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Expanded Liability in Unclaimed Property

Are States Going Too Far?

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Expanded Liability in Unclaimed Property

Are States Going Too Far?

by Joseph O. Blanco and Michelle A. Andre

Aggressive Enforcement of Expanded Liability

Although unclaimed property laws have been on the books for decades, companies say they are seeing a change in the patterns of enforcement, with some U.S. states becoming more aggressive in their approach and methods of collection.

Companies are becoming increasingly concerned that some U.S. states, aiming to increase revenues, are adopting a broad and systematic expansion of the concept of corporate unclaimed property liability that has moved beyond the original intent of the law.[1] States have acknowledged that the desire to increase revenue has intensified enforcement, but also point to historically low compliance rates, which they say remain far below tax compliance rates.[2]

Some states have been significantly increasing the number of unclaimed property audits performed, in large part, by hiring third-party unclaimed property auditing firms, often on a contingent-fee basis. According to results from The Conference Board survey, 64 percent of the reported audits were conducted by such auditors (Chart 1). When auditors are engaged by states on a contingent-fee basis, they receive a percentage of the property collected, usually between 12 percent and 13 percent.[3] Auditors are entitled to compensation only if unclaimed property is remitted to the state as a result of the audit.

Engaging auditors on a contingent-fee basis helps states to expand their resources. However, the risk is that the contingent fee may, perhaps inadvertently, create incentive for the auditors to inflate liability assessments. Most states have no procedures or safeguards in place to curb that incentive or to provide protection for the companies against which these assessments are made.

In addition, many of the auditors have contracts with multiple states, and companies are often hit with several audits simultaneously by the same contingent-fee auditor.[4]

Chart 1

In the majority of cases, auditors were on a contingency fee

N=25

One respondent reported that it received audit letters from nine states over a six-week period and received other correspondence causing the respondent to believe that the auditor was "shopping" the company's audit to additional states. Similarly, states often have contracts with multiple auditors. For example, in 2008, Tennessee had contracts with six third-party audit firms.

Expanding the Scope/Definition of Types of Property Reportable As Unclaimed Property

Some states have begun to include inventory, vendor samples, coupons, unused magazine subscriptions, and other items that some companies argue should not be considered unclaimed property. For example, in *McKesson Corp. v. Cook*, the auditor hired by the State of Delaware began requesting information on inventory mismatches, including vendor samples, five years into its audit of McKesson Corp., even though Delaware had not changed its statutes or regulations to put companies on notice for this category of property.[5] In an apparent response to the outcry over the lawsuit and other pressures, Delaware passed legislation last summer that provides a limited exclusion for inventory mismatches and vendor samples.[6] This exclusion does not apply to other states.

What Is Unclaimed Property?

Unclaimed property includes both tangible and intangible property. Although the types of property reportable to and claimed by the states continues to expand, major categories include:

- Unclaimed wages and accounts payable
- Uncashed dividend checks
- Credit balances of accounts receivable
- Unredeemed rebates and unused gift cards
- Amounts distributable from employee benefit plans
- Unredeemed vendor credits
- Interest and dividend payments
- Stock and other securities
- Retained asset accounts

Rebates and gift cards have also been especially problematic. For example, in *Fitzgerald v. Young America Corp.*, the treasurer of the State of Iowa filed a lawsuit against Young America Corp. and other companies to compel them to disclose their records to determine whether their rebate programs were in compliance with the state's unclaimed property laws. [7,8] The Iowa District Court denied the defendants' motion for summary judgment, indicating that just because the defendants may no longer be in possession of the property did not mean that the defendants were not holders under the statute and therefore obligated to satisfy the state's unclaimed property reporting and remittance requirements.[9]

Lack of a Business-to-Business Exemption

In the normal course of business, companies often reconcile their accounts between each other when small variances occur. These variances, in effect, represent one company's property in the possession of another company. Although some states offer a business-to-business exemption from unclaimed property liability, the majority does not.[10] Those states that do not recognize this exemption may claim property that has been considered "settled" by both relevant companies to escheat to the state, despite the fact that the original owner no longer considers the property to be owed. These states take the position that it is abandoned property under the statutory definition and should be remitted to the state, and the fact that its owner was a corporation instead of an individual is irrelevant. Businesses point out that credit balances are often not due another party, and business creditors are not in need of the protection of the states.

A subset of the business-to-business issue is intercompany transactions. Several respondents to the survey indicated that auditors have attempted to claim intercompany credit balances to be remitted to the state. It is unclear if any states have been successful in these attempts to claim amounts that would net out within a corporate family.

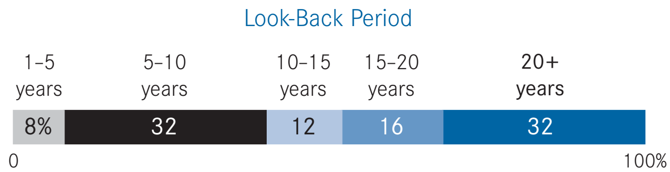
Maximizing the Scope/Value of Claims by Asserting Liability Back to the Inception of the Statutes

Most states have no statute of limitations for companies that have not previously filed an unclaimed property report.[11] Even companies that have previously filed can be asked to prove that their filings were complete and accurate. Without a statute of limitations, an auditor can "look back" and estimate unclaimed property liability for multiple fiscal periods.[12]

Chart 2

In almost a third of cases, the audit stretches back at least 20 years

N=25



According to the survey results, 32 percent of respondents were audited based on a look-back period of 20 years or more (Chart 2). Moreover, the burden of proof is on the holder. Because such look-back periods surpass most companies' document retention policies, and the burden of proof falls on the holder, companies frequently find themselves virtually unable to refute assessments. One survey respondent stated, "They ask for tremendous amounts of data and for periods long before our record retention."

