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What Corporate America Needs to Know About Unclaimed Property: A Primer for the Business Holder

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What Corporate America Needs To Know About Unclaimed Property: A Primer For The Business Holder

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I. Introduction

Accounting personnel who work "in the trenches" of a company's day-to-day financial operations often grapple with such questions as: "How should I treat uncashed vendor checks and payroll checks?" "Can such amounts be taken into income?" "Must they be reported and paid to a state and, if so, which state is entitled to the unclaimed funds?" The answers lie in the state statutes known as the unclaimed property laws. These statutes governing the disposition of unclaimed property are also sometimes referred to as "escheat laws," a term harkening back to the rule in feudal England that land "escheats" to the Crown when the tenant dies without heirs.

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Today, all 50 states and the District of Columbia have statutes regulating unclaimed property. Although there are important variations among state laws, most of the statutes are based on a uniform unclaimed property statute first adopted in 1954 and most recently revised in 1995. Almost all modern unclaimed property statutes are custodial in nature, meaning that title to the property does not pass to the state but rather is held (potentially in perpetuity) by the state on behalf of the absent owner.

Even though the states do not receive title to the unclaimed funds, they enjoy obvious benefits from the right to hold and use unclaimed funds for the general benefit of state citizens. Our increasingly mobile society has generated a large amount of lost wealth, with the total amount of unclaimed property in state coffers today estimated to be $20 billion or more.[1] According to some experts, roughly one in eight Americans is owed unclaimed property. In most states, despite increased state efforts to find missing owners and return property, less than half of the unclaimed property collected each year is ever returned to the original owners.[2]

Many businesses have historically treated unclaimed property as a source of revenue. As a general rule, however, businesses are not allowed to convert unclaimed payables on their books to income. Instead, they must report and remit such amounts to the appropriate state offices after the property has been abandoned for a prescribed period of time.

This article first provides an overview of the law of unclaimed property as enacted by most states, including how to determine if abandoned property is covered by the law and the appropriate states to which such property must be reported and paid. Next, the article reviews the risks of not complying with unclaimed property laws, followed by an examination of trends in the law and how those trends may benefit businesses holding unclaimed property. Finally, the article explains how businesses that may not have perfect unclaimed property compliance records can jump-start a compliance program.

II. Overview of the Law

A. The Four Essential Elements of Unclaimed Property

For property to constitute "unclaimed property" within the meaning of most state laws, the following four elements must be present:

1. The property must be intangible. Land and other tangible assets (such as jewelry and furniture) generally do not fall within the reach of the unclaimed property laws.[3]

What is intangible property? Intangible property is most easily understood as a right to hold or receive something of value. That right is often evidenced by a written document. Uncashed checks and unclaimed stock certificates are classic examples of unclaimed property. In those examples, the check is written evidence of the intangible right of the payee to receive money from the maker, and the stock certificate is written evidence of the intangible right of the stock owner to share in a corporation's net profits.

Although uncashed checks and unclaimed stock and stock dividends may be the most easily recognizable types of unclaimed property, most state statutes include a general requirement that all intangible property held or owing in the ordinary course of business be reported and paid to the state. To guide holders in identifying covered intangible property, the reporting instructions published by many states list more than 100 different types of unclaimed property that must be reported and remitted to the state. The following items, in addition to uncashed checks, stocks, and dividends, are typically listed by the states as property subject to their unclaimed property laws:

- accounts payable, such as refunds due or credit balances owed to customers;
- unredeemed gift certificates;
- unclaimed debt obligations, such as unclaimed interest on bonds, debentures and notes;
- dormant bank accounts;

- unclaimed royalty payments, including mineral royalties;
- certain unclaimed insurance policy benefits; and
- abandoned utility deposits and security deposits.

2. The apparent owner of the property cannot be located. A common occurrence giving rise to unclaimed property is a change of the property owner's address. When an individual entitled to receive money, such as a stockholder entitled to a dividend, changes addresses and fails to leave a forwarding address with the company that owes the obligation, unclaimed property is created. In most states, the law requires the business that owes the unclaimed property (known in unclaimed property law parlance as the "holder") to make an effort to return the property to the owner before reporting and remitting the property to the state. This process is frequently referred to as "due diligence." In some states, such as Massachusetts, Virginia, and Kansas, specific monetary penalties may be imposed on a holder for failure to undertake required due diligence efforts. If a holder's due diligence efforts fail, the holder must turn the property over to the applicable state office, which then attempts to locate the owner.

