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Interview

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Corporations Must Have Policies and Procedures In Place to Address Unclaimed Property Compliance

Editor's Note: Michael Houghton and Walter C. Tuthill, Morris, Nichols, Arsht & Tunnell LLP, Wilmington, Del., are co-authors with Josiah S. Osibodu, Valerie M. Jundt, and Mark A. Paolillo, Deloitte & Touche LLP, of BNA Corporate Practice Series Portfolio No. 74-2nd, "Unclaimed Property," which was mailed to subscribers last month. The authors recently answered questions from BNA concerning a variety of unclaimed property issues.

BNA: What is unclaimed property? What are some common examples?

Deloitte & Touche LLP: Unclaimed property includes intangible personal property that has gone unclaimed by its rightful owner after a specified period of time. When the owner cannot be located, the property is reportable to the state of the owner's last known address or, if there is no last known address, to the company's state of incorporation.

Unclaimed property laws generally do not include real or tangible property such as land, automobiles, and furniture. It includes those items that can be represented by a "symbol" or reduced to a monetary value such as a savings bond, stock certificate, uncashed payroll check, etc. However, some states claim certain types of tangible personal property, such as contents of safe deposit boxes and safekeeping repositories maintained for valuables.

An example of unclaimed property might include a refundable utility deposit made by a college student where the student has moved away without leaving a forwarding address. The utility company generally is not allowed to "keep" the deposit. If they are unable to find the college student, they are required to report the refundable deposit to the appropriate state. Other common examples of unclaimed property include out-

standing shares of stock (e.g., those resulting from mergers or acquisitions), uncashed checks (e.g., dividend, payroll, accounts payable, refund, rebates), accounts receivable credit balances, insurance proceeds, outstanding customer deposits, and unredeemed gift certificates or cards.

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BNA: At what point is property considered abandoned or unclaimed?

D&T: This varies by state and by the property type. Generally, a three to five year dormancy period is common among the majority of the states. Outstanding payroll checks usually have a shorter period (one year), while traveler's checks have a longer abandonment period (15 years).

BNA: Generally speaking, what jurisdictions have adopted an unclaimed property law, and what are the reporting requirements involved with filing unclaimed property reports?

D&T: Every state, the District of Columbia, Puerto Rico, U.S. Virgin Islands, and Guam have unclaimed property reporting requirements.

Unfortunately, while all of these jurisdictions have passed a law, not all of the laws are "uniform." For example, the reporting due date for filing unclaimed property reports vary from state to state. Approximately forty states have an Oct. 31 or Nov. 1 reporting due date, while others have a reporting due date in the spring, which varies between March 1 and May 31.

Prior to reporting the property, it is recommended (and in many jurisdictions mandated by law) for the holder to perform "due diligence" (i.e., make an additional effort to contact the rightful owners and reunite them with their property). In addition, proper record retention is critical in order for companies to have the information required to properly prepare reports and to present supporting documentation of compliance in the event of an audit.

BNA: What are some of the major features of the Uniform Unclaimed Property Acts (Uniform Acts or Acts)? How have the Uniform Acts changed since first promulgated in 1954? What property is subject to custody under the Acts?

Morris, Nichols, Arsht & Tunnell LLP: The first Uniform Act crafted by the National Conference of Commissioners on Uniform State Laws in 1954 was designed to create "symmetry" in the law for the benefit of businesses which were expanding rapidly beyond the borders of one state. As a result the first versions of the Uniform Acts focused on streamlining reporting requirements and assisting companies in transferring liabilities with a certain degree of uniformity.

Since the 1954 Act, the Uniform Acts have evolved in many respects as a direct response to United States Supreme Court opinions addressing disputes between states over who has the right to certain unclaimed property. The most notable of these cases was *Texas v. New Jersey*, 379 U.S. 674 (1965), in which the court established priority rules principally to facilitate "ease of administration" designed to determine which state may escheat unclaimed property when more than one state claims the property. The court held that priority is

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first given to the state of the last known address of the owner of the property as shown on the holder's books and records. If no last known address can be determined, or if the owner's last known address is within the borders of a state whose laws do not provide for escheat of the property, then the property can be taken into the custody of the state of the holder's domicile, i.e., the state of formation—the so-called “secondary rule.” Prior to the *Texas v. New Jersey* decision, states were claiming abandoned property based on several theories rooted in principals of personal jurisdiction, which led to situations in which multiple states could and did make claims to the same unclaimed property. As a result of the court's decision, the 1981 Uniform Act incorporated the court's priority rules.