Using Extrapolation Methods to Determine Liability

Some states are using a limited sample set of data, select years, and/or a segment of the enterprise to extrapolate a company's liability when no documentation is available, and sometimes even when it is. For example, in *McKesson Corp. v. Cook*, the auditor disregarded years of available actual data, insisting upon using an extrapolation method by which it expanded what the company believed to be about $19,337 of unclaimed property into a claim of about $4.5 million. [13]

An example of an Auditor's extrapolation formula is:

> (Determined Liability for Base Year(s) with Records) / (Revenue for Base Year(s)) = Escheat Percentage
>
> (Escheat Percentage) x (Revenue for Years with Insufficient or No Records) = Projected Liability[14]

It is important to note that the "Determined Liability for Base Years with Records" is not only the property escheated to the state of incorporation in the base, but also includes:

> …unclaimed property that *was reported* to *any* State during the base period; items discovered during the audit and considered abandoned property reportable to *any* State and *returned to the rightful owner* during the audit; and items that could be abandoned property reportable to *any* State, but for an *applicable exemption* provided by the State to which the property otherwise would be reportable.[15]

Imposing Significant Penalties and Interest on Claimed Amounts

Companies that fall short of compliance are often required to pay penalties and interest on top of remitting the past-due unclaimed property and/or are subject to criminal prosecution.[16] Much like reporting and remittance requirements, penalty and interest charges vary widely from state to state. In Delaware, penalties can be as much as 50 percent of the unclaimed property value, or 75 percent if fraud is thought to be involved, with interest accruing until the claim is paid.[17] The interest charged is typically around 12 percent of the past-due remittance, from the time the property was due until it is actually remitted, and is sometimes charged on the penalty fee as well as the past-due property.[18]

Failing to Provide an Independent Appeals Process by which a Company Can Contest the Assessment or Obtain a Refund

The majority of states do not provide an independent appeals process, which means holders with disputes may feel compelled to either settle or initiate court action to settle a dispute.[19]

In recent years, many companies have found that unclaimed property audits are raising legal and political dynamics beyond the traditional realms of the corporate tax or finance department. Companies have begun to involve general counsel and outside counsel to protect the company through compliance, audits, negotiation, and (if necessary) litigation. The survey results found that 16 percent of respondents involved their legal department in the unclaimed property audit (Chart 3). Those respondents that indicated their legal departments were involved generally became involved in unclaimed property audits between 2008 and present.

Chart 3

Audits are beginning to involve legal departments as well

N=32

What department in your company handled the audit?

Percentages do not add to 100 due to rounding.

Practical Guidelines for Companies

Companies can take steps to mitigate their liability and unclaimed property risk.

Maintaining Compliance

Due to the multitude and complexity of unclaimed property laws to which companies must adhere and the extreme consequences for noncompliance, companies are spending more time and money on compliance. Although compliance programs will vary depending on the size, industry, and type of entity, companies should confirm that their unclaimed property policies and procedures are in writing and are appropriately designed to protect the company. By being proactive, companies can significantly mitigate their unclaimed property liability and risk. Before a company is audited, it should:

Establish or review the company's unclaimed property compliance program

- Ensure the company's unclaimed property policies and procedures are in writing.
- Determine if the unclaimed property department has sufficient staff and resources, including appropriate systems or software for gathering and tracking data. The company may need to determine whether this function should be handled in-house or outsourced.

Assess the potential gross liability

- Identify all populations of potentially escheatable property types and identify detailed documentation available and related sources for each applicable property type.
- Conduct an in-depth review of available documentation (e.g., general ledger detail, write-off reports, research supporting documentation) to identify risk management strategies and quantify the extent of any exposure identified.
- Coordinate the company's resources throughout the organization to gather necessary data and supporting information from all business units, divisions, and financial systems for unclaimed property identification.
- Develop methodologies for estimating past due unclaimed property liabilities when records are not available.

Conduct appropriate due diligence to mitigate liability and risk

- Apply available state exemptions to amounts identified as unclaimed property.[20]
- Identify accounting or system errors and/or exemptions (statutory and/or administrative positions) that can possibly mitigate identified exposures.[21]
- Research potential unclaimed property to determine if the items truly represent escheatable property or can be otherwise resolved.
- Conduct due diligence mailings and other forms of research to mitigate potential items of unclaimed property.
- Reconcile credit memoranda with other businesses to reduce exposure in the absence of a business-to-business exemption.

Determine liability under attorney-client privilege

- Assess liabilities and standard deductions for each state.
- Use statistical sampling methodologies, where appropriate.

Retain experienced unclaimed property advisors

- Consider engaging advisors who are knowledgeable about the states' unclaimed property laws and administration, have experience with states' and their third-party auditors' methods, can provide access to state unclaimed property administrators, and can apply statistical sampling methodologies, where appropriate.
- Consider engaging specialists who can assist with data and document management and sampling methods.

Consider working with states to resolve the liability or report and remit property as usual

- Determine whether the reportable states have amnesty or voluntary disclosure agreement programs for which the company qualifies.
- Determine the appropriate strategy for each applicable state, considering the extent of the company's liability, the company's past reporting history, and the particular state's practices and policies regarding release of liability and waiver of penalties and/or fees.
- Determine whether it would be beneficial to contact certain states through a third-party advisor.
- Negotiate look-back periods and sampling methodologies when possible.

