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Unclaimed Property: What You Need To Know

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Agenda

- The Basics
- Recent Cases, Updates and Developments
- In-House Policies/Procedures
- Controversies: Audits, VDA, Amnesties
- Uniform Law Commission Update
- Key Takeaways/Q&A



The Basics

Unclaimed Property Introduction

- All 50 states and the District of Columbia have enacted unclaimed property laws
- The purpose of unclaimed property laws is custodial – the state holds property until the rightful owner is located. States also use funds earned on such property for the public good.
- Unclaimed property is not a tax
 - However, states actively pursue unclaimed property as an additional source of revenue for the state, which avoids raising taxes
- States' unclaimed property laws apply to all entity types, including:
 - Corporations
 - S Corps
 - Partnerships
 - LLCs

Unclaimed Property Introduction

- Unclaimed property is generally intangible personal property for which there has been no owner activity for a specified period of time
 - “dormancy period” usually 1 – 5 years depending on property type
- Examples of unclaimed property:
 - Uncashed payroll or commission checks
 - Uncashed payable/vendor checks
 - Gift certificates/gift cards
 - Customer merchandise credits, layaways, deposits, refunds or rebates
 - Overpayments/unidentified remittances
 - Suspense accounts
 - Unused/outstanding benefits (non-ERISA)
 - Goods received, not invoiced
 - Miscellaneous income/bad debt expense accounts

Unclaimed Property Introduction

- The Supreme Court of the United States *in Texas v. New Jersey*, established the following unclaimed property priority rules:
 - First, the state of the rightful owner's last known address, if known, may claim the property; or
 - Second, the state of the holder's incorporation may claim the property, if there is no last known address
- Priority rules in *Texas v. New Jersey* were upheld in the subsequent cases *Pennsylvania v. New York* and *Delaware v. New York*

Unclaimed Property Audits & Extrapolations

- States commonly use contract auditors.
- Many states, including Delaware, use extrapolation to establish past liability, at previously back to 1981, in the event of unavailable and/or incomplete records
- The determination of whether or not to extrapolate may depend on factors such as:
 - Historical unclaimed property reporting practices
 - Filing history
 - Materiality of errors found for periods where records were reviewed
 - Record availability and reliability by property type



Recent Cases, Updates & Developments

Unclaimed Property Litigation

- In *Temple-Inland, Inc. v. Cook*, 1:14-cv-00654 (D. Del., filed May 21, 2014), the U.S. District Court for the District of Delaware declared some of the Delaware Department of Finance's controversial unclaimed property enforcement practices to be unconstitutional executive action that "shocks the conscience."
- In 2014, the Delaware State Escheator assessed Temple-Inland Inc. approximately \$1.4 million of unclaimed property liability for the audit period extending back to 1981.
 - The assessment included \$147.30 of actual unclaimed payroll items owed to payees with last known addresses in Delaware.
 - The rest of the assessment was a statistical estimate of Temple-Inland's unclaimed property liability for the period of 1981-2002 for which the company lacked records of its unclaimed property items.

Unclaimed Property Litigation

- The court held that the following actions by Delaware, taken together, violated Temple-Inland's Due Process rights:
 - (i) waited 22 years to audit;
 - (ii) exploited loopholes in the statute of limitations;
 - (iii) never properly notified holders regarding the need to maintain unclaimed property records longer than is standard;
 - (iv) failed to articulate any legitimate state interest in retroactively applying Section 1155 except to raise revenue;
 - (v) employed a method of estimation where characteristics that favored liability were replicated across the whole, but characteristics that reduced liability were ignored; and
 - (viii) subjected plaintiff to multiple liability.

Unclaimed Property Litigation

- The court denied Temple-Inland's Takings claim as not ripe for summary judgement.
- The court denied Temple-Inland's Ex Post Facto Law claim
- The court had set a statu date for September 9, 2016.
- On August 5, 2016, the parties asked the court to dismiss all claims with prejudice because the parties had settled.
 - The court's decision on Due Process stands.
 - Delaware is reportedly conducting a review and revision of its enforcement practices.
 - What those changes will be is unclear, but evidence points to a further reduction of the lookback period.
- Depending on the circumstances, refund may be pursued under DE's six year statute of limitations.

