

***STATE
UNCLAIMED PROPERTY
LAWS***

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December 2008*

Executive Summary

- All 50 states, the District of Columbia and various United States Territories have unclaimed property laws.
- All of these jurisdictions have greatly increased their enforcement of this law.
- Laws are changing every year.
- Companies must know and understand all aspects of the various unclaimed property laws, including where it may have a legal obligation to file, what properties are subject to the law, dormancy periods, aggregate amounts, notification procedures, and filing requirements.
- The responsibility to file and pay extends beyond the state where the company is incorporated or domiciled. The requirement to report and remit is governed by the law of “True Owner’s” domicile.
- Companies may not avoid unclaimed property laws by creating a “private escheat”.
- Many states have implemented amnesty programs to entice companies to become compliant. These may offer an opportunity for the company to begin filing.
- Various states have also implemented voluntary disclosure programs in an effort to entice companies come forward without the fear of having to pay penalties and interest. This is another opportunity for your company to begin filing.
- Various states allow the company reporting funds to deduct the actual costs of postage, envelope and stationery or a percentage of the amount being remitted.
- The company is required to retain records for a period of time. In some states, up to fifteen (15) years.
- It is important that read the package in its entirety before preparing your return.
- Unclaimed property laws are incredibly complex, vary from state to state and are changing at such a rapid pace that it is difficult to keep on top of existing requirements not to mention breaking legislation, pending legal decisions and new industry trends.
- It is important for companies to become knowledgeable and understand how unclaimed property laws work. A clean process can save the corporation significant monies, not just fines and penalties but in recoveries. Recoveries from the states and recoveries in the sense of not over escheating when it comes to the actual remittance to the states.
- Some states are imposing the costs of performing an audit/examination in addition to interest and penalties on companies that are not in compliance.
- At the federal level, the chance that failing to report, underreporting, or misreporting unclaimed liabilities could spawn both potentially misleading financial statements and violations of Section 404 of the Sarbanes-Oxley Act.
- Companies that ignore their responsibility may find the cost of non-compliance to be very expensive.

Introduction

Every company that employs personnel, issues checks, sells gift certificates or holds customer credit balances is a potential holder of unclaimed property and may have a reporting obligation to every state.

All 50 states, the District of Columbia and various United States Territories have unclaimed property laws.

Many businesses have treated unclaimed property as a source of revenue. As a general rule, though, businesses are not allowed to convert unclaimed payables as income on their books. They must report and remit such amounts to the appropriate state.

Until approximately 10 years ago, unclaimed property tax laws were poorly publicized and rarely enforced. That has changed as state governments have determined that enforcing unclaimed property laws present them with potential windfalls of additional money for their budgets without having to pass new legislation to raise taxes.

As a result, the states are increasing audits and will continue to do so in future years.

History

Today's unclaimed property laws were derived from the English common law principles of "escheat", "bona vacantia", and "title by occupancy".

In the early 1700s, the states adopted laws recognizing the English common law doctrine of escheat and later the doctrine of bona vacantia.

In the beginning, most states only dealt with the escheat of real property. During the twentieth century, states began to escheat personal property then added intangible property.

Early Supreme Court decisions all supported the states' constitutional rights to escheat. These included Hamilton v. Brown 161 U.S. 256 (1896), Cunnius v. Reading School District 198 U.S. 458 (1905), United States v. Klein 303 U.S. 276 (1938), Anderson National Bank v. Lockett 321 U.S. 233 (1944), Connecticut Life Insurance Co. v. Moore 333U.S. 541 (1948) and Standard Oil Co. v. New Jersey 341 U.S. 428 (1951).

The Uniform Unclaimed Property Tax Acts

It was not until 1954 that the first uniform act was approved and adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL). This Act was called “The Uniform Disposition of Unclaimed Property Act” (1954 Act), and was revised in 1966 (1966 Act), again in 1981 (1981 Act) and 1995 (1995 Act).

The intent of these acts was to create uniformity, ease compliance for businesses, eliminate possible multiple liability for entities that conducting businesses in various states and give the states, rather than the businesses, the benefit of retention of the unclaimed property.

At this time, only the States of Louisiana, Maine, Montana, New Mexico, West Virginia and Wisconsin have formally adopted the 1995 Act. Other states are considering formal adoption.

As a result, there is no true uniformity between the states setting forth the definition of unclaimed property, dormancy period, dormancy charges, dates for reporting and payment, method of reporting, statute of limitations, and the requirement to notify the owner of property, and special provisions for certain holders vary among the states.

