

Business Credit News

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MAY 2014 Chairman: Mark Haley
Johnson Oil Company

“ESCHEATMENT TIME IS UPON US?”

Once again it is that time of the season that we should be looking at open credit balances on our customer accounts and determine whether they need to be reported or turned over to the state. Between May and November is the period that the majority of states require escheatment. What exactly is escheatment?

We doubt there are any credit professionals among our readers who would voluntarily commit an illegal act such as misappropriating property that does not rightfully belong to them or their employer. Unfortunately, the fact is, every day many credit professionals, both new and experienced, throughout America do commit an unlawful act. They either reverse credit memos or write off credit balances on customer accounts who they no longer do business with; have gone out of business; or where the customer is unaware money is owed to them by the creditor. This is unlawful because businesses, whether they sell a product or provide a service, are required to report to the appropriate state agency when customer property has been abandoned or unclaimed and at some point, depending on the particular state law, transfer the property to the state to keep in trust until the property owner claims its property. This law is known as escheatment and is also sometimes referred to as the unclaimed property law. The law exists in all fifty states, the District of Columbia and Puerto Rico. Businesses that fail to comply with the state escheatment laws and do not report unclaimed property can be fined, and required to pay interest on the unreported property, and depending on the state, incur other financial penalties.

Insufficient record-keeping and inadequate accounting practices are not considered acceptable excuses to avoid fines and penalties for failing to escheat. The passage of Sarbanes-Oxley has provided additional assistance for many states in their diligence to enforce the laws against those companies who fail to comply voluntarily. In fact, according to the National Association of Unclaimed Property Administrators, many state compliance officials have credited Sarbanes Oxley with increasing corporate awareness and compliance with the law. George Tamayo, a manager with the Texas Unclaimed Property Division, told the Austin American Statesman that unclaimed property reported and remitted increased over \$45 million the first year after SOX became law.

In our present economy and given the current fiscal health of many states such as California, Michigan, and Florida to name but a few, every state is looking for sources of revenue to pay for the services they provide to their citizens. One available source is enforcement of their escheatment laws. In addition to the fines, interest and penalties collected from the firms who have failed to report and escheat, the states may and often use a large portion of the unclaimed property to help fund those services until the rightful owner comes forward to claim their property. For example, in 2010 the State of California had \$5.7 billion dollars in unclaimed property belonging to 11.6 million individuals and corporations.

The history of escheating can be traced back to early English common law where abandoned or unclaimed property would revert back to the Crown. In America the purpose of the unclaimed property laws is to reunite owners with their property, limit the liability of the holder of unclaimed property, and to provide states with a stream of income. To this end the Congress has enacted several uniform laws to control the procedures relating to unclaimed property among the various states.

As credit professionals one of our responsibilities for unclaimed property and reporting should be to have adequate knowledge of or consult with experts in the laws and regulations of each jurisdiction. Even though a uniform version of unclaimed property law does govern the majority of the country's jurisdictions, roughly 44 states have adopted a form of the Uniform Unclaimed Property Act, as state laws change with each legislative session and create different methods for reporting and remittance, we need to have a process in place so we can readily comply with these changes. For example, since 2005 several states have reduced the dormancy period for unclaimed property from five years to three and one state, we are familiar with, has lessened the time requirements for mailing due diligence letters. Also, these laws are not uniform as to where they are enacted and can be found in various sections of state law. For example, in Texas the law is contained in Chapters 72 and 74 of the Texas Property Code whereas in California the law is contained in their Code of Civil Procedure, Title 10, Chapter 7.

A major component of unclaimed property law compliance is performing the required due diligence. Most unclaimed property laws require that a letter be sent via first class mail to the customer within a specified period of time prior to the state reporting deadline. Another significant control activity is to have an effective process for creating accurate and timely remittances to the state agency when the property has to be transferred. The elements of this process would include procedures to report details, check requests, and adequate oversight of these processes by appropriate management levels.

It is also important that we have a plan in place for the appropriate state record retention requirement and for any potential audit defense. For example, in Texas, all businesses are required to retain records of unclaimed property for ten years after the property has been reported. Therefore, a procedure for maintaining evidence of report and remittance delivery, copies of reports and remittances, supporting documentation of item reversals, and evidence of due diligence is essential.

Credit professionals also have to know what state has authority over the unclaimed property and who to report customer unclaimed balances to. Do we report to the state where the customer resides or is incorporated? The state where the property is located? The state where the company has their headquarters? The answer to these questions was decided in 1965 by the United States Supreme Court in the seminal case titled *Texas v. New Jersey* which contrary to its title was a dispute between four states, Texas, New Jersey, Pennsylvania and Florida, who each claimed property that had been abandoned by Sun Oil Company. Texas believed they were entitled to the property because the majority of the property was physically located in Texas while New Jersey thought they were entitled to the property because Sun Oil was a New Jersey corporation. Pennsylvania believed they should have the property

because Sun was headquartered in their state and Florida believed they had claim to the property because the owner resided in their state. Congress had yet to address the question and the parties wanted one rule to ease the administration of unclaimed property. The Supreme Court thus established the *first priority rule* for determining what state had governing authority over unclaimed property. They opinioned the last known address of the creditor or owner of the property is the state entitled to the property. The opinion went on to say in the event no last address is known than the *secondary rule* is that the holder's state of incorporation is entitled to the property.