Maintain copies of reports and supporting documents

- Keep documentation to evidence that all filing, due diligence, and reporting requirements were satisfied for each of the states for which unclaimed property is reported and remitted for the entity, including for all subsidiaries and acquired entities.[22]

Conducting Due Diligence

Conducting proper due diligence can help a company to significantly mitigate its liability and risk. Often, there are owners that can be located or accounting errors that can be resolved, which will help to reduce the amount of property that is required to be remitted. This can be especially significant when that amount is multiplied over the look-back period. The failure to conduct proper due diligence, in accordance with the state's laws, may also cause the holder to be liable to the owner for any property loss resulting from an improper remittance. For example, in *Vondjidis v. Hewlett Packard,* the California Court of Appeals found that the immunity provisions of the California Unclaimed Property Law did not apply when the company remitting property failed to comply with the provisions of the law where the owner's address was in a former employee database. [23]

Audit Defenses

When audited, the company can help protect itself by taking the following actions:

- Approach the audit as if it will eventually go to litigation (e.g., privilege). The best way for the company to protect itself is to prepare for the worst-case scenario.
- Use outside counsel to communicate with the auditors. This can help the company preserve privilege and allow more room for negotiation.
- Negotiate with the auditors regarding information requests. Auditor information requests are often quite burdensome in timing and volume. Negotiate to narrow the scope of the request and to allow the company sufficient time during which to fulfill the request.
- Keep thorough records throughout the audit. Document all communications, inconsistencies, and missed deadlines by the auditors, as they are likely tracking that information for the company, but not for themselves.
- Submit all responses to the auditors with a qualifier. Indicate that the company's cooperation does not mean that the company agrees with the auditors' methods, theories of liability, etc.
- Designate a centralized, internal team to handle the audit. Especially if the audit spans multiple divisions or subsidiaries of the company, designate a centralized, internal team to handle the audit to provide consistency.
- Hire outside advisors, as needed. Outside advisors, such as unclaimed property consultants, can provide resources and answer complex questions regarding the treatment of certain situations.

Unclaimed Property Advisors

Involving appropriate advisors in the company's unclaimed property process can also help to mitigate liability and risk. Among other things, financial advisors can help to:

- determine and negotiate the appropriate scope of the unclaimed property audit;
- determine whether estimation and extrapolation methodologies are necessary or appropriate;
- sort through and identify "true" unclaimed property versus false positives, such as accounting errors, to determine the company's real unclaimed property liability; and
- negotiate a final resolution with the states.

For example, in determining the appropriate audit scope (including the appropriate entities, time period, property types, and states) companies should consider the following:

What entities can/should be included in the audit? Often, companies are composed of multiple entities, including foreign and U.S. operating entities, subsidiaries, and affiliates. Companies should ensure that the audit is focused on entities legally subject to audit.

For the entities included within the audit, what are their states of incorporation, and do they match the states participating in the audit? Companies should consider whether it would benefit them to sign amnesty or voluntary disclosure agreements (VDAs) with states not already included in the audit. VDAs often limit the look-back period as well as the interest and penalties that a state would normally charge and can afford companies more flexibility in selecting a liability calculation methodology.

What are the dates of organization, reincorporation, acquisition, and/or disposition of the entities included in the audit? Each of these dates affect the time periods covered by the audit. For example, a recently formed company can significantly restrict the audit's look-back period due to its date of incorporation.

For acquisitions and/or dispositions, was the transaction a stock or asset deal? The type of transaction affects liability for any exposure related to particular entities. Some auditors take the position that acquirers are responsible for the unclaimed property liability of the company acquired, including pre-acquisition liabilities. With that being the case, companies should consider whether the deal agreement provided for any special treatment that could affect their unclaimed property obligations.

What property types are potentially at issue for the company? Companies in different industries or with different business plans will have different types of property that are potentially at issue. This can implicate the audit defense strategies most advantageous to the company. For example, some companies could benefit from customer settlement offers.[24]

Involving legal counsel and other advisors in the process can provide the company with guidance and the opportunity to invoke the attorney-client privilege and work-product doctrine as the company seeks to assess its liability ranges and options. During the audit process, legal counsel can:

- establish privilege;
- assist in requiring confidentiality for third-party firms working on behalf of the state;
- maintain applicable documentation;
- identify company policies and procedures surrounding unclaimed property identification and reporting;
- assess availability of detailed supporting records, including what details are available, how far back they are available, and the format of availability; and
- negotiate a final resolution with the states or position the company for litigation, if necessary.

Litigation

With extremely limited ability to appeal an assessment or obtain a refund after the unclaimed property assessment is paid, companies are sometimes forced to settle or to sue under aggressive constitutional theories. Litigation, however, has significant risks, and the current state of the law makes success difficult. Few states provide any process to dispute unclaimed property assessments. If the state does not provide a holder with standing to sue in court, companies must either prove a violation of a state or federal constitutional right (which is challenging absent a documented interest in the property) or seek equitable relief (which is challenging if the company is in violation of the unclaimed property laws to some degree). For these reasons, there are relatively few unclaimed property cases.

In general, states can raise the following defenses:

- sovereign immunity, where the company has not been granted permission to sue the state;
- Doctrine of Unclean Hands, where the company has committed a violation of the state's unclaimed property laws, so the courts will not consider a remedy in equity; and
- failure to state a claim entitled to relief, where, even if the company's position is sound, the facts do not create a claim for which the law provides a remedy.

