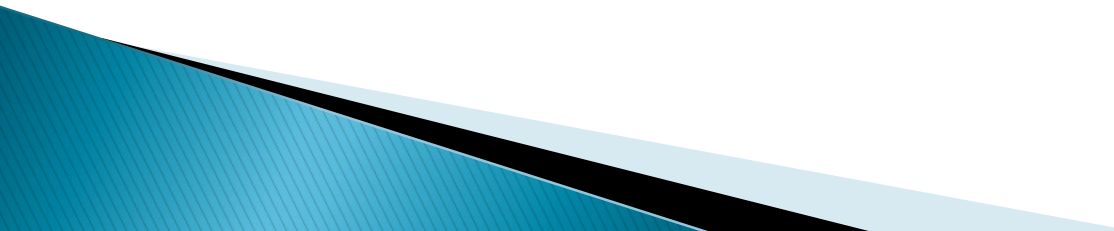
CONCLUSIONS

- Powerful new tool for asset protection in the State of Alabama.
 - Not as strong as other jurisdictions (specifically Nevada, Alaska and South Dakota), but clearly enforceable for Alabama residents, and provides protection for just about any situation except (1) fraudulent transfers or (2) child support.
 - These are specialized trusts. Do not recommend that clients do this with individual trustees. Needs to be at least one institutional trustee involved.
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CONCLUSIONS

- Best use? Nest egg for wealthier clients with potential creditor exposure!
 - (1) Doctors
 - (2) Business owners who have to sign personal guarantees
 - (3) Other high risk clients who need protection
 - (4) Older clients with potential heir issues
 - (5) Second marriage scenarios

Types of Assets for this Trust? Liquid assets, such as cash or securities. Not real estate or closely held businesses.



BUILDING A TEAM

- ▶ For ANY estate planning, the team approach works best. Team members include the following:
 - Financial advisor
 - Insurance broker
 - CPA
 - Estate planning lawyer
 - ▶ Each of the above team members has a different role to play in estate planning. And the team approach is usually CHEAPER (you don't want a tax lawyer drafting your financial statement!) and more reliable.
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A Warning...

- ▶ It is unwise for your clients to do estate planning **by themselves**, or by using **online documents**.



Questions?

CONTACT THE SPEAKER

J. Robert Turnipseed

(251)405-1311