

Keeping you up-to-date on state and local tax matters.



Unclaimed Property

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Unclaimed property receipts are generally deposited into a state's general fund until they are returned to their rightful owner, and any income earned on the invested funds is kept by the state. With the downturn in the economy and the states' desire to fulfill their cash needs and close their budget deficits, we suspect that states will aggressively start pursuing unclaimed property as a source of "revenue."

New York, for example, is issuing inquiry letters to businesses that it *suspects* are not in compliance with its unclaimed property laws. The "inquiry letter" begins with "*A recent review of our records indicates that your company may not be in compliance with the filing requirements of New York State's Abandoned Property Law.*" Attached to the letter are an abandoned property questionnaire and a self-audit checklist that is expected to be returned. Other states are issuing similar inquiries.

A rise of unclaimed property audits (either directly by state auditors or outsourced to contract audit firms) is sure to occur. An increase in audit activity is likely to happen due to the continuing lack of businesses' compliance with laws regarding unclaimed property. In Connecticut, as well as in many other states, the states' fiscal situation has only compounded the issue. Upon audit, if you are found to not be in compliance, your business could be subject to the imposition of significant interest and penalties (as well as the requirement to turn over escheatable property to the state), an unexpected hit to your cash needs.

History Lesson:

Escheat laws date back to colonial America and ostensibly exist to protect unclaimed property and help return it to its rightful owner. These laws have developed over time in the United States and, although states have adopted model legislation, significant differences in escheatable property, dormancy periods, reporting, due dates and administration exist among the states.

Nexus and Priority Rules

Businesses often believe that because they don't have "nexus" in a state (i.e., they don't have a presence and/or are not "doing business" within a state) they are not subject to escheat jurisdiction. However, the concepts of nexus and "doing business" do not apply in unclaimed property law. The state to which property must be reported is based on U.S. Supreme Court-established priority rules of jurisdiction, not on whether a business has nexus within a state (the seminal case on unclaimed property is *Texas v. New Jersey*, SCt, 379 U.S. 674 (1965)). Generally, under the priority rules unclaimed property must be reported under the following priorities:

1. *First Priority*: Report to the state of last known address of the payee/owner (or the entitled party) as reflected on the books and records of the holder.
2. *Second Priority*: If the address is unknown or if that address is in a state that does not provide for escheat of the type of property in question, the property is subject to escheat by the state of legal

domicile of the business. While states vary in their definition of “legal domicile” for unincorporated entities, the domicile for an incorporated entity is the state of incorporation (not necessarily the state of “commercial domicile”). For example, if a corporation is based in Connecticut but is *incorporated* in Delaware, Delaware (not Connecticut) receives the unclaimed property under this priority rule.

3. *Third Priority*: Some states have instituted a third priority whereby property is escheated to the state where the transaction giving rise to the property occurred.

Therefore, even if your business has no presence in a particular state, it will nevertheless be subject to the state’s unclaimed property tax laws. Furthermore, ascertaining the state to which unclaimed property is reported and remitted must be in accordance with the state’s priority rules.

Unclaimed Property Defined

Unclaimed property is any financial asset for which there has not been owner-generated activity for a set period of time (“dormancy period”). Unclaimed property generally includes cash, safe deposit box contents, tangible property and *intangible property*.

Examples of intangible property include uncashed payroll checks, vendor checks, benefit checks, royalty payments and dividend checks; unclaimed security deposits, insurance benefits, bonds, stocks and mutual funds. Other types of intangible property include customer overpayments, vendor and consumer credit balances, unrefunded overcharges, discounts due and unredeemed gift cards/certificates (in certain states). This listing is not exhaustive; there are many more types of unclaimed property.

Dormancy Period: The dormancy period depends on the type of property and governs when property must be escheated (remitted) to the state. A dormancy period may be as short as one year (i.e., for uncashed payroll and commission checks) or as long as fifteen years. To accelerate unclaimed property into the state, the recent trend is to reduce the holding periods to three or fewer years from the typical five- or seven-year periods. Once the stipulated dormancy period for a particular property type has been exceeded, the holder (you, the business) of such property is required to escheat the property (e.g., cash) to the appropriate state based on the above priority rules (i.e. owner’s last known address).



Requirements for Holders of Unclaimed Property

Notify Owners: States generally require that the holder of unclaimed property issue “due diligence letters” to owners prior to a presumption that property is abandoned. For example, Connecticut unclaimed property law requires that within 180 days before a presumption of abandonment is to take effect for wages, salary or other compensation, and within 1 year before a presumption of abandonment is to take effect for all other property, the holder must notify the owner by mail. Once the due diligence letters have been sent without response, and the dormancy period has expired, the holder is then required to remit the unclaimed property to the appropriate state.