An entity conducting business in multiple states must research the unclaimed property law and keep current with any changes for each state.

To give you additional insight into the terms used in this article and in reading the various state laws and statutes, see “Glossary of Terms” following this article.

Unclaimed Property

In order to constitute “unclaimed property” within the meaning of most state laws, the following four elements must be present:

- The property must be intangible. The only exception to this is tangible personal property held in a safe deposit box or a different type of safekeeping depository.
- The apparent owner of the property cannot be located.
- The property must remain unclaimed by the owner for a period of time referred to in the law as the “dormancy period”.
- There must be a fixed and certain legal obligation of the holder to the owner.

Presently, there are more than 140 different categories of unclaimed property. Examples of unclaimed property include but are not limited to:

- Contents of safe deposit box or a different type of safekeeping depository
- Customer overpayments
- Customer credit balances
- Customer outstanding credit memos
- Deposits (including security deposits)
- Gift certificates
- Insurance proceeds
- Mineral proceeds
- Retirement plan property
- Royalties
- Security deposits
- Stock or other evidence of ownership of or interest in a business
- Suspense accounts
- Travelers' checks
- Uncashed accounts payable checks (including bonus payments)
- Uncashed dividend checks
- Uncashed expense checks
- Uncashed interest checks
- Uncashed refund checks
- Uncashed payroll checks
- Uncashed vendor checks
- Unclaimed money orders
- Unidentified deposits or remittances
- Unredeemed awards
- Unrefunded overcharges

Abandonment (Dormancy) Period

Property is considered abandoned when the company cannot locate the owner after a predefined period of time (dormancy period), but the periods for the presumption of abandonment vary by state and type of property.

The dormancy period can be as short as one year for payroll checks and for as long as 15 years for travelers' checks. States are constantly changing their dormancy periods, so it is important to check the applicable state law.

See exhibits A, B, C, and D following this article for more information.

Service (Dormancy) Charges

The general rule is that a company may deduct from the property presumed abandoned, a charge imposed because of the owner's failure to claim the property within a specified

period of time. However, this charge may only be imposed if there is a valid and enforceable written contract between the holder and the owner and the holder regularly imposes the charge and does not reverse or otherwise cancel on a regular basis. The amount of the deduction is limited to an amount that is not unconscionable.

The laws regarding whether the holder is permitted to impose a service charge and any requirements that must be met, vary from state to state. Some states do allow the company to deduct some administrative costs from the amounts remitted.

See exhibit E following this article for more information.

Private Escheat

A company cannot avoid unclaimed property laws by creating a “private escheat”; i.e. the company cannot trump states’ rights to unclaimed property by including in its contracts a provision specifying that the property reverts to the company after a period of time.

This principle is codified by the majority of states through provisions in their unclaimed property law that provides that the expiration of a statute of limitations pursuant to a contract provision does not prevent the property from being presumed abandoned.

See State v. Jefferson Lake Sulfur Company, 178 A.2d 329 (N.J. 1962) and Screen Actors Guild, Inc. v. Cory, 91 Cal. App.3d 111 (Calif. Ct. App. 1979).

Notification to Owner of Property Presumed Unclaimed (Due Diligence)

A company holding property that is presumed abandoned is required under most state laws to send a written notice to the apparent owner if all of the following requirements are met: (1) the company has an accurate address for the apparent owner, (2) the claim of the apparent owner is not barred by the statute of limitations, and (3) the value of the property exceeds the threshold set by the state entitled to the property.

The time for notification and the dollar threshold varies by state.

All notices should be sent via first-class mail, marked “address correction requested” and contain a self-addressed return envelope.

See exhibit F and sample Notification to Owner Letter (Due Diligence Letter) following this article for more information.

Nexus

The location of your entity is entirely irrelevant. It is common for an entity to be located in one state but be required to comply with the unclaimed property laws of several states.

Under the 1981 and 1995 Uniform Acts, a company holding unclaimed property has a duty to report to all states based on the last known address of the owner of the property. This duty exists regardless of whether the company is subject to the jurisdiction with the state, and is based on the right of the state of the owner's last known address to step into the shoes of the owner and demand custody of the owner's property.

The two basic rules of priority derive from Texas v. New Jersey, 379 U.S. 674 (1965). The primary rule is that unclaimed property goes to the state of the owner's last known address, as shown on the company's books and records. The secondary rule is that property owed to persons for whom there is no address will be subject to the company's state of domicile, provided that another state, with proof, may claim that the last known address of the owner entitled to the property was within its borders.