3. The property must remain unclaimed by the owner for a period of time referred to in the law as the "abandonment period" or "dormancy period." In most states, this period of time ranges from 1 year for a few types of property – most notably, unclaimed wages – to 15 years for travelers checks. The most common dormancy periods are 3 and 5 years. Since the first uniform unclaimed property law was approved in 1954, there has been a trend toward shortening dormancy periods. State law must be consulted to determine the dormancy period for the particular type of property. The dormancy period generally begins at the time the property first becomes payable or distributable to the owner and typically continues so long as there is no communication or expression of interest from the missing owner. Each state sets a deadline date for reporting and remitting to that state all property for which the applicable dormancy period expired during the preceding year.

4. There must be a fixed and certain legal obligation of the holder to the owner. A holder is not subject to the unclaimed property laws with respect to a debt that is not clearly owed and fixed in amount. For example, the Comments to section 1 of the Uniform Unclaimed Property Act (1995) state that "The requirement that the right be 'fixed and certain' excludes unliquidated claims from the coverage of the Act, such as disputed tort claims." Thus, a check written by an insurance company as a conditional offer of settlement, even if uncashed by the payee for many years, is not unclaimed property, since the insurance company was not legally obligated to make the payment.

B. Which State Law Applies

Whether a business is establishing a program for ensuring future compliance with unclaimed property laws, or is considering how best to remedy historical noncompliance, the first step must be to determine which state unclaimed property laws apply. The result of this inquiry will determine the applicable abandonment periods, any available exemptions, the relevant reporting and payment periods, and other information critical to proper legal compliance.

In several landmark cases, the Supreme Court of the United States has established and reaffirmed a priority scheme for unclaimed property. These rules, which are essentially incorporated into both the 1981 and 1995 versions of the Uniform Unclaimed Property Act, govern the priority rights of the states to take custody of unclaimed property. In this high stakes arena, the state having the enviable first priority right to take and hold unclaimed property is the state shown on the holder's books as the state of the last known address of the property owner. For example, if the holder's books show an address in Oklahoma as the last known address for the payee of an uncashed check, Oklahoma law applies and the holder must report and pay the amount of the check to Oklahoma at the conclusion of the dormancy period.

Many types of unclaimed property are anonymous, meaning the holder never obtained or no longer retains an address for the owner in its records. In that case, the state of domicile of the holder (which is the state of incorporation for a corporate holder) has second priority rights to receive and hold the property. The state of the holder's domicile also has second priority escheat rights where the state of the owner's last known address does not assert a claim to the type of property in question (*e.g.*, where the state expressly exempts the property from the reach of its unclaimed property laws). Popular states of holder's domicile such as Delaware are greatly enriched by this priority scheme, which frequently gives them second priority status.[4]

III. The Risks of Noncompliance

In the early years of state unclaimed property legislation, unclaimed property law was a relatively obscure area of state law. Little was written about unclaimed property law in legal or accounting circles, state unclaimed property offices were generally small, enforcement cooperation among states was limited or nonexistent, voluntary compliance with the unclaimed property laws was very low, and businesses rarely joined together to more effectively advocate their concerns to unclaimed property regulators. A lot has changed.

Perhaps the most significant change is that many state governments have greatly increased their level of interest and activity in this area, realizing that substantial revenues have been lost in the past because of a combination of low voluntary compliance levels and minimal state enforcement. States have discovered that active compliance education programs, along with more vigorous enforcement of the law, can provide a politically painless means of bolstering a state's financial resources.

Increased state activity has taken various forms in recent years. Many states have instituted one or more of the following changes:

- Increasing the size of their unclaimed property offices;
- Increasing the number of auditors and the number

of audits conducted each year;
- Repositioning their unclaimed property offices within the state government (presumably to increase effectiveness); and
- Initiating community education programs, formal amnesty programs, and informal outreach programs to encourage voluntary holder compliance.

