Overview of Unclaimed Property

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Overview of Abandoned and Unclaimed Property

What Is Unclaimed Property?

- Property that has not been claimed by an “Owner” (creditor) for a specified period of time (dormancy period) is considered abandoned or unclaimed.

- After statutorily defined holding periods, the “Holder” (debtor) of the property has an obligation to file annual reports and remit the property to the appropriate state(s).

- Generally, must be a fixed and certain legal obligation of the Holder to the Owner.

- Unclaimed property is not a tax to the Holders, but is often a source of revenue to states.

- In excess of 100 types of property are considered potential sources of unclaimed property.

- Some states have become increasingly aggressive in asserting unclaimed property as a source of non-tax revenue – affecting “business friendly” ratings. (Common confusion with “Escheat”)
Additional Common Terms

• **Property** - tangible personal property held in a safe deposit box or a fixed and certain interest in intangible property held, issued or owed in the ordinary course of the holder’s business and all income therefrom.

• **Apparent Owner** – person whose name appears on Holder’s books and records as the one entitled to Property.

• **Dormancy Period** - period of time that must pass from the issue date or creation of Property before Property is presumed unclaimed or abandoned.

• **Due Diligence** – requirement imposed on Holders to attempt to contact Apparent Owners and return Property before remittance to the state.

• **Notice** – required notice that Holders must give Apparent Owners as part of the required Due Diligence.

• **Aggregate Amount** – value of Property that triggers the Holder’s Due Diligence and detailed reporting requirements.

Common Reportable Property

• Varies By State

• Some common reportable intangible property
  – Unpaid (voided/outstanding) checks, drafts, deposits, interest or dividends
  – Credit balances (note TX exemption), overpayments, gift certificates (note Texas exemption), security deposits, refunds, credit memos, unused tickets
  – Unpaid wages and benefits, including self-funded workers comp and certain distributions from trusts or other custodial funds (health, welfare, pension, vacation, severance, death, stock purchase, retirement, etc)
  – Mineral interest proceeds (reporting rules vary – Texas is “current pay” state)
  – Stock or other evidence of ownership of an interest in a business, bonds, debentures, notes, exchange accounts to redeem securities or pay litigation awards
  – Proceeds from annuity or insurance policies (life, property, casualty, worker’s compensation, health or disability)
Model Laws – Reference for legislatures

  - NCCUSL goal: to promote fair and adequate treatment among the states and provide uniform laws for the benefit of multistate businesses.
  - 1981 Act adopted (with revisions) in 24 jurisdictions: AK, CO, DC, FL, GA, ID, IL, IA, MD, MN, NH, NJ, ND, OK, OR, RI, SC, SD, TN, UT, VA, WA, WS, and WY.
  - Some version of the Uniform Act is followed by all but six states (Delaware, Kentucky, Massachusetts, New York, Ohio and Texas). Notable highly-revised, non-uniform law also in California.

Key Elements Of Uniform Acts

- States take custody of property, not title.
- Uniform priority rules for determining custodial state.
- Uniform presumptions of abandonment.
- Require at least minimal effort to locate owner.
- Annual reporting and remittance.
- Specify record retention rules (generally to tie to audit period).
- Interest and penalties for noncompliance.
Purpose Of Unclaimed Property Laws

• To reunite lost owners with their property.
• To protect the Holder from subsequent claims by owners.
• To ensure that any economic windfall benefits the state and its citizens, not Holders.

Texas: Governing Laws

• Texas Property Code Title 6, Chapters 72 – 75 govern unclaimed property reporting in Texas.
• Texas Insurance Code Title 7, Chapter 1109 governs unclaimed life insurance and annuity contract proceeds.
• Ranking by Business Community – “middle of the pack” in recent survey.
Jurisdiction and Priority Claim Rules

Jurisdictional Issues and Priority Rules

• In *Texas v. New Jersey* (1965), the Supreme Court established a two-pronged approach for determining priority among states:

• **First Priority:** State of the Owner’s last known address as shown on the Holder’s books and records may escheat the unclaimed property, and its claim is superior to all competing claims.