Reporting of Unclaimed Property

The holder is required to report and remit the property to the states when the property remains unclaimed after the expiration of the dormancy period.

All of the states require annual reporting, with the exception of the state of Mississippi, which requires reporting every three years.

Each state has unique reporting forms and formats that a company must use.

Reporting forms, instructions and the law are available on each state's website.

It is important that you read the package in its entirety before preparing your return to ensure a correct filing.

Negative (Zero) reports are required by many states.

Electronic filing is required by some states.

Online reporting is allowed by many states.

A deduction for the actual costs of postage, envelopes and stationery for performing due diligence or a percentage of the amount being remitted is allowed by some states. This deduction is known as "holder compensation".

Before filing any returns, perform a final check to ensure that you are furnishing all of the required information.

The majority of states have a rule regarding the retention of records. Some states require that the company retain records for three to fifteen years. Therefore, it is important that the company maintain all work papers, documents, etc. for the period required.

All the states have some type of audit program in place. Some states have their own auditors, other use third-party auditors and some states coordinate audits and hire third-party auditors who perform a “multi-state” audit.

If you are unable to file timely, an extension must be obtained to avoid any penalties and interest for late filing.

See exhibits G, H, I, J, and K following this article for more information.

Failure to Report

A company that is found to be non-compliant following an audit or other enforcement action may face significant risks.

Section 24 of the 1995 Uniform Act set guidelines for states to penalize companies that fail to comply with state unclaimed property laws. Under this section, states can charge civil penalties of \$1,000 per day for willfully ignoring unclaimed property laws, plus 25 percent of the value of any property that should have been but was not reported.

Some states have a provision in their law that if an audit results in the disclosure of previously unreported property, the state may assess the audit costs to the company.

At the federal level, the chance that failing to report, underreporting, or misreporting unclaimed liabilities could spawn both potentially misleading financial statements and violations of Section 404 of the Sarbanes-Oxley Act.

Failure to comply can result in increased litigation risks. One large company was sued in federal court for RICO violations associated with alleged “false and fraudulent unclaimed property reports” in a suit brought by an individual owed funds by the company.

In particularly egregious situations, interest and penalties have been extraordinarily large.

In November 1998, Bank of America agreed to pay \$187 million for mishandling of unclaimed interest and payments, double charging and charging for services it did not perform. In another, Bankers Trust Company pleaded guilty to federal criminal charges

that its employees had illegally diverted \$19.1 million in unclaimed checks and other credits owned to its customers. This suit was settled in 1999 by paying fines in excess of \$60 million to the federal government and turning over \$3.5 million to the State of New York. In yet another case, executives at Old Republic Title Company had reason to realize the importance of passing unclaimed property on to its rightful owners. Years ago, an Old Republic agency subsidiary failed to report and pay over \$9.5 million of unclaimed escrow funds to the State of California. The failure to "escheat," was one of a number of charges against the company that resulted in it paying over \$33 million.

Recent Activity

Throughout the past several years, a number of states have exempted gifts certificates and gift cards from their unclaimed property laws and have adopted a business-to-business exemption.

Gift certificates and gift cards, which are generally includable as unclaimed property if abandoned for the dormancy period, have been expressly exempted from unclaimed property statutes in certain states. The availability of these exemptions generally depends on whether the issuer maintains the name and addresses of the purchasers, or issues the gift certificates or gift cards on an anonymous basis. If such records are maintained, the state of the purchaser's last known address has the first priority right to escheat the unused balance. If either (a) the purchaser's last known address is in a state that exempts gift certificates or gift cards, or (b) the gift certificates or gift cards are issued anonymously, the second priority rule applies, and the holder may be liable to report and pay the unused balances to the holder's state of incorporation after the relevant dormancy period. However, if the holder's state of incorporation also exempts gift certificates or gift cards, the holder may decide not to report and pay the unused balance to any state. Even if the first and second rules do not apply, some states may use the transactional-based priority rule to assert the right to escheat unused balances of gift certificates or gift cards that are purchased in that state. Although this third priority rule is of questionable constitutional validity, it has been successfully applied on several lower state courts.

When an exemption is not available, some retail issuers have attempted to impose services charges in unused gift certificate and gift card balances after a certain period of product nonuse. Whether an issuer can impose such charges depends on the law of the state that would otherwise be entitled to claim the unused balances. Although state law on the service charge issue varies widely, many states do permit such charges if they are imposed under a valid contract, are uniformly enforced and are not "unconscionable" in amount (for states that adopted the 1995 Act).