So to clarify their decision, let's say our firm is a Texas corporation and the holder of unclaimed property. Under the *primary rule* the last known address of our customer is in California so the state of California would be who we would file our report with. Continuing under the *primary rule* if we did not know the last address of our customer but their bank held a security interest in their assets and the banks last address was in Oregon then the state of Oregon would be where we would file our report. And lastly, under the *secondary rule*, if we could not locate an address for our customer and we could not find any secured creditor with an interest in the unclaimed property than we would file our report with the state of Texas where we, the holder, are incorporated. Two later Supreme Court cases; *Pennsylvania v. New York* heard in 1972 and *Delaware v. New York* heard in 1993, failed to change the 1965 established priority rule.

Many states distinguish how one reports unclaimed property by setting an amount at which the reporting entity may report the property in the aggregate. The aggregate amount sets a minimum dollar amount at which the reporting entity must provide detailed information regarding the owner of the property to the state. If the unclaimed property has a value less than the aggregate amount, then each account may be reported together as one total amount. For example; let's assume the aggregate amount is \$100 and we have 10 accounts with credit balances of \$50.00 each. We are allowed to report \$500 in the aggregate and transfer the cash value of the credit balance to the state without having to provide detailed information for every account under the aggregate.

The holder of unclaimed property is required to submit an annual report to the state entitled to the unclaimed property. There are some states that require negative filing, stating the holder is not in possession of any unclaimed property. The holder should file the report using the forms provided by the individual states as forms are not required to be uniform. Most annual reporting requires the following information: The name & address of the property owner, social security or federal tax ID number, and a description of the property and the date of the last transaction with the property owner.

Before actually turning the property over to the state, many states require what is deemed a final notice period. The holder of the unclaimed property is required to provide notice to the owner that the property is subject to escheatment. This notice is usually required 60 to 120 days prior to escheatment.

The majority of states enforce their escheatment laws through audits. Audits are usually performed by either the state's treasurer or controller's office; however some states have begun to outsource the audits to private firms who receive a percentage of state fines assessed for non-compliance. The scope of the audit usually goes back several years and the auditors review the following company documents: chart of accounts; general ledger and trial balances; journal entries; bank reconciliations; account receivable ageing and trial balances; annual reports; and accounting policies.

In an effort to avoid turning over property to the state, some businesses have included provisions in their contracts that cause the loss of the owners' property to revert to the business similar to old English law where the property would revert back to the Crown. This form of "private escheatment" has been ruled by several state courts as a fraudulent attempt to avoid compliance with state unclaimed property laws. In addition some businesses have argued that credit balances and memos resulting from business to business transactions should not be subject to escheatment. So far only nine states have exempted businesses from filing annual reports; they are Illinois, Iowa, Kansas, Maryland, Massachusetts, North Carolina, Ohio, Virginia, and Wisconsin. However, application of the exception has proven to be a problem under the ruling of *Texas v. New Jersey*, in that should one state not require unclaimed property be reported or transferred but another state does require reporting and transfer, then the state requiring reporting and property turnover would prevail. Therefore, only those cases where both states do not require turnover is the credit professional free not to escheat. For example, the customers' last address is in Maryland and the holder is an Ohio corporation.

Generally, compliance with a state's unclaimed property law is mandatory. There are significant civil penalties for failing to comply with reporting and transfer requirements. The penalties range from simple interest to the full value of the unclaimed property. In addition, some states impose daily penalties up to \$1,000 a day and if a business is found to willfully fail to or fraudulently file a report then the daily penalties can exceed \$1,000. Regardless of whether we believe it is right or just, our state legislature, the Congress of the United States and the U. S. Supreme Court have all held that dormant accounts and unclaimed property belongs to someone other than the holder and is to be held in trust by the state until its rightful owner makes claim.

Compliance should be an ongoing process that requires conscious efforts to implement procedures and comply with state laws. The states have several methods to enforce their unclaimed property laws. It is necessary that our firm and we, as credit professionals, comply with these laws and file annual reports and escheat the unclaimed property to the states when due.

David Balovich is an accomplished author and public speaker. He is presently the North Region credit manager for Holt Cat.

***** **MAY 2014** *****

Day	Date	Group	Location	Time
Tues	6	Austin Construction	Texas Land & Cattle, 6007 N IH 35 & Hwy 290, Austin TX	11:30
Tues	6	Coastal Bend Group	***** WILL ATTEND SW CREDIT EXCHANGE *****	
Wed	7	Rio Grande Group	***** WILL ATTEND SW CREDIT EXCHANGE *****	
Thurs	8	SW Food Credit Group	Las Palapas, 4802 Walzem Rd, San Antonio TX	11:00
Th/Fri	8-9	SW Credit Exchange	OMNI Bay Front Hotel, Corpus Christi TX	5:30/8:00
Th/Fri	8-9	SW Petroleum Meeting	OMNI Bay Front Hotel, Corpus Christi TX	5:30/8:00
Thurs	15	Austin Ad Media	Teleconference Meeting 1-800-791-2345	2:00
Fri	16	SW Electrical Group	The Onion Creek Country Club, Austin TX	11:30
Tues	20	Austin Construction	Texas Land & Cattle, 6007 N IH 35 & Hwy 290, Austin, TX	11:30
Wed	21	Victoria Credit Group	Sky Restaurant, 236 Foster Field, Victoria TX	11:30
Thurs	22	Fuel & Lube/Heavy Eq.	Teleconference Meeting 1-800-791-2345	2:30
Thurs	22	HVAC Credit Group	Texas Air Products, 11122 Gordon Rd, San Antonio TX	11:30
Tues	27	SA Construction	Las Palapas, 4802 Walzem Rd, San Antonio TX	11:30
Wed	28	Laredo Credit Group	The Laredo Country Club, Laredo TX	11:30