On the other hand, companies generally raise the following defenses:

- the property is reportable to other states based on the established priority rules[25];
- traditionally, the claimed property was not considered unclaimed property under the state's statutes and the statutes have not been amended to provide the company with notice of any change in policy;
- under the Uniform Commercial Code's statute of limitations, the corporation had become owner of the property before the unclaimed property dormancy period had run, such that the property never became unclaimed property[26];
- a claim is barred by the statute of limitations provided by statute, where the corporation has filed a report and the state has failed to notify the corporation of a deficiency within the prescribed time period[27];
- the auditor's extrapolation methods are based on erroneous data and assumptions[28];
- it is an unlawful taking without just compensation[29]; and
- other violations of due process.[30]

Because constitutional challenges may be the only viable avenue for protesting unclaimed property laws, it is important for companies to preserve their constitutional defenses. When litigation is pursued, some companies have found it beneficial to learn from the experiences of others so that they are better equipped to defend themselves.

Potential Approach for Addressing the Systemic Problems

As companies find themselves increasingly confronted with what they perceive as unfair and inflated unclaimed property demands, some in the business community are beginning to see the need for addressing unclaimed property law at a systemic level.[31]

Some companies are fighting back by deciding to litigate, despite the challenges. Litigating unclaimed property issues, however, is considered a time-consuming, difficult, and risky road, thus causing other companies to look into government and public affairs efforts as an option for initiating the systemic changes they feel are needed.

Several organizations, including the Unclaimed Property Professionals Organization, the Council on State Taxation, the American Bar Association, and State Chambers of Commerce have begun to consider potential reforms in unclaimed property statutes.[32] This approach has its own challenges. Because unclaimed property law is state law, the laws of each state need to be addressed, requiring a tremendous amount of time and resources. In addition, addressing state laws individually is unlikely to solve the inconsistencies and complexity of the unclaimed property laws among the states. If unclaimed property law cannot be addressed on a state level, it may need to be pushed to the federal level or the Supreme Court.

In addition to these efforts, some companies have begun to suggest that to compel change, a coordinated, comprehensive solution is needed. These companies have begun to join with others to establish coalitions to work to remedy perceived unclaimed property abuses, both through sharing information to assist with audits and litigation and coordinating a strategic public affairs and government affairs program.

Conclusion

Given the current unclaimed property environment, compliance is more important than ever. Companies must be proactive to maintain compliance with each applicable state's reporting and remittance requirements. If a company is not currently in compliance with a state's unclaimed property laws, a VDA program may allow the company to come into compliance without requiring it to pay the penalties and interest that would otherwise be owed. Financial and legal advisors can also help companies to mitigate unclaimed property liability, manage risk and invoke the attorney-client privilege and work-product doctrines that allow a company to protect itself and its information.

Moreover, as more and more companies begin to feel the effects of the current unclaimed property environment, companies are starting to look for ways to make systemic changes through litigation and government and public affairs efforts.

Appendix

Additional Background Information

The theoretical purpose of unclaimed property law is to return lost or abandoned property to its rightful owner. As a matter of public policy, properties due to third parties, such as stocks and dividends, that are not claimed within a certain period of time, are reportable and must be remitted to the state to be held for the third-party owner.

Unclaimed Property Includes Both Tangible and Intangible Property

Although the types of property reportable to and claimed by the states continue to expand, major categories include:

- Unclaimed wages and accounts payable
- Uncashed dividend checks
- Credit balances of accounts receivable
- Unredeemed rebates and unused gift cards
- Amounts distributable from employee benefit plans
- Unredeemed vendor credits
- Interest and dividend payments
- Stock and other securities
- Retained asset accounts

Corporations holding unclaimed property are generally expected to report and remit the property to the state of the owner's last known address.[33] If there are no such records or the state of last known address does not provide for remittance, the holder, if a corporation, is to report and remit the unclaimed property to the state of the holder's incorporation.[34] Typically, companies must report and remit their unclaimed property holdings to several states, and each state has its own requirements to which companies must adhere.[35]

A state's ability to claim unclaimed property derives from common law and has been upheld by the U.S. Supreme Court.[36] Although the state's right is initially derivative of the owner's right, states have enacted laws that provide a statute of limitations or contract term will not prevent such property from becoming unclaimed property subject to the state's escheat.[37] These types of laws act to prevent the holder of the property from obtaining a property interest in the unclaimed property and have also been upheld by the Supreme Court.[38]

Most states have adopted some version of the Uniform Unclaimed Property Acts, promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL)[39] in 1954, 1966, 1981 and 1995.[40] Although each Act was adopted to varying degrees, the most recent Act promulgated by NCCUSL was adopted by only 14 of the 50 states.[41] The most widely adopted Uniform Unclaimed Property Act was the 1981 Act, which was adopted in some form by 25 states.[42]

The 1981 Act provides that a "Holder" is an individual or entity "wherever organized or domiciled, who is: (i) in possession of property belonging to another; (ii) a trustee, or (iii) indebted to another on an obligation."[43] If the owner of such property has not communicated in writing or otherwise indicated an interest in the property within a certain amount of time (often called the holding or dormancy period), generally from one to 15 years, depending on the type of property, the property is presumed abandoned and subject to state custody.[44] Holders of abandoned or unclaimed property must report the property to the appropriate state, within the required time period, pursuant to the rules of the state to which the property must be remitted. The 1981 Act requires the holder to send written notice to the apparent owner's last known address to inform the owner that the holder is in possession of property and that it will be placed in the custody of the state if not properly claimed.[45] Then, in general, if the property is not claimed within six months after the final date for filing the report, the 1981 Act requires that the holder pay or deliver to the state's administrator all of the abandoned property that was required to be reported.[46] Once the property is remitted to the administrator in good faith, the holder is relieved of liability for the property.[47]

General Priority Rules

- Complete address available. Remit to state of the owner's last known address.
- Complete address unavailable (or foreign[48]). Remit to either holder's: (a) state of incorporation, if a corporation; or (b) state of organization or principal place of business, if an unincorporated business.