• **Second Priority:** If no last known address for the Owner is indicated on the Holder’s books and records, or if the state of the Owner’s last known address does not have applicable unclaimed property legislation, then the Holder’s state of incorporation (corporate domicile) may escheat the unclaimed property.
What Is A “Last Known Address”

• “A description of the location of the Apparent Owner sufficient for the purpose of delivering mail.”
  – Generally, the Owner’s mailing address, but states are currently addressing policy/rules on electronic contracts, signatures, and other communications (which may create disputed claims and added costs to businesses without uniformity).
• Address contained in the Holder’s books and records controls; generally not required to verify accuracy.
  – Recent state legislation in some states may require the Holder to verify accuracy to receive protection from future indemnity claims.

Nexus?

• Unclaimed property is not a tax. It derives from property rights; history in English common law, now codified in every state.
• Physical presence not required for the state to have priority claim.
• May have duty to remit to a state where the Holder has not conducted business (based on Owner’s last known address).
Texas
Unclaimed Property Overview

Unclaimed Property Defined

• § 72.101 Personal property presumed abandoned
  — (a) Except as provided by this section and sections 72.1015, 72.1016, and 72.102, personal property is presumed abandoned if, for longer than three years:
    • (1) the existence and location of the owner of the property is unknown to the holder of the property; and
    • (2) according to the knowledge and records of the holder of the property, a claim to the property has not been asserted or an act of ownership of the property has not been exercised. Tex. Prop. Code Ann. § 72.101 (West)
Texas Dormancy Periods

- MS08 - Accounts Payable (A/P) Checks - 3 years
- CK13 - Vendor Checks - 3 years
- MS01 - Payroll Wages and Salaries - 1 year
- MS09 - Accounts Receivable Credit Balances - 3 years
- MS11 - Refunds and Rebates - 3 years
- MS16 - Misc. Outstanding Checks - 3 years

- SC01 – Dividends - 3 years
- SC02 - Interest (Bond Coupons) - 3 years
- SC08 – Shares of Stock (Returned by the Post Office) - 3 years
- SC09 – Cash for Fractional Shares - 3 years

- MI01 – Net Revenue Interest - 3 years
- MI02 – Royalties - 3 years
- MI04 – Production Payments - 3 years
- MI06 – Bonuses - 3 years
- MI07 – Delay Rentals - 3 years

*This list is not comprehensive – see Texas Unclaimed Property Reporting Instructions (March 2015), 35-36

Due Diligence

- Holders who on March 1 hold presumed abandoned property valued at more than $250 shall mail a notice on or before the following May 1 to the last known address of the known owner. Tex. Prop. Code Ann. § 74.1011 (West)

- Mutual fund owners may designate a representative, by providing the name and mailing or e-mailing address, for notice to preclude abandonment of the property. H.B. 1454 (effective September 1, 2017)
Holder Reporting

• Reports and payments are due on or before July 1 of every year for holders who on March 1 hold property presumed abandoned. Tex. Prop. Code Ann. § 74.301 (West); Tex. Prop. Code Ann. § 74.101 (West)
• The cut-off date for reviewing your records is March 1 of every year. Texas Unclaimed Property Reporting Instructions (March 2015), 21
• Local telephone exchange companies may deliver reported money to a scholarship fund for rural students as an alternative to delivering the reported money to the comptroller. Tex. Prop. Code Ann. § 74.3011 (West)
• Similarly, local exchange companies may deliver reported money to a scholarship fund for urban students instead of delivering the reported money to the comptroller. Tex. Prop. Code Ann. § 74.3012 (West)

Interest & Penalties

• Texas imposes an interest payment against holders at an annual rate of 10% from the date holder should have paid or delivered the property until the date holder pays or delivers the property. Tex. Prop. Code Ann. § 74.705 (West)
• Failure to timely pay or deliver property results in a penalty of 5% of the value of the property due. An additional 5% penalty is imposed for failure to pay or deliver the property “before the 31st day after the date the property is due.” Tex. Prop. Code Ann. § 74.706 (a) (West)
• Willful failure to file, pay or permit an examination of records is a Class B misdemeanor. Tex. Prop. Code Ann. § 74.710 (West)
• The comptroller may waive interest or penalty if the comptroller determines the holder made a good faith effort to comply with the unclaimed property laws (Chapters 72-75). Tex. Prop. Code Ann. § 74.707 (a) (West)
Record Retention