Filing Requirements: Holders of unclaimed property (held after the dormancy period) *belonging to Connecticut residents* (i.e., last known address is in Connecticut) are required on an ANNUAL basis to report and transfer such property to the Connecticut State Treasurer. **All business entities, for profit and non-profit, are required to file a Connecticut unclaimed property report by March 31 for the prior calendar year.** Holders (e.g., Connecticut businesses) of unclaimed property belonging to Connecticut nonresidents (i.e., last known address is outside Connecticut) must also report and transfer such property to the appropriate states (which have various definitions of escheatable property, dormancy periods, report filings and due dates). As there are generally no exempt minimum dollar amounts, all amounts are to be reported.

Voluntary Compliance and Audits

Several years ago, in an effort to induce compliance, states participated in the National Association of Unclaimed Property Administrators Voluntary Compliance Program. Nevertheless, voluntary compliance was

and continues to be virtually ignored by holders of unclaimed property. Consequently, as a result of continued widespread noncompliance by businesses, and the states' fiscal crisis, states are increasing their vigilance regarding escheat law compliance.

Generally, there is no statute of limitations for holders of unclaimed property who have never reported in the past. However, as a practical rule, an unclaimed property audit will generally "look back" 10 years (some states are now going back 15 to 20 years). If records are unavailable for the entire audit period, an assessment may be extrapolated for missing years using available records. In addition to the assessment, interest and penalties are typically imposed for each year of noncompliance.

Businesses should make every effort to become compliant with unclaimed property laws. Most constructive would be a concerted effort to "clean up" the books, i.e., to reconcile unreconciled accounts as much as possible rather than ignoring them or writing them off. Given the focus that is being placed on unclaimed property, there is a good chance that your business will eventually be audited by Connecticut (or some other state). To become compliant and mitigate liability, businesses should seek out state-offered amnesty programs or opportunities to enter into a voluntarily compliance "agreement(s)" which may allow businesses the ability to negotiate "look-back" periods and methodologies to identify and quantify unclaimed property. We suggest that the initial contact with a state be on an anonymous basis utilizing an outside advisor.

With Respect to Connecticut

Detailed information regarding Connecticut's unclaimed property and filing requirements can be obtained from the Office of the Treasurer's Unclaimed Property Division website www.state.ct.us/ott/. To reiterate, **unclaimed property for calendar year 2009 must be reported and transferred to Connecticut by March 31, 2010** (an extension, if requested in a timely manner, may be allowed). Furthermore, if your company is incorporated (i.e., legal domicile) in Connecticut, you must file every year even if the company has no property to report (i.e., "Negative Report"). Connecticut now requires that all holders file the Report of Unclaimed Property (Form ST-77) electronically (e.g., CD-ROMs are accepted).

Action Steps:

What should you do if you suspect that your business is not in compliance with state unclaimed property laws? Following is a suggested path to take:

- Determine if you have any "unclaimed property" and the types of unclaimed property.
- Identify the owners of such unclaimed property and their state of last known address.
- Determine the appropriate dormancy period (by state) for each type of unclaimed property.
- Determine whether the dormancy period for unclaimed property which you hold has been exceeded.
- Mail "due diligence letters" to all owners of unclaimed property *before* the dormancy period expires (and/or undertake other identification efforts). Even if the dormancy period has expired, we suggest that you perform procedures to identify the rightful owners of the unclaimed property. Give owners plenty of time (at least a month or two) to comply with your inquiry before you are required to transfer property to the applicable state.
- Consider Amnesty or Voluntary Compliance Programs offered by states to mitigate liability for unreported back years.
- File applicable Holder Reports and remit unclaimed property to appropriate state(s) based on the priority rules.
- Implement internal controls to remain in compliance.
- Consider accounting issues and Sarbanes-Oxley implications related to unclaimed property.
- Determine if your business has any unclaimed property *to claim* (i.e., whereby you're the owner as opposed to the holder).

Unclaimed property laws are not consistent among the states (and District of Columbia). You need to check each state's definition of "unclaimed property," the due diligence procedures, dormancy periods, unique priority rules and reporting due dates. You may wish to visit the following website that has links to all of the states' unclaimed property divisions' websites where you can find specific information for each state:
www.unclaimed.org

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We recognize the inherent complexities and practicalities in becoming compliant with the escheat laws. If we can help you, please do not hesitate to contact us:

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