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Can States' Budget Woes in the Wake of COVID-19 be Resolved by Increased Enforcement of Unclaimed Property Laws?

Economies around the world have experienced significant loss as a result of the COVID-19 pandemic. In the United States, state governments have suffered from declining tax revenues while expenditures have increased. As the pandemic subsides, state governments may shift their focus to finding additional sources of revenue to counterbalance these expenditures and to provide economic stimulus to businesses that have sustained losses due to the restrictions, shutdowns, and other actions imposed as a consequence of the pandemic. In past years, states have looked to unclaimed property as a source of revenue in the face of budget shortfalls. We expect this trend to continue, perhaps to an even greater extent, as the states attempt to recover from the pandemic and rebuild their economies. Companies holding unclaimed property (knowingly or not) should be prepared for more aggressive enforcement activities and legislative initiatives (which could, for example, remove longstanding exemptions or minimize dormancy periods). Once a company is audited for unclaimed property, its options become limited and it may be exposed to penalties, fines, interest and, in rare cases, criminal sanctions. A company that is audited may also not be able to avail itself of settlement programs that may be available. Accordingly, it is in the interest of holders of unclaimed property to become proactive in reporting and escheating such property to the appropriate state.

Overview of Unclaimed Property

Unclaimed property laws require the remittance or escheat of certain types of tangible and intangible property to the state for safekeeping if the holder of such property is unable to contact the owner of the property after a statutorily specified period of time, known as the dormancy period. Examples of the types of property subject to escheat under state unclaimed property laws include uncashed money orders and travelers checks, uncashed rebate checks, customer credits, unclaimed royalty payments, unused gift certificates and gift cards, uncashed employee payroll checks, vendor checks and dividend checks (and the underlying stock or other evidence of an ownership interest in the business), amounts due and payable under insurance policies or annuities, unclaimed bank account balances, contents of safe deposit boxes, amounts distributable from employee benefit plans, and certain pre-payments, credit balances, deposits, and layaway items. Once the holder has held the property for the applicable dormancy period without communication with the owner, the property is deemed unclaimed or abandoned and becomes subject to escheat to the state. General priority rules with respect to escheat of unclaimed property require a holder to report and remit the property to the state of the owner's last known address, as shown on the holder's records, or, if the holder does not have a last known address for the owner in its records, then to the state of the holder's domicile or incorporation.

Each of the 50 states has adopted its own unique set of unclaimed property laws that defines the types of property subject to escheat, sets a dormancy period for each category of property, determines the timeframe for reporting, establishes penalties, fines, interest, and even criminal liability for the failure to report, and sets out procedures authorizing the state to audit holders to determine their compliance with the state's unclaimed property laws. Failure to comply with these laws can mean millions of dollars in liability, interest and penalties for a holder, which can negatively impact a company's bottom line.

State Audits and Voluntary Compliance Programs

States have the ability to audit companies to determine their past and present compliance with applicable unclaimed property laws. Audits are time-consuming and disruptive of ongoing business activities; they are expensive and may result in significant liability for past and present noncompliance. States often engage third-party audit firms to conduct these audits, usually on a contingency basis. These third-party audit firms, which may represent multiple states at once in a multi-state audit of the holder, are financially incentivized to take an aggressive approach and maximize the states' recovery. Audit rules and regulations vary from state to state, but state auditors can often look back as far as 15-20 years to determine a holder's liability for past noncompliance.

Many states have also implemented voluntary compliance programs, whereby participant unclaimed property holders enter into a Voluntary Disclosure Agreement (VDA) with the state. VDA programs allow holders that have underreported or failed to report unclaimed property in the past to become compliant through voluntary participation in the program, typically without the imposition of penalties or interest for past noncompliance. Participation in a VDA program is usually less expensive, less time-consuming, and more efficient than an audit, and generally involves reduced penalties and a reduced lookback period to determine liability for past noncompliance. In certain states, such as Delaware, a holder must be invited to participate in the state's VDA program before the state can initiate an audit against the holder.

As a result of the COVID-19 pandemic, state unclaimed property administrators may likely become more aggressive in auditing unclaimed property holders for compliance, assessing penalties and interest to the fullest extent possible as a means of generating state revenue. In addition, states may likely encourage more and more companies to participate in VDA programs, particularly in states like Delaware where an invitation to the VDA program is a prerequisite to a state-initiated audit. 2020 trends suggest that

companies in the health care, payment processing, and financial services and products industries may be primary targets of state unclaimed property audits in 2021.

Conclusion

As noted, holders should be prepared for increased enforcement activity as the unclaimed property landscape continues to evolve in the COVID-19 era. As a result of the states' increased focus on unclaimed property, companies need to be proactive in monitoring and, if necessary, improving their unclaimed property compliance practices. Companies can take proactive steps to determine their rights, minimize their liabilities, and streamline their accounting and reporting processes with respect to unclaimed property.

Companies that are unfamiliar with the unclaimed property reporting process and have no history (or a limited history) of unclaimed property reporting should (1) establish an unclaimed property compliance program, (2) conduct an initial internal audit or risk assessment to determine the types of unclaimed property they may be holding, the states to which such property may be subject to escheat, and the potential liability they may be facing as the holder of such unclaimed property, and (3) explore their options for participating in a voluntary disclosure program in each relevant state where they may be subject to past and/or present unclaimed property reporting obligations.

Companies that are more experienced with unclaimed property reporting and have already established internal compliance programs should (1) revisit, reassess and, if necessary, update or enhance their internal policies and procedures with respect to unclaimed property reporting, (2) track changes in legislation and enforcement activity in the states where they may be required to report unclaimed property, and (3) be prepared for increased enforcement activity and heightened scrutiny from state unclaimed property administrators as they continue to review their records and report unclaimed property on an annual basis.

Counsel can assist in navigating the holder reporting requirements and procedures, audit process, and voluntary disclosure programs in each state where a company maintains business operations, holds property for a person with a last-known address in such state, or otherwise may be required to report unclaimed property.

Authors

This GT Advisory was prepared by:

- **Marc J. Musyl** | +1 303.572.6585 | musylm@gtlaw.com
- **Brooke E. Condran** | +1 916.868.0771 | condranb@gtlaw.com

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