
Increased State Activity Makes "Escheat" a Trap for the Unwary Business

Legal Alert

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Under a state's "escheat" law, the ownership rights to unclaimed property (for example, an escrow fund or funds underlying uncashed checks) pass from the asset holder to the state if not claimed by the rightful owner within a requisite period. Although the escheat rules have been around forever, the current circumstances of reduced tax collections during bad economic times have prompted many states to give new and enhanced attention to collecting all such escheated assets. If nothing is done to eliminate the unclaimed item in the interim, the asset holder becomes responsible to transfer the asset to the state at the end of the escheat period.

Many businesses pay little attention to the potential escheat of its unclaimed personal property, and they may some day find to their surprise that they have become subject to a material state claim for assets that should have escheated but were never transferred to the state. Moreover, since no filings have likely been made by the asset holder, the state's claim may extend retroactively to recover all such unclaimed assets since the inception of the business.

What is unclaimed property?

Unclaimed Property generally consists of "intangible property that is held, issued or owned in the course of a holder's business." Such items typically include:

- Uncashed payroll checks
- Uncashed pension benefit distributions
- Uncashed vendor checks
- Uncashed dividend checks
- Unapplied credit balances
- Unused gift certificates
- Unapplied customer deposits
- Unapplied escrows

When is property considered abandoned?

Generally, property that is deemed to be "unclaimed" by the owner for more than the requisite period (3 years in New Jersey and 5 years generally and 2 years with respect to unclaimed wages in Pennsylvania) is considered abandoned and subject to escheat. However, there may be factual circumstances or transactions undertaken to refute the position that the property was "unclaimed" or otherwise refute the applicability of that state's particular escheat laws.

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Is there a duty of the holder of the property to report?

Yes. For example, in New Jersey, a person holding "unclaimed property" beyond the requisite period is obligated to file a report by November 1 of the year with respect to all unclaimed property deemed abandoned as of June 30 of that year.

What are the penalties for failure to file a report?

Not only does the asset-holder remain obligated to remit the unclaimed property to the State, there is also a penalty of \$200 for each day that an annual report remains unfiled (up to a maximum of \$100,000), and the penalty applies to each year's report that remains unfiled. In addition, if the failure to report is considered to be "willful," then the penalty is increased to \$1,000 per day (up to a maximum of \$250,000.)

What time limits apply?

Effectively, none. If no escheat reports were filed, there is essentially no statute of limitations applicable to the State's claims.

What records do I have to keep?

A holder of unclaimed property is required to maintain records showing the name and last known address of the entitled owner for five (5) years after filing a report.

What happens if I do not have records?

New Jersey (for example) can estimate what is owed based on a statistical assessment of the asset holder's historic operations and "typical" level of abandonment.

How does this affect my business?

States have become much more active in conducting escheat audits, since this has become a prime but essentially untapped source of tax revenue, and there likely will be little warning. The State may simply start it's inquiry by asking for a list of all checks outstanding at least three years and may also contact customers and vendors to derive an estimate of the amount due. Further, to enhance their collection efforts, the states may contract with third party auditors and/or collectors (i.e., "bounty hunters") to pursue claims outside their borders.

What do I do?

The first step is to estimate you exposure. Do you have long-standing escrows or deposits on uncashed checks to customers or vendors or payroll checks? Have they been outstanding - without activity - for more than the applicable escheat period (3 years in New Jersey and 5 years generally and 2 years with respect to unclaimed wages in Pennsylvania)?

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If it appears that you have a future exposure, there are several planning techniques may obviate or lessen the risk, and you may wish to discuss your special circumstances with one of our corporate/tax attorneys.