A. The Audit Risk

More vigorous enforcement by the states means more audits. Because of the complexity of state laws and the statutory variations among the states, even businesses that have historically tried to comply with the law could suffer significant additional assessments as a result of a comprehensive state audit.

If a business entity is audited, the stakes can be very high, primarily because standard statutes of limitations do not apply in this area. Although the permitted "look back" period varies by state, almost all states permit auditors to reach back at least 10 years, and sometimes 15 or 20 years or more, before the expiration of the dormancy period in their quest for unreported property subject to the law. When unreported property is identified in an audit, it may be subject to interest as high as 18 percent per year. Monetary penalties as high as $500 per day for each day of noncompliance and 25 percent of the value of the property may also be assessed. Finally, criminal penalties, though very rarely imposed, are available under the statutes of several states if noncompliance is proven to be willful.

Because of the complexity of state laws and the statutory variations among the states, even businesses that have historically tried to comply with the law could suffer significant additional assessments as a result of a comprehensive state audit.

The following additional factors make the risk of audit truly ominous, particularly for a business with a significant history of noncompliance:

- Auditors are entitled to estimate unclaimed property liability when business records are nonexistent or incomplete, and such estimates may be based on techniques which are statistically questionable or inappropriate for the business being audited;
- States are increasingly using outside contract auditors, many of whom are paid on a contingency fee basis, thereby giving them every incentive to interpret ambiguities in favor of the state;
- The law in many states expressly endorses interstate information sharing and multi-state auditing, meaning that one state's audit could result in assessments from multiple states and trigger audits in other states; and
- It is not uncommon for penalties and interest to exceed the principal amount of the assessment because of the number of years covered by the audits.

If a business has a serious historical noncompliance problem, it may be possible before an audit has commenced to approach the states that are owed money to negotiate a payment that does not include interest or penalties and is based on the holder's own good faith determination of the amount owed. Particularly if the amounts involved are significant, this negotiation should be handled with the assistance of experienced advocates, such as legal or accounting professionals, who are familiar with the laws and policies of the states in question and who may also be able to approach state officials on a confidential basis.

B. Other Risks of Inattention to the Law

The following are four significant non-audit risks associated with inattention to these laws.

1. Failure to observe unclaimed property laws can result in misleading financial statements. Business entities sometimes engage in the practice of writing off their unclaimed property obligations to income, as opposed to reporting and remitting the money to the appropriate states. When this occurs, financial statements reflecting the inflated income are misleading. State auditors know this, and routinely ask for the entity's income tax returns in their document production requests. When miscellaneous income items are found reflecting such improper practices, they will be reversed by the auditor.

2. Failure to comply with the law can result in increased litigation risks. For example, 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 to whom the company owed mineral proceeds. In another example, a class action lawsuit was brought by a state controller in behalf of home buyers in the state. The case sought millions of dollars in damages against more than 200 title insurance and escrow companies for systematically retaining unclaimed escrow deposits in violation of the state's unclaimed property law. Whether or not litigation of this type is ultimately successful, the defendant spends considerable time and incurs significant expense in the defense of the case.

3. State "whistle-blower" statutes create incentives for former employees to turn in their former employers for unclaimed property violations. "Whistle-blower" laws in some states permit individuals who become aware of wrongdoing to file suit for damages in behalf of the government and to receive a share of the funds that are recovered in the litigation. For example, in 1995, a former Bank of America vice president, acting under the California whistle-blower statute, brought suit against the Bank of America alleging that the bank improperly retained hundreds of millions of dollars in un-

claimed municipal bond principal and interest. Subsequently, the State of California joined the suit. After extensive, and undoubtedly expensive, pre-trial proceedings, the case settled for more than $187 million (with substantial payments to the plaintiffs).