For additional information and state legislation on gift cards and gift certificates see www.ncsl.org/programs/banking/giftcardsandcerts.htm.

Generally, credit balances issued in the ordinary course of the issuer's business that have remained unclaimed by the owner for more than the dormancy period is presumed abandoned. However, many states have enacted a business to business (B2B) exemption so as to exempt such credit balances from the unclaimed property laws. As a result, such credit balances are not subject to escheat. The B2B exemption is premised on the idea that the unclaimed property laws are designed to protect consumers and were never intended to permit a state to demand payment of amounts appearing on the books of one business as a credit balance owed to them by another business, and most such credit balances actually represent flawed bookkeeping.

See exhibits A, B and C following this article for more information.

Amnesty Programs

Many states have implemented amnesty programs to entice companies that have not been in compliance to begin reporting unclaimed property in accordance with their law.

Generally, the state will waive penalties and interest. If your company is not in compliance, these programs offer an excellent opportunity for it to do so.

Voluntary Disclosure

As a matter of practice, states have implemented a voluntary disclosure program for companies that are not in compliance with their unclaimed property law. The company may desire to use this program to bring the company in compliance and minimize the costs to the company.

The Road to Compliance

Using the Sarbanes-Oxley guidelines as a starting point is a good first step towards minimizing your risks. Your company must establish a good set of internal controls and follow the best practices as follows:

- Define the liabilities impacting your company
- Preemptively resolve outstanding liabilities
- Develop a corporate due diligence philosophy
- Document an annual compliance road map
- Eliminate audit red flags
- Perform sound recordkeeping and accounting
- Encourage continuous learning and review

There are a number of software products available to help your company effectively and cost efficiently manage your compliance and reporting responsibilities. These systems have been designed to proactively manage the abandoned property in accordance with the various state laws.

Summary

Unclaimed property laws are incredibly complex, vary from state to state and are changing at such a rapid pace that it is difficult to keep on top of existing requirements--not to mention breaking legislation, pending legal decisions and new industry trends.

It is the fiduciary responsibility of a company to be in compliance with all state unclaimed property laws. A company must have established unclaimed property policies and procedures and create a system to identify, track, manage and report unclaimed property. All levels within the company should be made aware of the policy and procedures.

Every company must realize that the states are placing an emphasis on collecting abandoned property and take its legal responsibility seriously.

Selected Judicial Decisions

- Anderson National Bank v. Lockett, 321 US 233 (1944)
- Christianson v. King County, 239 US 356 (1915)
- Connecticut Life Insurance Co. v. Monroe, 333 US 541 (1948)
- Cunnius v. Reading School District, 198 U.S. 458 (1905)
- Delaware v. New York, 507 US 490 (1993)
- Hamilton v. Brown, 161 US 256 (1896)
- New Jersey v. The Chubb Corporation, 239 N.J. Super. 257, 570 A.2nd 1313 Super. Ct. (1989)
- Pennsylvania v. New York, 407 US 206 (1972)
- Presley v. City of Memphis, 769 S.W. 2d 221 (Tenn. App. 1988)
- Presley v. County of Nassau and State of New York, 188 A.D. 2d 594, 491 N.Y.S. 2d 72 (1992)
- Provident Institution for Savings v. Malone, 221 U.S. 660 (1911)
- Riggs National Bank of Washington, D.C. v. District of Columbia, 581A2nd. 1229 (Ct. of App. 1990)
- Screen Actors Guild, Inc. v. Cory, 91 Cal. App.3d 111 (Calif. Ct. App. 1979)
- Security Savings Bank v. California, 263 US 282 (1923)
- Standard Oil Co. v. New Jersey, 341 US 428 (1951)
- State v. Jefferson Lake Sulfur Company, 178 A.2d. 329 (N.J. 1962)
- State v. Liquidating Trustees of Republic Petroleum, 510 S.W. 2d 311 (Texas 1974)
- State v. Sperry & Hutchinson Co., 127 A.2d 169 (N.J. 1956)
- State v. Sperry & Hutchinson Co., 139 A2d 463 (N.J. Super. 1958)
- Texas v. New Jersey, 379 US 674 (1965)
- TXO Production Corporation v. Oklahoma Corporation, 829 P2d 880 (Okla. 1992)
- United States v. Klein, 303 U.S. 276 (1938)
- Western Union Tel. Co. v. Pennsylvania, 368 US 71 (1961)