Because states adopted so many different versions of the various model acts or created their own, uniformity was never achieved. Unclaimed property rules are, instead, largely inconsistent from state to state and often vaguely drafted. The result is wide administrative latitude in the approach to enforcement adopted by the states. For example, the majority of states require property to be remitted to the company's state of incorporation if the owner's last known address is unknown; however, the State of New Jersey passed a bill, initially to be effective July 1, 2010, and which has since been partially enjoined, that, among other things, adopted a transaction test that would require companies to remit certain property to the State of New Jersey if the owner's last known address is unknown and the place of purchase was in New Jersey.[49] Because many companies are incorporated in Delaware, and Delaware follows the priority rules requiring companies to remit property to the state of incorporation, many companies would owe the same property to both Delaware and New Jersey.

Reporting and Remittance Requirements

Property becomes "unclaimed" or "abandoned" and therefore reportable and deliverable to the state if the owner of the property has failed to exercise dominion or control over the property during a certain period of time called the holding or dormancy period. Dormancy periods vary from state to state and even within a state, based on the type of property and the industry of the holder. Currently, in most states, the dormancy period is three to five years for most types of assets (Table 1).

Table 1
Examples of the dormancy period

Property Type	Dormancy Period (generally)
Payroll	1 year
Money orders	7 years
Travelers checks	15 years
Other property	3 to 5 years

Few companies are exempt from unclaimed property reporting and remittance requirements. Some states, including Florida, require annual reporting even when there is no unclaimed property to report, often called negative or zero reports.[50] Others highly encourage it.[51] Reporting and remittance requirements vary based on the company's industry and the reporting state.

To stay in compliance with the various reporting and remittance obligations, companies must:

1. Identify, track and safeguard property
2. Conduct proper due diligence
3. File annual reports, including negative (zero) reports, when applicable
4. Remit unclaimed property

Knowing what, how, and when to report unclaimed property among the several states, in accordance with each state's laws, can be a big challenge. It is important to note that companies do not need to have a business presence nor employees in those states for a potential reporting and/or remittance obligation to exist and, in some cases, may not even need to be in possession of the property.[52] Although no single database compiles all state unclaimed property rules and requirements, there are several vendors that sell unclaimed property compliance software to help companies manage their reporting and remittance obligations.

It is important to note that states are constantly amending their unclaimed property statutes. The current trends are for states to extend liability to additional property types, shorten dormancy periods, and require companies to file reports electronically. For example, Louisiana enacted a law in 2009 that specifically adds cashier's checks, teller's checks, or other official bank-issued checks to the types of property that are escheatable to the state.[53]

Table 2
Examples of the shortened dormancy periods

State	Property type	Old period	New period
Arizona*	Money order or similar written instrument	7 years	3 years
	Demand, savings or time deposits	5 years	3 years
	Stocks or other equity interests	3 years	2 years
Delaware	Securities related property	5 years	3 years
Indiana	Several types of property	5 years	3 years
New York	Money orders	7 years	5 years
	Surplus from the sale of pledged property	6 years	3 years
	Services not rendered or goods not delivered	5 years	3 years
	Several other types of property	5 years	3 years
South Carolina	Stock or other equity interests	7 years	3 years

* Arizona changed the dormancy period for traveler's checks from 15 years to three years, but changed it back to 15 years again. Ariz. S.B. 1003 (Nov. 23, 2009); Ariz. H.B. 2111 (July 27, 2010.

Arizona, Delaware, Indiana, New York, and South Carolina, among others, have recently shortened their dormancy periods (Table 2), and several other states have legislation pending.[54] Several states are passing legislation that requires electronic filing if a holder is reporting over a certain number of items of property.[55]

Shorter dormancy periods mean that property must be remitted to the states sooner, granting states access to a larger pool of funds sooner than they would have had otherwise. Shortened dormancy periods may be susceptible to constitutional challenges; however, success may be difficult. For example, in *American Express Travel Related Services Co. v. Hollenbach*,[56] Kentucky passed a budget bill to shorten the dormancy period for traveler's checks from 15 years to seven years. American Express filed suit, and the U.S. District Court for the Eastern District of Kentucky held that, because "the state's objective was to raise revenue rather than to reunite citizens with lost property," the statute amending the dormancy period did not satisfy rational-basis review and violated the Due Process Clause of the U.S. Constitution. This holding, however, was recently vacated by the U.S. Court of Appeals for the Sixth Circuit, which held that the amendment did not violate the Due Process Clause and remanded the case for consideration under American Express's remaining constitutional claims.[57]

In California, the general sense that revenue generation was behind many of the changes in California's unclaimed property law caused a federal judge in California to observe: "If the purpose of the law is . . . to reunite owners with their lost or forgotten property, its ultimate goal should be to generate little or no revenue at all for the state."[58]

Although each state has the authority to amend and maintain its own unclaimed property laws, it appears that the states have started to push the limits of this authority. The ever-changing and often conflicting laws have made it very difficult for companies to stay in compliance.