- Holders are required to retain records of unclaimed property for 10 years from the date on which the property is reportable, including property reported in the aggregate. Tex. Prop. Code Ann. § 74.103 (b) (West)
- The comptroller, attorney general or an agent may examine the books and records of a holder “at any reasonable time.” Tex. Prop. Code Ann. § 74.702 (a) (West)
- Records should contain: (1) the abandoned property owner’s name, social security number, and last known address, if known; (2) a brief description of the property; and (3) the balance of each account, where appropriate (effective until September 1, 2017). Effective September 1, 2017, records shall include the name and last known address (mailing or e-mail) of any representative designated to receive notice. Tex. Prop. Code Ann. § 74.103 (a) (West)

Exemptions
Business To Business Exemption Overview

- Some states exempt business to business (B2B) transactions from being reportable as unclaimed property.
  - Rationale: businesses are in the best position to determine if they hold the property of other businesses. Businesses are sophisticated parties that can reconcile and settle accounts without the state’s help.

- These states either exclude B2B transactions from reporting requirements or do not classify the transactions as unclaimed property.

- Exempting B2B transactions is good policy for businesses and provides protection for holders.

Texas Business-to-Business Deferral/Exemption

- Texas has no express B2B exemption in the statutes, but the policy derives from “lost contact” with owner.

- Under § 72.101(a), property is only presumed abandoned if “the existence and location of the owner of the property is unknown to the holder of the property.”

- SO – if there is an ongoing relationship and ongoing account activity between Holder and Owner, the property is not reportable.
Texas-Style “B2B” Exemption (cont.)

• Texas Comptroller Reporting Instructions Manual confirms this:
  – Credit Balances: “Balances owed to current customers should not be reported.” (p. 7)
  – Uncashed Checks to Vendors: “Balances owed to current vendors should not be reported.” (p. 7)
  – But such balances should be reported if there has been no affirmative contact from the owner for three years. (p. 7)
  – Holder must have documentation of owner-generated activity, e.g., activity in the account, email, letter or documented phone call. (p. 7; Tex. Admin. Code, Title 34, § 13.3)

Texas-Style “B2B” Exemption (cont.)

• **Note:** The nonreturn of a statement, confirmation or other correspondence sent by Holder to Owner does not establish knowledge of “the existence and location” of Owner. (p. 7; Tex. Admin. Code, Title 34, § 13.3)
• Note also that in fact, this “exemption” applies to customers and vendors who are individuals, as well as those who are businesses.
Gift Card Exemption Overview

- Gift certificates, gift cards, stored value cards and related products raise many unclaimed property issues.
- Unless an exemption applies, unused balances must be remitted.
  - Most states have a three-year or five-year dormancy period.
  - Several states exempt gift cards as long as appropriate disclosure of terms and NO EXPIRATION DATE; otherwise, consumers may lose ability to redeem gift cards after three or five years and be required to submit claims to the state of incorporation of Issuer of the gift card to prove right to a refund, which may be limited.

Texas Overview on Gift Card Exemption

- In 2005, the Texas Legislature, in an effort to protect consumers’ rights in the value placed on stored value cards, changed the criteria in which such property would be considered unclaimed property. See S.B. 446, Act of May 17, 2005, 79th Leg., R.S., ch. 81.
- Under the “general rule,” Texas requires reporting of abandoned stored value cards, to the extent of the value unredeemed and uncharged, if the card is presumed abandoned and the existence and location of the owner is unknown to the holder. Tex. Prop. Code Ann. §72.1016 (West)
- A “stored value card” is defined as a record that (1) evidences a promise made for monetary consideration; (2) is prefunded; and (3) the value is reduced on redemption. This definition includes gift cards and gift certificates. Tex. Bus. & Com. Code Ann. §604.001 (West)

Exception generally swallows “general rule”:
- S.B. 446 (session law) is described in Texas Audit Manual – Unclaimed Property: “From an audit perspective the bill’s wording is confusing…. In all cases the following guidelines should be used: A stored value card is not reportable as unclaimed property if the stored value card has no expiration date AND no fees are assessed, other than those permitted under Section 35.42(d) ….” (underlining in original)
Texas: Mineral Proceeds

Abandoned Mineral Proceeds

• Under Texas Property Code Annotated § 75.101(a), mineral proceeds unclaimed by the owner longer than three years after the proceeds became payable or distributable are property presumed abandoned.