In 1993, the Supreme Court decided *Delaware v. New York*, 507 U.S. 490 (1993), in which the court addressed confusion among the states as to the identity of the holder when an obligation, such as the payment of dividends on corporate stock, had been transferred by the original obligor to an intermediary. The court held that intermediaries who hold unclaimed securities distributions in their own name are the relevant holders of property under the secondary rule. As a result, the reporting, payment, and related obligations under the Uniform Act were clarified and conformed to the Supreme Court's holding by the 1995 Uniform Act's modification of the definition of “holder” to focus exclusively on the person actually obligated to hold for the account of, or deliver or pay to the owner property subject to escheat under state law.

The definition of unclaimed property is also constantly evolving, and a review of your particular state law is essential. Generally speaking, unclaimed property not only includes dormant bank accounts, unclaimed security deposits, unclaimed shares of stock or uncashed dividend checks, but may consist of numerous other categories of property including:

- unused gift certificates or gift cards,
- unused rebates and customer credits,
- accounts receivable,
- uncashed vendor checks, and

■ various types of credits reflected on the books and records of a company.

BNA: What are the rules governing priority of state claims?

MNA&T: In general, the first priority goes to the state of “owners” last known address, while the second priority goes to the “holders” state of incorporation when there is no last known address for the property owner. These rules were derived from *Texas v. New Jersey*, 379 U.S. 674 (1965), which was affirmed in 1972 by *Pennsylvania v. New York*, 407 U.S. 206, and again in 1993 by *Delaware v. New York*, 507 U.S. 490. (See § V, *Rules Governing Priority of State Claims*, of the portfolio for further discussion of these rules.)

BNA: Could you please explain the third-priority transactional rule that is included in both the 1981 and 1995 Uniform Acts?

MNA&T: This rule is designed to allow states in which the underlying transaction took place to take possession of unclaimed property in situations where states that would otherwise have claims to that property—based on the address of the owner or state of formation of the holder—do not have escheat laws in place that allow those states to assert those “first” or “second” priority claims.

This so-called “third priority rule” has been recognized as valid in disputes between holders and states by various state courts but has also been deemed preempted by at least one Federal Circuit Court of Appeal pursuant to the priority rules established by the U.S. Supreme Court decision in *Texas v. New Jersey*, 379 U.S. 674 (1965). There are arguments on both sides of the debate, and the topic is discussed in more detail in § V, *Rules Governing Priority of State Claims*, of the portfolio.

BNA: What are some typical audit formats that states utilize? What steps can a company take to demonstrate that it is in compliance with its multistate unclaimed property obligations?

D&T: States utilize a wide variety of audit formats. Until recently, the “single state audit,” conducted by state employees, was the most common. Occasionally, states conduct joint audits. However, many states are now utilizing contract auditors to conduct their unclaimed property audits. The contract auditors are not state employees, and they may be compensated on a contingent fee basis. It is important for companies to

have written policies and procedures to address their compliance with multistate unclaimed property laws and reporting requirements. These policies and procedures, in addition to related internal controls, should be tested periodically to determine if they are functioning as management intends. It is also important for companies to review their books and records, in order to identify outstanding obligations that may be unclaimed property. Finally, companies should report their unclaimed property to the appropriate states and maintain copies of their unclaimed property reports.

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DELOITTE & TOUCHE LLP

BNA: What sort of custodial and enforcement responsibilities do states have once unclaimed property has been transferred to the state? Is there a state duty to find lost owners/heirs?

D&T: With a few exceptions, the majority of states have enacted “custodial” statutes which require the state to honor the owner's claim (or the owner's heirs) to their funds in perpetuity; and it also requires the state to make diligent efforts to locate and reunite the rightful owner with their funds. Many states make additional efforts beyond the statutory requirements, including posting the owners' names on their Web sites, advertising in newspapers, hosting booths at state/county fairs, or publishing names of lost owners at county offices and public libraries. Our experience has been that the majority of states take their duty to find the missing owners very seriously.

BNA: How long should holders of unclaimed property retain records and other documentation on unclaimed property that has been reported to the state?

