



## Unclaimed Property: Giving "The First State" a Second Look

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More than one million business entities have their legal home in Delaware, including more than 50 percent of all U.S. publicly-traded companies and 64 percent of the Fortune 500 companies. Is one or more of your business entities incorporated in Delaware? If so, you may have an unclaimed property reporting obligation, **even if you have no business operations there.**

### What Is Unclaimed Property?

Unclaimed property is intangible property that has not been claimed by its rightful owner after a certain period of time has lapsed. Common examples of unclaimed property include: uncashed payroll checks, uncashed payments to suppliers, uncashed dividend checks, credit balances due to a customer, customer refunds, unreturned deposits, and security deposit box contents.

Unclaimed property laws are based on the common law doctrines of "escheat" and "bona vacantia," which are the reversions or forfeitures of real or personal property to the state, due to either the absence of anyone competent to inherit the property or as a result of default. Under most unclaimed property statutes, states exercise the power of escheat over abandoned property by collecting the property from the holder and assuming a custodial role over the property with the intent of returning it to its rightful owner. For example, if a former employee did not cash his or her last paycheck, the company (as the "holder") may need to turn these funds over to the appropriate state.

All 50 states, the District of Columbia, Puerto Rico and Guam have enacted statutes requiring the reporting and delivery of unclaimed property to the appropriate state by those persons holding such property. Many states have modeled their unclaimed property statutes based on the Uniform Unclaimed Property Acts drafted by the National Conference of Commissioners on Uniform State Laws.

In general, unclaimed property is intangible property that:

1. Is held or issued in the ordinary course of the holder's business;
2. Represents a debt or obligation of the holder to a creditor or owner; and
3. Remains unclaimed for more than the statutory dormancy period (the period of time required to pass in which no action has been taken by the owner as determined by property type and by each state) after it has become payable or distributable by the holder to the owner.

## Who Is Required to Report Unclaimed Property?

Typically, all holders of reportable property belonging to another person have a reporting responsibility upon the lapse of the statutory dormancy period for that property. A "holder" is generally defined as any person obligated to hold, deliver, or pay to the rightful owner property that is subject to the unclaimed property laws. A holder can be an individual, a business, a government, an estate or trust, or even a not-for-profit corporation.

## When Does Unclaimed Property Become Reportable?

Property becomes reportable when it remains unclaimed and reaches the end of its dormancy period. Dormancy periods vary by state and by property type. For example, the dormancy period for wages, in most states, is one year. If a payroll check remains uncashed at the end of that one year dormancy period, the check would be reportable to the state as unclaimed property. The dormancy period for most other property types is generally three to five years.

## To Which State Is Unclaimed Property Reportable?

Since the obligation to surrender unclaimed property is not a "tax," the general income tax rules requiring "nexus" do not apply. So to whom should the unclaimed property be reported when there are multiple states with a connection to the property?

In *Texas v. New Jersey*, the United States Supreme Court in 1965 developed priority rules to resolve competing claims by four different states. The Court reasoned that the intangible property represented a debt and thus was an asset of the creditor. Following this reasoning, the Court determined that the first priority claim belonged to the state of the last known address of the creditor or holder as shown by the debtor's books and records. From a policy standpoint, the Court was also motivated by the fact that this first priority rule was simple and clear and turned on factual issues rather than technical legal ones. It also served the equitable benefit of distributing escheated property to states based on the commercial activities of their residents.

The Court also recognized that there are instances where there may be no record of the last known address or that the owner may reside in a state that does not provide for escheat of the property owed. For those instances, the Court created a second priority rule whereby the holder's state of corporate domicile (*i.e.*, state of incorporation, or principal place of business for a non-corporate holder) has the next right to the unclaimed property. Thus, a corporation incorporated in Delaware could have an unclaimed property reporting obligation there even if it conducts no business within Delaware's borders.

These priority rules have been subsequently affirmed by the United States Supreme Court in other decisions, and adopted in both the 1981 and 1995 versions of the Uniform Unclaimed Property Act.

## How Has the Landscape of Unclaimed Property Changed?

Unclaimed property has become an increasingly popular area for scrutiny by state governments. Although unclaimed property laws have been around since the early 1900s, states have begun more broadly interpreting and strictly enforcing these rules over the past 15 years. Due to deteriorating economic conditions and budget deficits, state governments are seeking non-tax revenue to supplement their revenues. For many states, a popular option has been the stricter enforcement of unclaimed property laws, especially considering that states are rarely able to locate and return the collected property to the rightful owner.

Many states have reduced dormancy periods and/or are expanding their interpretations of unclaimed property definitions to cover new types of reportable property in order to generate more property collections. Some states have also resorted to the use of third-party audit firms, often paid on a contingent fee basis, to enable them to overcome internal resource limitations.

While Delaware is considered a relatively business friendly state, it does place heavy importance on unclaimed property reporting, which represents its third largest source of revenue. From 2007 to 2010, Delaware took in more than \$1.7 billion in abandoned property while only returning \$46 million (less than three percent) to the rightful owners.<sup>1</sup>

## How Can Holders Become Compliant with Unclaimed Property Laws?

Many states offer amnesty or voluntary disclosure programs to encourage non-compliant businesses to become compliant in exchange for benefits such as limited look-back periods and waivers of penalties and interest. Currently, Delaware is offering a [voluntary disclosure program](#) through the Secretary of State for certain eligible holders. The program allows holders to come forward with past due unclaimed property obligations in exchange for audit protection, waiver of penalties and interest, and a reduced look-back period. For holders that enroll before June 30, 2014, the look back period is dramatically shortened from 1981 to 1993. After June 30, 2014, holders will no longer be allowed to enter the program through the Delaware Secretary of State.

## Conclusion

Many businesses which are incorporated in Delaware often presume erroneously that no unclaimed property reporting obligations exist since those businesses have no operations in the state of Delaware. But if there is no record of the property owner's address or it is a foreign address, that unclaimed property is due to the state of Delaware. Unfortunately, noncompliance can be costly. Businesses are encouraged to seek guidance from an unclaimed property advocate to assist them in identifying any areas of exposure or noncompliance. If problem areas are identified, remediation efforts can be initiated via amnesty or voluntary disclosure agreements with the appropriate states.

For more information concerning unclaimed property, the Delaware Secretary of State Voluntary Disclosure Program, or other states' amnesty or voluntary disclosure programs, contact your CBIZ Tofias tax advisor, or you may also contact Tarra Curran, Leader of the State and Local Tax Practice, at [TCurran@cbiztofias.com](mailto:TCurran@cbiztofias.com) and 401.626.3240.

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<sup>1</sup> Chase, Randall; Delaware Among States Eyeing Unclaimed Property; Boston Globe; available at [http://www.boston.com/news/education/higher/articles/2010/11/24/delaware\\_among\\_states\\_eyeing\\_unclaimed\\_property](http://www.boston.com/news/education/higher/articles/2010/11/24/delaware_among_states_eyeing_unclaimed_property) (November 24, 2010).