4. Lack of familiarity with unclaimed property law can result in lost opportunities to structure transactions in a manner which minimizes unclaimed property liability. A business may avoid substantial liability when acquiring another business if the employee handling the negotiation understands the potential sources of unclaimed property liability and insists upon appropriate escrows, indemnifications or other risk allocation mechanisms to shield the acquiring business from the target's potential liability. Similarly, a retail business manager considering a new gift-card or loyalty program (such as a "frequent shopper" program) should know that it may be possible to structure the program to reduce the risk that a state will seek to characterize unclaimed value arising from the program as unclaimed property. It may also be possible to reduce or eliminate escheat liability by taking advantage of certain provisions of state law, though some structuring strategies may be risky because of the lack of settled legal precedent.

IV. Recent Trends of Interest To Business Holders

Trends that are notable for business professionals can be categorized into two groups: non-legislative and legislative. Non-legislative trends are changes in society at large or in numerous state governments or communities relating to or affecting unclaimed property. Legislative trends are statutory changes that are being considered or adopted in numerous states.

A. Non-Legislative Trends

The most important non-legislative trend for the business community is the aggressiveness of state enforcement activity. Importantly, the ever-expanding efforts to force holders to remedy past noncompliance are often accompanied by efforts to encourage holders to voluntarily comply with the law.

In 1999, for example, the National Association of Unclaimed Property Administrators (NAUPA) initiated an unusual voluntary compliance initiative calling for states to waive interest and penalties on past due unclaimed property for all holders who came forward voluntarily to report and pay past due unclaimed property. Ultimately, more than 40 states participated in the joint state initiative. Today, only a very few states still have an official amnesty period in effect. For example, in Oklahoma, an amnesty period remains in effect until December 31, 2002, and an Illinois's amnesty period will expire on January 1, 2003.

While a concerted, multi-state amnesty is unlikely to be repeated for another few years – the states having so recently tapped the reservoir of long-delinquent property with the NAUPA amnesty window – individual states may adopt formal amnesty periods from time to time. It is therefore worthwhile for holders, particularly those with multi-state operations, to inquire periodically about amnesty availability or to monitor statutory updates provided by the Unclaimed Property Holders Liaison Council (UPHLC) or Council on State Taxation (COST).

Although there may be few formal amnesty programs during the next few years, many state statutes or regulations expressly permit the state unclaimed property officer to waive penalties and interest if certain standards of good faith or good cause are satisfied.[5] In other states, such as Texas and Oregon, waiver of penalties or interest may be obtained upon any voluntary disclosure prior to holder's receipt of an audit notice. Still other states have instituted "outreach programs" to encourage holders who have not been audited to come forward voluntarily to report and pay past due unclaimed property. For example, New York's outreach program involves sending "intent to audit" notices to corporations doing business in the state that have failed to file unclaimed property reports. The holder who receives such a notice has six months to avoid an audit by filing a "catch up" report and remitting past due amounts, in which event interest and penalties are waived. Delaware operates a similar program, but holders are given only 60 days after notice to come into compliance.

A few states have initiated programs designed to respond to complaints of the business community about overzealous state policies. For example, Arizona recently adopted a "Holder Bill of Rights." Among other holder protections, it requires a new Arizona Unclaimed Property Assistance Office to evaluate complaints by holders of improper, abusive, or inefficient service by employees of the Department of Revenue. Additionally, states such as Iowa and Maryland have instituted appeals processes for holders dissatisfied with audit results, and California has adopted special fairness rules governing audits by third-party contractors.

Another important non-legislative trend is the growth of a holder advocacy movement. For example, though starting in 1992 with just more than 30 members, the Unclaimed Property Holders Liaison Council (UPHLC) now has hundreds of members. A principal goal of UPHLC is reducing unclaimed property compliance burdens for holders. The Council on State Taxation (COST) is also active in advocating the concerns of the business taxpayer in the unclaimed property arena. On its website, COST notes "the need of corporate taxpayers to be represented by a united voice on state tax issues – to counterbalance a number of organizations of state tax authorities."

Finally, a non-legislative trend affecting unclaimed property is the widespread use of advanced technology by state unclaimed property offices. This has benefitted owners because the improved hardware and software tools have made it possible for states to track and return unclaimed property to its owners more efficiently. For example, many states now have improved websites enabling owners to search for lost property online, and most states participate in the searchable online database offered free of charge by the National Abandoned Property Processing Corporation (NAPPCO) at www.missingmoney.com. In some states, owners can also initiate and submit claims online.