Unclaimed Property Litigation

- In *Plains All American Pipeline, L.P. v. Cook*, No. 1:15-cv-00468 (D. Del., filed June 5, 2015), Plains filed a pre-emptive suit in the DE District Court, seeking, in part, an injunction against continuation of a Kelmar audit.
- District Court held that the company lacked standing to sue Kelmar and that most of Plain's constitutional claims were not yet ripe.
 - Before bringing a judicial challenge to Delaware's unclaimed property enforcement practices, a company must either:
 - complete the audit, and potentially exhaust available administrative remedies, or
 - force the state to engage in a formal enforcement action, such as issuing a subpoena.
- Department of Finance's authority to enforce a subpoena is currently being litigated in Delaware's Chancery Court. See *Department of Finance v. Blackhawk Engagement Solutions (DE), Inc.*, No. 11737-CB (Del. Ch., filed Nov. 20, 2015)

Unclaimed Property Litigation

- In *Marathon Petroleum v. Cook*, C.A. No. 16-80-LPS (D. Del. Sept. 23, 2016), after a 9 year audit of two DE incorporated entities, state requested extensive information on two OH gift card companies.
- Companies argued the priority rules preempted DE's audit of the OH companies.
- Judge heavily criticized Delaware's unclaimed property audit practices
- However, the judge refused to apply the priority rules as a defense to the audit.
 - Followed the *Temple-Inland* court limiting priority rules to state disputes
 - Use fraud allegations to distinguish *N.J. Retail Merchs. Ass'n v. Sidamon-Eristoff*, 669 F.3d 374 (3d Cir. 2012)
- Court also found no 4th Amendment search and seizure violation because the state had not yet employed any enforcement measures and the company could ignore the requests.

Unclaimed Property

- Many states have enacted laws favorable to stored value cards and gift certificates.
 - Treatment of items such as stored value cards as unclaimed property is often tied to the state's consumer protection law
 - Consumer protection laws often provide disclosure requirements, and prohibit or limit expiration dates and service fees
 - When the consumer protection criteria are met, the unclaimed property laws may not apply

Unclaimed Property Litigation

- *State of Delaware ex rel. French v. Card Compliant LLC, et al.*, C.A. No.: N13C-06-289 FSS [CCLD] (Del Sup. Ct. Nov. 23, 2015).
 - Qui tam whistleblower case brought under Delaware’s False Claims Act
 - Whistleblower was the former controller and vice president of CardFact Ltd., a card services company that entered into contracts with Delaware companies to issue and manage gift cards
 - Complaint alleges the arrangements were schemes designed to defraud the state of unclaimed property properly due from Delaware companies
 - Arguing the arrangements lack substance and allow the companies to retain possession, custody, and control of the value of unredeemed gift cards.

Unclaimed Property Litigation

- *State of Delaware ex rel. French v. Card Compliant LLC, et al.*, C.A. No.: N13C-06-289 FSS [CCLD] (Del Sup. Ct. Nov. 23, 2015).
 - The court generally denied the Defendants’ motion to dismiss, but made some key findings:
 - Dismissed a defendant that had been previously audited by Kelmar, even for post-audit liabilities
 - The second priority rule applied based on the state of formation, not the principal place of business.
 - Lack of consent by owner a key fact in validity of delegation
 - In light of impending loss of revenue due to *Temple-Inland*, more such challenges to gift card structures may be anticipated.
- In *Delaware v. Pennsylvania*, No. 22O145 ORG (U.S., filed May 31, 2016), and two other cases, nearly half of U.S. states have alleged Delaware circumvented federal law in escheating \$400 million in checks.

Multi-State Updates

- B2B exemptions: Missouri, Nevada (partial)
- Other Missouri unclaimed property reforms (AHC appeals, statute of limitations)
- Michigan unclaimed property legislation impacting audits
- NJ repeals data collection requirement for gift cards
- Raising revenue through unclaimed property:
Pennsylvania lowers dormancy periods, other changes as part of budget (2014 H. 278)

Business-to-Business Exemption Enactments: MO

- Missouri H.B. 1075, enacted July 9, 2014
 - Blanket exemption for “Business credits between two business entities or two business associations”
 - Any credit offered by one business entity to another business entity to be applied in exchange for goods or services but does not have a redeemable cash value
 - Further, “any outstanding check, draft, credit balance, customer's overpayment, or unidentified remittance issued to a business entity or association as part of a commercial transaction in the ordinary course of a holder's business shall not be presumed abandoned **if the holder and such business entity or association have an ongoing business relationship.**”
 - Effective 90 days after adjournment of Legislature (approx. Aug. 28, 2014)