• Mineral proceeds include:
  – “(A) all obligations to pay resulting from the production and sale of minerals, including net revenue interests, royalties, overriding royalties, production payments, and joint operating agreements; and
  – (B) all obligations for the acquisition and retention of a mineral lease, including bonuses, delay rentals, shut-in royalties, and minimum royalties.” Tex. Prop. Code Ann. § 75.001 (a)(2) (West)

• Holder shall preserve the abandoned property. Tex. Prop. Code Ann. § 75.102 (West)
Reporting Mineral Proceeds

• Due diligence letters should be mailed to owners whose property is valued at more than $250. Diligence letters are not required after the owner name has been reported to the state for the first time. Texas Unclaimed Property Reporting Instructions (March 2015), 19

• Texas is a “current pay” state, meaning the first time a holder reports a missing owner, holder must remit the total net amount being held for the owner as of the date of remittance, even if the three-year abandonment period has not run on the entire balance owed to the owner (as long as the oldest payment due exceeds the three year abandonment period). Tex. Prop. Code Ann. § 75.101 (West); Texas Unclaimed Property Reporting Instructions (March 2015), 19

Reporting Mineral Proceeds (cont.)

• Do not report mineral proceeds in the aggregate. Texas Unclaimed Property Reporting Instructions (March 2015), 3 and 19

• Effective January 1, 2016, Holders reporting information concerning well production that resulted in the mineral proceeds, will be required to include in the holder report (1) the lease, property, or well name; (2) any lease, property, or well identification number used to identify the lease, property, or well; and (3) the county in which the lease, property, or well is located. S.B. 1589; Tex. Prop. Code Ann. § 74.101 (West)
Credit Balances

Credit Balances Overview

- Customer and accounts receivable credit balances are an aggressive area of focus for auditors.
- Customer credit balances result from overpayments, double payments, volume discounts, product returns and other customer transactions.
- Credits and debits for the same customer may be netted under certain circumstances.
- Auditors will trace removed credits to other GL accounts, *e.g.*, allowance for bad debt account, small balance/tolerance write-off accounts.
Texas Policy on Customer Credit Balances

• Customer credit balances are reportable whether in the form of an uncashed refund check or an unrefunded balance. (Texas Comptroller UP Reporting Instructions, p. 7)

• Three-year dormancy period commences on the date of last actual contact with the customer. (Unreturned mailings are not sufficient.) *(Ibid.)*

• Balances owed to current customers (actual contact or transactions within the last three years) should not be reported. *(Ibid.)*

Texas: Customer Credit Balances

• Texas UP Reports must be submitted to the Comptroller using the standard NAUPA 2 format. (Tex. Admin. Code, Title 34, § 13.21)

• The NAUPA 2 property type codes for various types of customer credits fall under the “MS” category (“General Business, Miscellaneous Checks and Intangible Personal Property”) and include:
  – MS05 – customer overpayments
  – MS07 – unfunded overcharges
  – MS09 – accounts receivable credit balances
  – MS10 – discounts due
  – MS11 – refunds/rebates due

(Texas Comptroller UP Reporting Instructions, p. 36)
Voluntary Compliance

Common VDA Requirements

• Most voluntary disclosure programs share the following requirements:
  – The state has not previously contacted the Holder.
  – The Holder is not currently under audit by the state.
  – Waiver of penalty, and often interest.
  – Limited look back.
  – Note: some states, not Texas, limit VDA to only a first-time filer.
Texas VDA Process

• Texas has a formal voluntary disclosure program (written agreements are available to all filers who fit the requirements).
• In Texas, the voluntary disclosure program may be available to Holders that have previously filed unclaimed property reports.
• A company may have a representative or authorized employee initiate the VDA process on its behalf.
• § 74.707, Tex. Prop. Code, authorizes the Comptroller to waive penalty and/or interest on delinquent unclaimed property if the Holder made a good faith effort to comply, or if the property was subject to delivery on or before November 1, 1997.