Holders are also benefitted by technological advances. States have widely adopted uniform electronic reporting,

substantially decreasing the administrative hassle of multi-state reporting. Additionally, technological advances adopted by holders for their businesses will make it easier for them to collect, process, and store information relevant to unclaimed property liability, such as information about employees, stockholders, vendors, and various transactions giving rise to unclaimed property. Improved recordkeeping means holders should have less unclaimed property to report and, in the event of an audit, should be able to minimize or avoid potentially excessive estimates of past due amounts.

B. Legislative Trends

The two most notable legislative trends over the past several years are (i) the increasing number of states that are exempting gift certificates, gift cards, and other retail payment and loyalty products from their escheat laws, and (ii) the very recent adoption by a number of states of a business-to-business (B2B) exemption.

1. Gift Certificates. Gift certificates, which are generally includible as unclaimed property if abandoned for the statutory abandonment period, have been expressly exempted from unclaimed property statutes in certain states for many years. What is interesting is the number of new states that have adopted gift certificate and gift-card exemptions in the last few years. This trend parallels the dramatic rise in the issuance of gift certificates and electronic gift cards during the same period. Approximately 18 states now have gift certificate or gift-card exemptions, though the exemptions often apply to a limited type or category of gift certificate or card (*e.g.*, those without expiration dates, those in denominations of under $50 or under $100 and those that are redeemable only for goods or services). The retail lobby has apparently galvanized around this issue, pressing and winning passage of these exemptions despite the clear loss of revenue to the states adopting the exemptions.

The availability of these exemptions generally depends on whether the issuing stores maintain name and address records for purchasers or issue the gift certificates or gift cards on an anonymous basis. If name and address records are maintained, the state of the purchaser's last known address has the first priority right to escheat the unused balances. If either (a) the purchaser's last known address is in a state that exempts gift certificates, or (b) the gift certificates or gift cards are issued anonymously, the second priority reporting rule (described in Section II B above) applies and the holder may be liable to report and pay the unused balances to the holder's state of domicile after the expiration of the relevant dormancy period.

If the holder's state of domicile also exempts gift certificates or gift cards, the holder may decide not to report and pay the unused balances to any state. This result is not available, however, if Delaware is the holder's domicile. Delaware, a common state of incorporation and therefore a frequent beneficiary of the second priority rule, recently considered and rejected an amendment to its escheat laws exempting gift certificates. The prospect of a large revenue loss to the State was likely the principal reason for the failure of the proposed amendment.[6]

Finally, even if it appears that nonpayment of the unused balances may be an available result under the second priority rule, the retail issuer should consult with professional advisers before deciding not to report or pay the unused balances to any state. Many states assert the right to escheat unused balances of gift certificates or gift cards that are purchased in that state, regardless of the domicile of the owner or holder. This transactional rule, also sometimes referred to as the "third priority" rule, is of questionable constitutional validity, though it has been successfully applied in several lower state court cases and is being closely monitored by unclaimed property professionals.

When an escheat exemption is not available, some retail issuers have explored the possibility of imposing service charges (also known as administrative fees or dormancy fees) on unused gift certificate and gift-card balances after a certain period of time of nonuse of the product (*e.g.*, 12 or 18 months of nonuse). The ability of an issuer to impose such charges is governed by the law of the state that would otherwise be entitled to escheat the unused balances which are being applied to pay these charges.

State law on the service charge issue varies widely. Many states permit such charges if they are imposed under a valid contract, are uniformly enforced, and in most states that have adopted the 1995 Uniform Act, are not "unconscionable" in amount. Many other states significantly restrict a holder's ability to impose service charges. Because these restrictions take a wide variety of forms (from dollar amount limitations to specific owner notification requirements to outright prohibition), a national business that wishes to impose service charges could easily become mired in the complexity of multi-state compliance. Moreover, if service charges routinely reduce customer account balances to zero, even states with no significant restrictions could challenge the charges on various public policy grounds.[7]

2. The B2B Exemption. The other recent trend of interest to a wide variety of business holders (not just retailers) is the entirely new B2B exemption. This is also known as a vendor-to-vendor exemption in some states. Thus far, 12 states have enacted such an exemption.[8] This innovative 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 another business. Proponents of these exemptions also argue that businesses do not generally neglect to claim funds truly owed to them by another business, and that most such credit balances actually represent flawed bookkeeping. Some regulators and commentators disagree with this theory, but it has nonetheless gained momentum, in part owing to the strong advocacy of the business community.