Audits

Each state is granted the authority by statute to examine the records of any company to determine whether the company has complied with the provisions of its unclaimed property law. During the last decade, states have been increasing the number of audits they perform and are becoming more sophisticated in detecting noncompliance and undercompliance. States often send inquiry letters, unclaimed property questionnaires, and/or requests for self-audit. Some are checking state tax and incorporation records to see whether companies that are paying state taxes or are incorporated in the state have complied with the state's unclaimed property laws.

Unclaimed property audits may be assigned to a state auditor or a third-party auditing firm. Most audits begin with an official letter from the state and can last anywhere from a few months to several years. During the typical unclaimed property audit, the auditor will review books, records, and relevant company policies and procedures, interview key personnel, and apply various extrapolation methodologies to calculate the company's unclaimed property liability.

The survey results show that 56 percent of the respondents had previously been or were currently being audited. Of those, 59 percent had been or were currently being audited by Delaware, 41 percent by Illinois, 41 percent by Michigan and 37 percent by Tennessee. Hawaii was the only state that had not audited any of the respondents; however, it is important to note that none of the respondents were incorporated in Hawaii, and Hawaii does engage in audits. Respondents reported that audits were generally handled by the tax, finance and legal departments, but the number of employees involved in the audit ranged from one to five to more than 25 (Table 3 on page 15).

Table 3
Numbers of employees involved in the audit (N=31)

Employees involved in the audit	Percent of respondents
1 to 5	48%
5 to 10	29
10 to 25	13
25 or more	10

While the audits had been completed seemingly without too much trouble or liability for 52 percent of the respondents, for the other 48 percent, the audits were still ongoing and many had been spanning several years. These companies have been required to produce tremendous amounts of data (including, but not limited to, general ledgers, common paymaster information, and historic revenue) for periods of time far beyond that which their document retention policies require and for unexpected property types. For example, in Delaware, a company can be audited back to 1981. One respondent noted "the audit is for a period of time that we do not have corporate records. We did not expect all of these property types to be unclaimed property." These corporations have had to tie up significant numbers of employees and resources for the duration of the audit. The difference in the completed audits from the ongoing audits appears to be the initial timing, such that audits occurring within the last two to three years have become much more burdensome than audits that took place prior to that time.

Amnesty and Voluntary Disclosure Agreement Programs

To encourage companies to voluntarily come into compliance with their unclaimed property escheat laws, many states, including Delaware, Florida, Illinois, Nevada, New York, and Texas, offer amnesty or voluntary disclosure agreement (VDA) programs. Roughly one-third of respondents indicated that they had received a notice encouraging them to consider participating in an amnesty program. These programs may be offered formally, informally, or on a temporary basis. Kentucky, for example, does not have a formal amnesty program; however, if a holder voluntarily reports and remits past-due funds, the penalty may be waived.[59] Pennsylvania and Indiana, on the other hand, recently offered temporary amnesty programs, which ended last fall.[60]

Though the programs vary from state to state, they are primarily set up such that, in exchange for voluntary compliance with the state's unclaimed property laws, the state will agree not to impose penalties and interest on the past-due remittances. The programs are normally available only to first-time filers and, sometimes, to companies with gaps in their reporting history. Once a company has been contacted by a state for audit, the company no longer qualifies for participation in the program.

These amnesty and VDA programs can be beneficial to companies that are not currently in compliance with a state's unclaimed property laws because penalties and interest for noncompliance can be steep, especially now that states have begun to enforce their unclaimed property laws more heavily. Often, the penalties and interest form up to 75 percent of the award. Although most survey respondents that had entered into one of these agreements had positive experiences, there were a few that did not. Some companies found themselves in extensive audits in which they were assessed huge penalties and interest. For example, in *CA, Inc. v. Pfeiffer*,[61] in an effort to come into compliance, CA, Inc., voluntarily entered Delaware's VDA program, which advertises that interest and penalties may be avoided by conducting a self-audit. CA, with the assistance of independent consultants, initially determined its unclaimed property to be approximately $700,000. It later recalculated the amount to approximately $2.3 million. Delaware rejected CA's assessment, claiming approximately $7.6 million, which it increased to approximately $8.2 million when CA disputed the amount. Unable to come to agreement after four years of audit, the parties sued each other, finally settling a year later for approximately $17.65 million.

If a company decides to enter into an amnesty or VDA, it is important to understand the scope of the agreement—including what states, what period of time, and what types of property are covered—so the company is not surprised later. For example, in *Staples, Inc. v. Cook*,[62] Staples voluntarily entered Delaware's VDA program in 2000, under which Staples paid the amount of deficiency, and Delaware released Staples from all claims for reporting years prior to 2000. Staples, thereafter, regularly reported its unclaimed property to Delaware without ever receiving a notice of deficiency. In 2005, Delaware hired a contingent-fee audit firm to audit Staples on its behalf. Based on the audit firm's extrapolation methods, and in disregard of its VDA agreement with Staples, Delaware demanded about $3.96 million in property which it considered unclaimed since 1995.

Endnotes

1 *See* Appendix (p. 12) for additional background information, including a description of what constitutes unclaimed property.

2 *See e.g.*, "Delaware's General Fund Revenue Portfolio: A report submitted in fulfillment of Senate Joint Resolution No. 5, 144th General Assembly," Dept. of Finance, Office of Management and Budget, Controller General's Office, 66 (February 2008).

3 *See, e.g.*, Comptroller of Maryland, General Procurements Awarded Contracts (April 21, 2011) (http://compnet.comp.state.md.us/Procurement/General_Procurements/Awarded_Contracts.shtml); *see also,* Memorandum to the Honorable M.D. Goetz, Jr., Commissioner, Department of Finance and Administration, from Dale Sims, Treasurer, Department of the Treasury October 10, 2008 (www.legislature.state.tn.us/joint/committees/fiscal-review/archives/105ga/08contracts/RFS%20309.01-131%20Treasury%20(Audit%20Services,%20U.S.).pdf).