Business-to-Business Exemption Enactments: NV

- Nevada S.B. 348, enacted June 9, 2015
 - Any credit memoranda, overpayments, credit balances, deposits, unidentified remittances, nonrefunded overcharges, discounts, refunds and rebates due or owing from a holder that is a business association to another business association shall not be presumed abandoned **if the holder and such business association have an ongoing business relationship**. The provisions of this subsection do not apply to outstanding checks, drafts or other similar instruments
 - An ongoing business relationship shall be deemed to exist if the holder has engaged in at least one commercial, business or professional transaction involving the sale, lease, license or purchase of goods or services with the business association or a predecessor-in-interest of the business association within each 3-year period that follows the date of the transaction giving rise to the obligation
 - Effective July 1, 2015

Statute of Limitations & Independent Hearings Reform: MO

- Missouri H.B. 1075, enacted July 9, 2014
 - The state treasurer shall not enforce this chapter for a reportable period more than three years after the holder: (1) filed a report with the state treasurer; or (2) gave express notice to the state treasurer of a dispute under this chapter. If a fraudulent report is filed with the intent to evade escheatment of property, the state treasurer may enforce this chapter within six years after the report was filed. If no report is filed, the state treasurer may enforce this chapter at any time
 - Effective 90 days after adjournment of Legislature (approx. Aug. 28, 2014)

Streamlined Audit Process: MI

- Michigan S.B. 538, enacted December 22, 2015
 - Provides an “eligible holder” under examination by the State Treasurer may elect to follow a streamlined audit process
 - Requires a streamlined audit to be completed within a time frame developed by the holder and the Treasurer, with the goal of completing the audit within 18 months after receipt of the audit notice
 - Provides that the Treasurer may not begin an action or proceeding more than four years after any duty of an eligible holder under the Act arose
 - Specifies that examinations of eligible holders may not include checks voided within 180 days of their issuance
 - Provides that property worth \$25 or less would not be subject to the custody of the State as unclaimed property, with exceptions
 - Applies to audits in progress as of Aug. 15, 2015

Gift Card Consumer Data Collection: NJ

- New Jersey S.B. 2235, enacted Feb. 5, 2015
 - **Eliminates consumer data collection requirements for retailers issuing stored value cards**
 - **In *NJRMA v. Sidamon-Eristoff*, the Third Circuit Court of Appeals rejected the “third priority rule,” but declined to strike New Jersey’s data collection requirement**
 - S. 1928 eliminated the “place-of-purchase presumption” invalidated by the Third Circuit but retained the data collection requirement, with a delayed effective date of July 1, 2016
 - S.B. 2235 eliminates the requirement well in advance of its delayed effective date

Closing Budget Gaps with Unclaimed Property: PA

- Pennsylvania H.B. 278, enacted July 10, 2014
 - **Dormancy periods for property formerly five years were generally reduced to three years**
 - The “State Treasurer may contract with any other person to conduct the examination on behalf of the State Treasurer, the selection of whom shall not be questioned.”
 - Allows sharing of documents and working papers with other states
 - Provides for assessment of the cost of the audit, penalties, criminal(!) sanctions
 - Enacted as part of 2014 budget “solution”



In-house Policies/ Procedures

In-house Policies and Procedures Best Practices

- Determine Potential UP Exposure
 - Identify Property Types to be reviewed
 - Look at each line of business-Property types may cross lines of business
 - Delegate a responsible person in each department that owns a property type
- Proactively Resolve Outstanding Liabilities Early
 - The earlier the better – departments should follow up while the trail is fresh
 - Outreach letters or calls within 90-180 days
 - Less formal than the statutorily required due diligence
 - Make sure to keep good records of communication (standardized)
 - Have all departmental activities monitored/validated by Tax
- Develop a Corporate Philosophy Regarding Due Diligence
 - Develop comprehensive policies and procedures
 - Form a committee responsible for compliance and follow-up (Legal, Accounting, Payroll, Tax, Treasury, AR/AP, Internal audit, etc.)