VDA/Self-Audit Benefits

• States limit lookback period.
  – State VDA periods generally range from 3 to 22 years (plus dormancy), with average of 10 years.
• Holder will conduct self-audit.
• Most states agree to waive non-compliance penalties, and many states waive interest.
  – California is exception.
• Indemnification from owners and states, generally available.
VDA Comptroller Contact Information

• To initiate the VDA process contact the Unclaimed Property Division at:
  – Texas Comptroller of Public Accounts
    Unclaimed Property Division
    P.O. Box 12247
    Austin, Texas 78711
    up.vda.requests@cpa.texas.gov
  – 1-800-531-5441, ext. 33120

General VDA Potential Detriments?

• Few, if any, for Texas!
• Resource requirement
• Short filing deadlines
• Due diligence requirements
• Full disclosure, all areas
• Affidavits might be required by some states
• Cautionary Notes:
  – Staples, Inc. v. Delaware
Practical Concerns: Planning and Prioritizing Possible VDAs

- Not unusual for a company to hold property that is due to owners in all 50 states.
- How does a company prioritize VDAs?
  - State of incorporation or formation
  - States in which company has physical location
  - States in which company has large number of customers or vendors
  - If a public company, consider states in which shareholders are concentrated.
- Need Policies/Procedures to monitor and track unused balances, conduct “proper” diligence, timely and properly remit to 54 U.S. jurisdictions, and monitor law/policy changes.
- Consider various industry resources.

Texas:
Beyond the Basics
Aggregate Reporting

• Holders may report individual owner records of less than $25 in the aggregate (changed from the $50 limit). Effective Sept 1, 2015. S.B. 1021; Tex. Prop. Code Ann. § 74.101(d) (West)
• Holders may combine amounts valued less than $25 by property type, providing one total per property type. Different property types should not be combined for aggregate reporting. Texas Unclaimed Property Reporting Instructions (March 2015), 3
• However, aggregate reporting is discouraged because an aggregated property report omits names of the individual owners, making it more difficult for owners to locate their property. Texas Unclaimed Property Reporting Instructions (March 2015), 3

Texas: Estimation

• If holder records are unavailable or incomplete for any portion of the required retention period, the Texas comptroller may determine the liability of a holder using the best information available. Tex. Prop. Code Ann. § 74.103(d) (West)
Key Controversies Nationwide

- **Combined Reporting** – Authority/strategy (many practical implications)
- **Estimation/Extrapolation** – Authority, methods and standards to invoke (If the Holder lacks adequate records, may auditor extrapolate past liability based on current records?)
- **2nd priority Domicile for Partnerships/LLCs** – issue pending in Delaware and other courts
- Contingent-fee Auditors – Administration/fairness concerns
- **Derivative Rights Doctrine**
- Burden of Proof – Statutory presumption/Due Process and Contract Clause challenges?
- **Indemnification Requirements**
- Implications of Mergers, Acquisitions, Restructuring, and Outsourcing

Texas:
State’s Responsibility
Tex. Prop. Code Ann. § 74.304 Responsibility After Delivery

• Texas shall assume custody of property reported and delivered to the comptroller, and is responsible for the safekeeping of the property.

• Holder is relieved of all liability to the extent of the value of the property delivered, if Holder delivers the property to the comptroller in good faith. Relief applies to any claim then existing, any claim arising after delivery to the comptroller, or any claim made with respect to the property.

Tex. Prop. Code § 74.304 Responsibility After Delivery (cont.)

• After holder delivers reported property to the comptroller in good faith, if a person or another state claims the property from the holder, the Texas Attorney General shall defend the holder against the claim, and the holder “shall be indemnified from the unclaimed money received under this chapter or any other statute requiring delivery of unclaimed property to the comptroller against any liability on the claim.”
Questions?/Contacts

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