4 Kelmar Associates, LLC, for example, is or has been an auditor for numerous states, including Delaware, Massachusetts, Michigan, New Hampshire, and Tennessee.

5 *See generally*, C.A. No. 4920-CC (Del. Ch. dismissed Aug. 2, 2010) (holding that McKesson was not liable as a matter of law after 77 Del. Laws c. 417 §2 was passed).

6 77 Del. Laws c. 417 §2 (July 23, 2010); .

7 *See generally*, No. CV 6030 (Iowa Dist. Ct. for Polk Cnty. Feb. 8, 2006).

8 Forty-five other states and the District of Columbia joined the suit, although they were later forced to file separate suits in their own states or district.

9 Order, *Fitzgerald v. Young Am. Corp.*, No. CV 6030 (Iowa Dist. Ct. for Polk Cnty. Jan. 5, 2009).

10 *See, e.g.,* K.S.A. § 58-3935(g); Md. Code Comm. L. art. § 17-101(m)(3). Missouri introduced House Bill 401 on February 2, 2011, that would, among other things, create a business-to-business exemption. Although the Rules Committee recommended on April 4, 2011 that the bill "do pass," the bill was not introduced for its required third reading before the legislative session ended and is currently not on a House calendar. Mo. H.B. 401

11 Missouri introduced House Bill 401 on February 2, 2011, that would, among other things, create a three-year statute of limitation from the date a report is filed; if no report is filed, there would be no statute of limitations. Although the Rules Committee recommended on April 4, 2011, that the bill "do pass," the bill was not introduced for its required third reading before the legislative session ended and is currently not on a House calendar. Mo. H.B. 401

12 In the case of Delaware, audits can go back as far as 1981.

13 *See generally,* C.A. No. 4920-CC (Del. Ch. dismissed Aug. 2, 2010).

14 *See e.g.,* Scott D. Smith, *Delaware & Unclaimed Property: One State's Aggressive Revenue Pursuit and How Targeted Businesses Can Respond*, Washington Legal Foundation, Critical Legal Issues Working Paper Series, No. 171 (March 2010), pp. 7–8.

15 Ibid.

16 *See, e.g.,* R.I. Gen. Laws § 33-21.1-34 (providing for fines and/or imprisonment for up to six months); 72 P.S. §1301.25 (providing for a fine of up to $10,000 or imprisonment for up to 24 months, or both).

17 12 Del. Code §1159.

18 *See, e.g.,* M.G.L.A. 200A § 12(e) (providing for 12 percent interest per annum); V.A.M.S. § 447.539(8) (providing for 1.5 percent interest per month); Del. Code § 12-1159(d) (providing for 0.5 percent interest per month on outstanding amounts, including penalty up to 50 percent of the amount required to be paid); M.D. Code Comm. Law § 17-323 (providing for 15 percent interest).

19 Jana S. Leslie, *The Best and Worst of State Unclaimed Property Laws: Scorecard on State Unclaimed Property Statutes: the Holders' Perspective*, Council On State Taxation, January 2009 (finding that 41 of 50 states did not provide for an independent appeals process); Delaware recently passed legislation providing a formal administrative appeals process. Del. S.B. 272 (July 23, 2010).

20 Some exemptions offered include a business-to-business exemption, a *de minimis* exemption, an exemption for gift certificates or gift cards, or certain industry-specific exemptions.

21 For example, some states have a business-to-business exemption or a *de minimus* exemption.

22 Due to the burden of proof being placed on the holder, unclaimed property is sometimes referred to as "a tax on a company's ability to maintain records."

23 *See generally*, 85 Cal. Rptr. 3d 806 (Cal. Ct. App. 2008).

24 For example, a customer may agree to settle the potential amount owed for something less than what is reflected on the company's books because the customer does not have records to support the full amount.

25 *See generally*, *Delaware v. New York*, 507 U.S. 490 (1993); *Texas v. New Jersey*, 379 U.S. 674 (1965).

26 *See, e.g.*, Del. UCC §§ 1-104, 2-275; *Standard Oil Co. v. New Jersey*, 341 U.S. 428 (1951).

27 *See, e.g.*, 12 Del. Code § 1158.

28 *See, e.g.*, *New Jersey v. Chubb Corp.*, 570 A.2d 1313, 1317 (N.J. Super. Ct. Ch. Div. 1989) (indicating that an expert's extrapolation methods must be "proven sufficiently reliable").

29 No state may take private property "for public use, without just compensation." U.S. Const. amend. V.

30 Although *American Express Travel Related Services Co. v. Hollenbach*, 630 F. Supp. 2d 757 (E.D. Ky. 2009), had held that a statute changing a dormancy period was a violation of due process, the district court's decision was vacated by the court of appeals, which held that the amendment did not violate the Due Process Clause. *Am. Express Travel Related Servs. Co. v. Kentucky*, No. 09-5898, 2011 WL 1676059 (6th Cir. May 5, 2011).

31 Jana Leslie, Kendall Houghton & Maryann Luongo, *In the Nick of Time? Reforming State Unclaimed Property Laws: Essential Goals and A Review of Potential Forums*, Council on State Taxation, October 2009, p. 15.

32 Ibid.

33 *See generally*, *Delaware v. New York*, 507 U.S. 490 (1993); *Texas v. New Jersey*, 379 U.S. 674 (1965).

