Ready for a Change? Updates Impacting Unclaimed Property (UP)

By Cathleen Bucholtz and Michelle Moloian*

Cathleen Bucholtz and Michelle Moloian provide a status update on the world of unclaimed property.

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Changes: I Don't Like the Sound of That…

Let's admit it, nobody likes change. However, companies should be aware that in the past few years the UP arena has been inundated with new state legislative and administrative actions that have significantly changed the overall UP landscape. While many of the basic UP reporting requirements have not changed, such as which state has the right to claim property or how to report past-due property, the risk factors and complexity of reporting have increased.

One of the major events that contributed to the recent changes is the well-known case *Temple-Inland v. Cook*, where the court rebuked the State of Delaware's "shocking" audit methodologies. The court's findings ended up having a domino effect impacting many holders given the number of companies incorporated in the State of Delaware.

There have been other forces at work as well contributing to the overall changes, many of which are still actively evolving and forcing the holder community to play a constant game of catch-up. This article summarizes some of the significant shifts of the UP terrain and explains how the changes may affect your organization.

Changes: Challenges to Audit Practices

One of the key issues raised by Temple-Inland in *Temple-Inland v. Cook* was that the estimation practices used by Delaware and its third-party auditors during UP examinations were inherently unfair. On June 28, 2016, the District Court for Delaware agreed, and granted Temple-Inland's motion for summary judgment on its substantive due process claim challenging Delaware's UP audit estimation methods. The District Court concluded that Delaware violated the Plaintiff's substantive due process rights, exploited loopholes in the statute of limitation, employed estimation methods that favored a greater liability, ignored facts that could reduce liability, and in short engaged in a game of "gotcha" with holders.

> *There is no time like the present to ensure your organization is in compliance and "audit ready." This can best be accomplished by having clear and complete UP policies and procedures coupled with a robust compliance process.*

After such a stiff rebuke, many observers were hopeful that a more reasonable UP audit environment would emerge in the state. Nevertheless, once Delaware patched the larger potholes in their audit super highway, it began to initiate an unprecedented amount of new UP audits, often joined by the large number of states that generally work with the third-party audit firms that facilitate Delaware UP audits. However, Delaware is finding that the road still has a few speedbumps. On December 3, 2018, *Univar, Inc. v. Geisenberger* lawsuit emerged wherein, Univar challenged Delaware's audit methodology on a number of issues, including: violations of federal common law, the Fourth Amendment, Delaware's own Escheat Law, the Due Process, Equal Protection and Takings Clauses of the Constitution, and a number of other issues. While some of these issues were recently dismissed, a few may be moving on to trial. The results of the new case will no doubt further change the UP landscape.

Changes: UP Statutes

Around the same time the *Temple-Inland* case was being decided, the Uniform Law Commission (ULC) was working to revise the outdated 1995 Uniform Unclaimed Property Act. During their annual meeting on July 13, 2016, the ULC, comprised of lawyers and lawmakers appointed by state governments, voted favorably on their 2016 Revised Uniform Unclaimed Property Act and "RUPPA" emerged. At first glance, a provision or two of RUUPA may appear to benefit the holder community, such as the shortened look-back period under audits and the creation of a much-needed statute of limitation provision. But other aspects, such as no provision for exemptions, non-recognition of ERISA preemptions, no restrictions on the use of estimations, shortened dormancy periods and the use of contingent fee auditors, clearly do not benefit holders and in fact, advance state interests to the detriment of holders.

In response to RUUPA, the American Bar Association (ABA) drafted their own unclaimed property "Model Act," which included many more holder-friendly provisions, including reporting exemptions, longer dormancy periods, restrictions on estimations and the use of contingent fee audit firms, allowing consolidated reporting, and the recognition of ERISA preemptions. Sadly, the ABA Model UP Act has not received much attention from the states, while RUUPA has been readily received by many states in the past few years. Here are a few examples:

- **Delaware SB13 (effective Feb. 2, 2017)**
  Soon after the rollout of RUUPA, Delaware moved to enact SB13, which included a number of RUUPA provisions. Among the more prominent provisions of SB13 were: mandatory interest for non-compliance up to a maximum of 50% of the exposure (with a provision for mitigating ½ of the interest), a codified estimation process, and a shortened audit look-back period (10 years plus dormancy). While the shortened look-back period can be a major benefit for companies with no filing history, the codified estimation process and increased interest may offset any benefits of the shortened look-back period.
- **IL SB9 (effective Jan. 1, 2018)**
  On July 6, 2017, Illinois Senate Bill 9 (SB9) was enacted. Originally, SB9 was focused on funding the state's 2017–2018 Fiscal Year Budget. However, several days before it went to vote, Illinois House Amendment No. 3 expanded the bill by adding RUUPA provisions and repealing Illinois' existing Uniform Disposition of Unclaimed Property Act.

  Among the most significant changes in Illinois was the repeal of their earlier Illinois' B2B exemption and the adoption of a "Transitional Provision." This provision required that the first report filed under the new law include all property that would have been presumed abandoned during the preceding five-year period as if new law had been in effect, even if it had been exempt under the old statute!

  As a result, companies that filed Illinois UP reports in May 1, 2018, were also required to report B2B amounts that were previously exempted on their 2013–2017 reports. For some holders, these amounts were significant. Illinois' RUPPA also reduced its former five-year dormancy periods to three years, so that companies' 2018 filings under RUUPA would also advance the amounts for items that would have not have been reportable until 2019 and 2020.