One point made by several commentators is that the B2B exemption is only useful in the limited number of cases where both the state of the owner's last known address and the state of the holder's domicile – in other words, the states with both first and second priority escheat rights – exempt B2B transactions. Delaware rejected the B2B exemption at the same time it rejected the gift

certificate exemption. Thus, the large number of companies incorporated in Delaware will not be able to take advantage of any B2B exemptions that may be available in the "first priority" states where their business creditors reside.

Even in those fairly unusual circumstances in which both the first and second priority states have adopted B2B exemptions, the state in which the transaction occurred could seek to escheat the credit balance on the basis of its "third priority" rights, as long as such state has adopted the third priority rule and has not adopted a B2B exemption.

Despite these clear limitations on the usefulness of the B2B exemption, its significance for business holders will certainly increase as it is adopted by additional states. As that occurs, there is also the possibility that corporations will make escheat exemption a more important factor in selecting a state of incorporation.

V. How To Jump-Start a Compliance Program

Because of widespread noncompliance (or frequent compliance lapses), many business professionals may one day confront the need to "jump start" an escheat compliance program. This section offers a number of practical suggestions to assist businesses to do just that.

First, businesses should adopt formal policies affirming their commitment to compliance with state unclaimed property laws. The policy should be signed by a high-level officer, should be communicated "down the line" to all accounting, payroll, and finance personnel, and should allocate specific responsibilities for unclaimed property recordkeeping and for filing unclaimed property reports.

Second, medium and larger businesses should establish a committee responsible for unclaimed property compliance. The committee should be composed of at least three individuals and should include a representative of the Chief Financial Officer or Comptroller, as well as representatives in each area of the business (such as payroll, vendor contracting, and securities) with responsibility for handling payments and distributions which may become unclaimed property. The committee approach has a number of advantages, such as (i) creating multiple points of responsibility (thereby increasing the likelihood of full and proper compliance), (ii) spreading the potentially significant tracking and reporting burden amongst several individuals or departments so that no one is overburdened, and (iii) providing for continuity and retention of information within the organization.

The risk of not specifically allocating responsibility to a committee (or, in smaller businesses, to one or two individuals) is obvious. If no one group or individual is clearly responsible for a particular function, such as unclaimed property reporting, it may simply "fall through the cracks." Alternatively, employees may waste time and energy shifting the reporting burden amongst various individuals or departments depending on such factors as who is least busy at a given time. No one gains expertise in the area and mistakes are bound to be made. Clearly, that system is less than ideal.

As an alternative to specifically allocating responsibility within the organization, some businesses are now outsourcing the unclaimed property function in the same manner that they outsource other specialty areas (*e.g.*, sales and use tax and payroll tax). If an organization elects to outsource this function, legal counsel should review the outsourcing contract for appropriate safeguards, such as strict record retention requirements, to ensure that the outsourcing does not compromise the business's audit position. Additionally, management should closely monitor any outsourcing arrangement on an ongoing basis.

Third, the business should consider whether a "special audit" is needed to get a firm grip on the firm's compliance history and current risk exposure. This may be particularly useful to a new manager or financial officer who wants to assess the status quo, or as part of a new business plan or strategy. An internal audit may also be warranted when particular opportunities arise at the state level, such as when a new amnesty program with a limited window of opportunity is adopted in the domicile state.

Because of widespread noncompliance (or frequent compliance lapses), many business professionals may one day confront the need to "jump start" an escheat compliance program.

Fourth, the business should offer educational programs to all personnel on the unclaimed property committee or, in the case of smaller businesses that do not have a committee, to the individuals who are responsible for unclaimed property compliance. NAUPA, UPHLC, and COST all offer educational seminars and forums, as well as excellent newsletters and educational materials.