34 Ibid.

35 Some states have adopted a third priority rule, providing that a state may claim property (and thus require reporting and remittance) if the transaction from which the property was created took place in that state. States have, in effect, used this theory to claim property owed to a third party whose last known address was outside of the United States.

36 *Conn. Mut. Life Ins. Co. v. Moore*, 333 U.S. 541 (1948).

37 *See, e.g.*, O.C.G.A. § 44-12-226; Texas Prop. Code § 74.308.

38 *Conn. Mut. Life Ins. Co. v. Moore*, 333 U.S. 541 (1948).

39 The National Conference of Commissioners on Uniform State Laws is also known as the Uniform Law Commission.

40 Notably, Delaware, which is one of the most active states with regard to unclaimed property, has not adopted any version of the promulgated Uniform Unclaimed Property Laws.

Endnotes (continued)

41 Unif. Unclaimed Prop. Act 1995 Refs & Annos, Table of Jurisdiction Wherein Act Has Been Adopted, Westlaw (2010).

42 Unif. Unclaimed Prop. Act 1981 Refs & Annos, Table of Jurisdiction Wherein Act Has Been Adopted, Westlaw (2010).

43 Unif. Unclaimed Prop. Act 1981 § 1(8).

44 As discussed, many states have adopted statutes to shorten dormancy periods so that property is considered unclaimed sooner and must be remitted to state custody sooner.

45 Unif. Unclaimed Prop. Act 1981 § 17(e).

46 Unif. Unclaimed Prop. Act 1981 § 19(a).

47 Unif. Unclaimed Prop. Act 1981 § 20(a). *See, contra*, *Vondijidis v. Hewlett Packard*, 85 Cal. Rptr. 3d 806 (Cal. Ct. App. 2008) (holding that a company was not entitled to immunity where it failed to comply completely with the provisions of the state's unclaimed property law).

48 Although *Texas v. New Jersey*'s priority rules did not specifically include foreign addresses, some states take the stance that foreign owners are included in this second priority.

49 N.J. A3002, section 1(t). After the law's enactment, American Express Prepaid Card Management Corp. brought an action to enjoin the State of New Jersey from enforcing the new law. The court granted the action in part and enjoined New Jersey from enforcing the transaction test. Order, *Am. Express Prepaid Card Mgmt. Corp. v. Sidamon-Eristoff*, No. 10-5206 (FLW) (D.N.J. Nov. 13, 2010), ECF No. 21. The State of New Jersey has filed an appeal. *See* Order, *Am. Express Prepaid Card Mgmt. Corp. v. Sidamon-Eristoff*, No. 10-5206 (FLW) (D.N.J. Mar. 28, 2011) ECF No. 38.

50 *Florida Unclaimed Property Reporting Instructions Manual,* Department of Financial Services: Division of Accounting and Auditing – Bureau of Unclaimed Property, 1.3.6 (www.fltreasurehunt.org/files/Reporting-Instructions-Manual-2011.pdf).

51 "Negative (Zero) Reporting," IndianaUnclaimed.com (http://ucp.indianaunclaimed.com/attorneygeneral/ucp/negativeReport.html).

52 *See, e.g.*, Order, *Fitzgerald v. Young Am. Corp.*, No. CV 6030 (Iowa Dist. Ct. for Polk Cnty. Jan. 5, 2009).

53 La. H.B. 65 (June 18, 2009).

54 Ariz. S.B. 1003 (Nov. 23, 2009); Del. S.B. 334 (June 30, 2008); Ind. H.B. 1083 (Mar. 17, 2010); N.Y. A.09710 (Aug. 11, 2010); 2011-12 New York State Executive Budget, Revenue Article VII Legislation, Part A; S.C. S.B. 741 (Apr. 15, 2008).

55 *See, e.g.*, Okla. H.B. 33l5 (May 10, 2010); Idaho H.B. 385 (July 1, 2010).

56 *See generally*, 630 F. Supp. 2d 757 (E.D. Ky. 2009).

57 *Am. Express Travel Related Servs. Co. v. Kentucky*, No. 09-5898, 2011 WL 1676059 (6th Cir. May 5, 2011).

58 *Taylor v. Chiang*, No. 2:01-CV-02407-WBS-GGH, 2007 WL 1628050, at *4 (E.D. Cal. June 1, 2007).

59 "Frequently Asked Questions," Kentucky State Treasury (www.treasury.ky.gov/apps/up/faq.htm).

60 Press Release, "Treasurer McCord: Last Chance to Enter Treasury's Holder Amnesty Program," Pennsylvania Treasury, October 15, 2010 (www.patreasury.org/PressReleases-2010-10-15%20Holder%20Amnesty%20Last%20Chance.htm); Letter from the State of Indiana Office of the Attorney General, May 2010 (http://ucp.indianaunclaimed.com/attorneygeneral/ucp/files/Letter_from_Attorney_General.pdf).

61 *See generally*, Case Nos. 4111-CC, 4195-CC (Del. Ch. Feb. 12, 2010).

62 *See generally*, C.A. No. 5447-VCS (Del. Ch. Apr. 30, 2010).

About This Report

This *Council Perspectives* report is the result of discussions held by The Conference Board Council of Chief Legal Officers over the course of two meeting in April and October 2010. The article analyzes findings from a survey of 55 corporations administered by The Conference Board in February and March 2011. The survey was mailed to 95 general counsels, chief finance officers and corporate treasurers, as well as the clients of KPMG's state and local tax practice. This survey was conducted in collaboration with KPMG.

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