- **Colorado Senate Bill 19-088 (approved April 16, 2019)**
  This bill takes effect on July 1, 2020, and has some provisions similar to the Illinois changes. For example, the most notable provision of this bill is the repeal of Colorado's long standing reporting deduction that allowed holders to deduct up to 2% or $25 (which ever was greater or less depending upon the property type reported) from the amount presumed abandoned. Further, the new C.R.S. §38-13-1503 language provides: "An initial report filed under this Article 13 for property that was not required to be reported before July 1, 2020, but that is required to be reported under this Article 13, must include all items of property that would have been presumed abandoned during the five-year period preceding July 1, 2020, as if this Article 13 had been in effect during that period." This is very similar to the "clawback" provision of Illinois. While this may not have a big impact on most holders, it will have a material impact on companies that chose to incorporate their "Gift Card" companies in Colorado due to the availability of the standard deduction. In addition to the above, the new CO bill reduces many dormancy periods from five years to three years.
- **Other States Adopting RUUPA**
  In addition to Delaware, Illinois and Colorado, many jurisdictions have adopted, are in the process of adopting or are considering adopting RUUPA style legislation. As of the writing of this article, some of those jurisdictions include Kentucky, District of Columbia, Idaho, Maine, Minnesota, Nebraska, Nevada, South Carolina, Vermont and Washington.

Changes: Audit Firms

If your company is incorporated in the State of Delaware and has significant revenue, it is likely that it has been or will be the subject of a comprehensive UP audit from the Delaware. In addition, if your organization has customers, vendors or employees in other states you are likely to be audited by other states independently or as participating states joining a Delaware initiated audit. Most if not all of these audits are being conducted by third-party contingent-fee audit firms (TPAFs). There are currently as many as a dozen key TPAFs performing UP audits on behalf of multiple jurisdictions. General ledger audits still predominately focus on unapplied accounts receivable, and uncashed vendor and payroll checks. However, many TPAFs are specializing in auditing specific industries such as banking and finance, securities, life insurance, healthcare and oil and gas.

For many years, most jurisdictions almost exclusively used the UP audit firm Kelmar and Associates (Kelmar), one of the oldest TPAFs. Most of the Delaware audits had lookback periods that exceeded 20 years. However, in the wake of *Temple-Inland v. Cook* and other cases, Delaware changed their UP laws to limit the lookback period to a maximum of 10 years plus the dormancy period, and to limit their utilization of any one TPAF to no more than 50% of their audits. The shortened lookback and Delaware's limit on the use of any one audit firm no doubt had a material impact on Kelmar's revenue stream.

So began the transformation of Kelmar from an exclusive TPAF to a compliance resource for the states. Kelmar now offers the states specialized services and solutions to help them administer their UP compliance programs. With the introduction of their KAPS system, Kelmar provides the states assistance with managing their UP databases by providing a utility for converting data to the required NAUPA format and uploading it directly into the state web-portals. While this streamlines the reporting process for holders by allowing holders to upload reports to state that formerly did not offer uploads, holders may never be sure whether Kelmar will have access to company's reporting records or to what degree, if any, they can review holder reporting data. This has holders and their advocates wondering "What's next?" and how they should adequately prepare for what could become a more comprehensive, less holder-friendly reporting and audit environment. In response, corporations will need to review and fortify their annual reporting process to ensure they are efficiently and effectively capturing and reporting UP.

Changes: New Questions—and a Solution

Since Kelmar is still a primary audit firm, Kelmar's new role in assisting states with their UP management is raising a lot of questions for holders. Is Kelmar also under contract with states to sift through their databases to determine which companies are compliant? What level of transparency is there in the relationship between Kelmar and the states? Does this expanded relationship create additional risks for first time reporting? For example, if a company files a first time report, will they then be identified by Kelmar and targeted by the states for an audit?

Of course, the best defense against all audit risk is to make sure your organization is in compliance. The good news is that help is available. Just as states have turned to TPAFs to supplement their lack of resources and knowledge, holders can access UP advocacy firms, software programs, training opportunities, law firms specializing in UP, as well as online content and holder organizations, such as the Unclaimed Property Professional Organization (UPPO).

If your organization does not already have a process in place, before spending hundreds of hours to educate staff only to have them leave, build an internal UP department only have to spend more time each year to monitor and update the department, or purchase expensive software only to have to pay annual license fees and training costs—learn a lesson from the frugal state administrators. Rather than doing it internally, it may cost considerably less for your company to outsource its UP processes to knowledgeable third parties that provide efficient and effective compliance services designed to proactively remedy the impact of a potentially overreaching audit administered by a TPAF.

There is no time like the present to ensure your organization is in compliance and "audit ready." This can best be accomplished by having clear and complete UP policies and procedures coupled with a robust compliance process. You can develop these on your own or bring in a company who can fill that void. Moreover, if your company has never been audited, it would be a good idea to bring in subject matter experts to do a thorough diagnostic that can identify and help you fix any UP issues your company may have. It can save a tremendous amount of time, energy and money down the road when the auditor comes knocking.

ENDNOTES

* Cathleen has extensive experience in all aspects of unclaimed property including consulting, audit defense, comprehensive diagnostic reviews, statistical sampling, the development of leading practices, annual compliance, and training. Michelle currently oversees the Unclaimed Property compliance practice and is responsible for accurate and timely annual filing of thousands of unclaimed property reports for an impressive list of Fortune 500 and middle market companies in various industries. Cathleen can be reached at *Cathleen.Bucholtz@tpctax.com*, (818-650-5801) and Michelle can be reached at *Michelle.Moloian@tpxtax.com*, (972-338-3671).