In-house Policies and Procedures Best Practices

- Set the tone at the top
 - Have a policy signed by a high-level officer
 - Disseminate policy to all subsidiaries and accounting/payment centers/departments
- Reconcile Accounts (Bank/GL) to Prevent Overpayments
 - Duplicate Payments
 - Accounting Errors
 - Exemptions
- Encourage Continuous Learning and Review
 - Offer educational programs to all personnel responsible for unclaimed property compliance
 - Conduct internal audits of unclaimed property processes and procedures

In-house Policies and Procedures

Best Practices

- Identify and monitor Third Party Administrators
 - Know what TPAs/Outsourcers are doing; conduct periodic review of their unclaimed property compliance activities
 - Review service contracts with legal
 - In most cases, escheat liability cannot be transferred to TPA's (holder is ultimately responsible)
 - If TPA is reporting on holder's behalf, make sure TPA is complying with unclaimed property obligations
- M&A Considerations
 - States and contract auditors are increasingly reviewing significant M&A transactions
 - In a stock transaction, the acquiring entity is generally liable for all unclaimed property liabilities associated with the acquired entity that arose pre-closing
 - M&A unclaimed property due diligence - before the transaction is completed - understand unclaimed property compliance history or lack of compliance history of the target

In-house Policies and Procedures

- Goal – Eliminate/document resolution of unclaimed property at the source
- Working with other teams/departments
 - AR-Resolve with customers
 - PR-Resolve with employees
 - AP-Resolve with vendors
 - Regular communication and controls (reconciliations and Tax)
- Compliance-owned by Tax, but involving others
 - Tracking
 - Exemptions
 - Due Diligence
 - Reporting/Remittance



Controversy: Audits, VDA's and Amnesties

Controversies: Audits

- Audit Triggers
 - Size of the company
 - State of incorporation
 - Principal place of business
 - Publicity about a company or industry
 - Industry
 - Merger or acquisition activity
 - Errors or omissions in Annual Reports or VDA's
- Types of Audits/Notifications
 - Third Party Contingency Audits (Multi-State)
 - Direct State Audits
 - Receive letter by "mandate" state
 - May receive telephone call/letter from state representative

Controversies: Audits

- Establish an audit team
 - Select one point of contact to represent the company
 - Select representatives for each property type under audit (Payroll, Accounts Payable, Accounts Receivable, Royalties, etc.)
 - Consider hiring consultants and attorneys with audit defense experience
- Execute Non-Disclosure/Confidentiality Agreement
 - Will help limit auditor soliciting additional states to participate
 - Include any provisions based on holder's business needs
- Communication is key
 - Communicate with the project team, the auditor, and the state
 - Be sure to obtain copies of state authorizations for the audit

Controversies: Audits

- Determine level of historic compliance
 - Which states and which property types
- Consider internal control process
- Identify risk areas through internal review
- Develop internal assessment of potential liability
 - Research and document business positions
- Assess which records are available per company's record retention policy

Controversies: VDA/Amnesty

- Most states have some form of voluntary disclosure agreement (VDA) program in place or periodically make available amnesty programs,
- VDA's/amnesties will often include a limited look-back period, which may be a way to alleviate the statute of limitations issue for older unclaimed property.
- When entering a VDA with a holder, a state may agree to waive penalties and interest.
- The state may also agree to indemnify the holder against certain claims involving the unclaimed property delivered to the state.
- Delaware Voluntary Disclosure Agreements
 - All property types (AP, PR, AR)
 - Limited scope of review
 - Brings company into compliance
 - Limited reach-back



Uniform Law Commission Update

Uniform Law Commission (ULC) Uniform Unclaimed Property Act

- Committee drafted revisions to Uniform Unclaimed Property Act (UUPA) in 2016
- Existing versions of UUPA:
 - 1954 – adopted by only a few states
 - 1966 – 13 states
 - 1981 – most widely adopted – 33 states
 - 1995 – 14 states
 - CA, DE, NY, PA + others have not adopted any version of UUPA

ULC UUPA Highlights

- Contingent fee auditors still allowed
- 5 year SOL (10 if no report filed)
- No B-to-B or and de minimis exceptions
- Life insurance and securities issues addressed
- Continues to apply third “transactional” priority rule
- Property owed to foreign parties can be claimed by state of incorporation