Fifth, the business should coordinate with all agents or fiduciaries that may be holding entity assets to make sure that they are complying with unclaimed property obligations related to the assets they hold. For example, securities agents and agents administering health plans should be contacted to ensure that unclaimed property responsibilities are being handled properly. The business will ultimately be liable for these obligations and it is usually no excuse to blame the agent when unclaimed amounts are not timely reported and paid.

Finally, the business should adopt procedural "checks" to ensure that the newly assigned committee members or individuals responsible for unclaimed property compliance are performing their tasks correctly. It is best to find out quickly if there is a leak in the system or a basic misunderstanding of roles or responsibilities. This is not something that should be discovered in a state audit.

VI. Conclusion

In conclusion, unclaimed property is an area that continues to grow in importance because of our increasingly mobile society and the increasing attention of cash-hungry states to this lucrative revenue source.

Few holders will be able to avoid being caught in the glare of the ever-brightening spotlight of one or more state unclaimed property offices. All business entities which have been in existence for even a few years and which have at least some employees, customers or business vendors are likely to hold unclaimed property. Businesses that operate in more than one state, have stockholders in more than one state or enter into contracts with vendors who operate in more than one state will likely have reporting and payment obligations to more than one state.

It is vital that holders, especially those which have never previously reported unclaimed property, take steps to get their "unclaimed property houses" in order. In some cases, particularly where there is overdue unclaimed property that may have been inadvertently taken into income, the holder should consult legal or accounting professionals to assist in the task of “coming clean” with the appropriate state offices. The participation of legal counsel in a comprehensive internal audit or exposure analysis by the holder can help preserve confidentiality and protect legal rights.

1 Examples of states holding large amounts of unclaimed property include New York (holding over $5 billion), California (holding approximately $3 billion), and Illinois (holding approximately $1 billion).

2 The figures listed by Florida for year 2000-2001, for example, show approximately $146 million in unclaimed property received and approximately $62 million in claims paid, for a return rate of about 42 percent. Other states also report a 30 to 50 percent annual return rate in recent years. These rates are actually high by historical standards, reflecting the fact that most states have greatly accelerated their efforts to return property to owners.

3 One important exception is that tangible property held is generally subject to unclaimed property laws if the property remains unclaimed for five years after expiration of the lease or rental period for the box.

4 Unclaimed property was the fourth largest revenue source for the State of Delaware in 2001. This statistic could change dramatically if there is a change in the existing escheat priority rules. According to a March 2001 report prepared by the Abandoned Property Study Committee (a group established by the Delaware House of Representatives), any change in the escheat priority rules that gives second priority escheat rights to the headquarters state of a corporate holder, rather than to its state of incorporation, would reduce Delaware’s escheat revenues by as much as 90 percent!

5 Section 24 of the 1995 Uniform Act permits the escheat administrator to waive interest "for good cause" and requires the administrator to waive penalties "if the holder acted in good faith and without negligence." The Comment to section 24 makes it clear that "good cause" is a high standard, and notes that "establishment of good cause will be difficult where the holder has failed to file a report." Other states have adopted different waiver standards. For example, the standard for waiver of interest or penalties in Delaware is "reasonable cause" and the absence of "willful neglect," and the standard in Nevada is a failure to report or pay which was not negligent or willful and which "occurred because of circumstances beyond [the holder’s] control."

6 In considering the probable effects of enacting a gift certificate and B2B exemption in late 2000, the Delaware Division of Revenue projected that such exemptions would result in a revenue loss of $15 million in fiscal year 2002, representing approximately 10 percent of fiscal year 2000 escheat revenues.

7 Given the enormous growth in the sale of retail gift cards in recent years, and an estimated 5 percent average rate of nonredemption of card value by gift-card owners, it is almost inevitable that in coming years states will more closely scrutinize service charges that are deducted from unclaimed balances by gift certificate and gift-card issuers.

8 Those 12 states are Arizona, Illinois, Indiana, Iowa, Kansas, Maryland, Massachusetts, North Carolina, Ohio, Tennessee, Virginia, and Wisconsin.