D&T: Both the 1981 and 1995 Uniform Acts generally prescribe that the holder retain all reports filed and supporting documentation for 10 “re-

porting years.” As this requirement varies from state to state, holders should consult with their legal counsel to determine what requirements apply to their factual situation.

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DELOITTE & TOUCHE LLP

BNA: How can a failure to comply with applicable unclaimed property laws result in a violation of Generally Accepted Accounting Principles (GAAP)?

D&T: If unclaimed property is reclassified or moved from the company’s balance sheet to its income statement (e.g., as an addition to miscellaneous income or as a reduction of an expense) rather than properly reported to the states, there may be a violation of GAAP. Such an adjustment could result in an understatement of the company’s liability and an overstatement of income. Unclaimed property is not an item of income.

It is also important to note that many states have enacted “anti-limitation” statutes, which generally abrogate the defense of the statute of limitations against the state in the unclaimed property arena. Removing the statute of limitations has resulted in unclaimed property audits which routinely go back in time for 15 to 20 years. When penalties and interest are assessed for this time period and are added to the unclaimed property liability, large assessments can occur that maybe material to the company’s financial statement.

BNA: How has the Sarbanes-Oxley Act impacted unclaimed property compliance? What are some of the suggested practices for holder’s to comply with unclaimed property laws as they relate to Sarbanes-Oxley?

D&T: Prior to the enactment of Sarbanes-Oxley, many companies felt the threat of a state unclaimed property audit was insignificant and

any potential unclaimed property liability was often viewed as immaterial.

However, since the Sarbanes-Oxley Act was passed, we have noted more companies proactively addressing unclaimed property compliance. This heightened awareness of compliance with unclaimed property laws is due to certain provisions included in Sarbanes-Oxley which require CEO/CFOs to certify that their company is in compliance with all applicable state laws and have implemented appropriate internal controls.

The impact of Sarbanes-Oxley is discussed in greater detail in § IX, *Compliance and Business Practices*, of the portfolio.

BNA: In the portfolio, you discuss business-to-business (B2B) exemptions. What type of unclaimed property exemption is this?

D&T: The routine exchange of goods and/or services between businesses typically does not give rise to unclaimed property which results in a liability consistent with the classic definition of “unclaimed property liability.”

These “business transactions” have been exempted by the B2B laws in about a dozen states because the state legislatures agreed that these transactions do not necessarily fall within the intent of the statute (e.g., to protect a “lost” owner’s property until located); however, the exemptions are not uniform in their scope of application.

Generally, the laws do not include exemptions for amounts owed to individuals, such as uncashed payroll checks; nor is it meant to apply to “equity-related” property, such as stocks and dividends. Rather, the exemption applies to transaction between businesses involved in ongoing relationships that continue to exchange goods, provide services, and have a “continuous business relationship.” We would advise that companies consult with their legal counsel as to the applicability of the B2B exemption in a particular state.

BNA: What national unclaimed property organizations represent the interests of either the states or the business community?

D&T: Traditionally, the National Association of Unclaimed Property Administrators (NAUPA) has been an active player in this area. NAUPA is comprised of representatives (including administrators, elected officials, auditors, and legal counsel) from the state agency charged with the author-

ity to administer the unclaimed property law.

The governmental agency charged with this responsibility also varies but typically will be the Office of State Treasurer, the Department of Revenue, the Comptroller, Commissioner of State Lands, or the Attorney General’s Office.

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In recent years, the Unclaimed Property Holders Liaison Council, recently renamed the Unclaimed Property Professional Organization (UPPO), has emerged as the leading “holder organization” to address unclaimed property issues. UPPO’s annual meeting provides an opportunity for holders to receive quality continuing education, keep abreast of ever-changing state laws, network with fellow holders, and meet state officials. Their next annual meeting is tentatively planned for San Antonio in the spring of 2007 and more information regarding this organization can be found on their Web site at <http://www.uphlc.org>.

BNA: How can an individual determine if a state is in possession of unclaimed property belonging to the individual?

D&T: Most states have developed an Internet site that can be accessed to determine if a state is in possession of unclaimed property.

In addition, it is possible to access the various states’ Web sites through the NAUPA Web site (<http://www.unclaimed.org>) and follow the instructions for the state contacts. Another Web site available for use by individuals is <http://www.missingmoney.com>. Of course, an individual can always contact the state directly. Names and addresses for all states agencies responsible for escheated unclaimed property are provided in Worksheet 6 of the portfolio.