How Did This “Tax” Land On My Desk?

Presented by:

Katie Friel, Assistant General Tax Counsel, Entergy Services, LLC

Michael Giovannini, Partner, Alston & Bird LLP

Lynn Hall, Manager, District of Columbia Unclaimed Property Unit

Mary Ann Horgan (Moderator), Vice President-US Tax, RELX Inc.

30th ANNUAL

PAUL J. HARTMAN

STATE AND LOCAL TAX FORUM

Agenda

1. General Overview
2. Best Practices
3. Deep Dive: Issues in Unclaimed Property Law
4. Wrap-up/Q&A
5. Unclaimed Property Addendum

1. General Overview

“TAX” NOTICES

EXPECTED

- Notice of Assessment or Adjustment
- Notice of Proposed Assessment or Adjustment
- Audit Notice
- Statement of Account
- Notice of Return Adjustment and Adjustment of Credit Carryforward

UNEXPECTED

- Escheat/Unclaimed Property
- Garnishments for employees or vendors
- Business license notices
- Notices of changes to city limits
- Requests to buy property
- Unemployment claims
- US Census Bureau information
- Notice of Offset/TOP (Treasury Offset Program)
- Customer contract language/potential issues

ATTITUDES Towards the unanticipated

NOT MY RESPONSIBILITY!

- Unwilling to take on matters even arguably within the scope
- Exacerbated by staffing issues

EVERYTHING IS MY RESPONSIBILITY!

- Takes on whatever work happens to land on desk
- Handles matters regardless of qualification

MIDDLE GROUND

- Is the work within the scope of my responsibilities?
- If not, is there a reason for me to handle (one off, special knowledge, etc.)?
- If better handled by someone else, who? Requires knowledge of your business, personnel and capabilities

2. Best Practices

Best Practices

First Question to Answer: Does this fall within or outside my responsibilities? This will drive the next step(s).

Which other team(s) might need to be involved?

Who are the appropriate stakeholders within that team(s)?

Can/should someone from that team lead the resolution?

These situations have great hidden opportunity in partnering with your businesses.

Best Practices

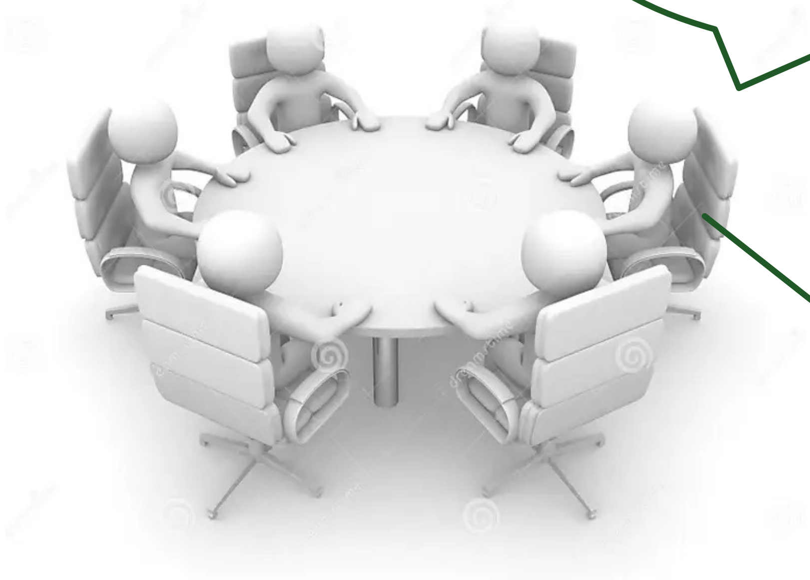
If you are still asked to remain involved, make sure there is a clear understanding of your role.

You may contribute information, you may manage the process and/or be the main point of contact.

Do a post-mortem to identify the lessons learned and share them among those who were involved.

Is there a process that needs to be put in place or revised?

Do you need to be involved in the future? Maybe not.



But it is critical that you keep those other stakeholders involved and responsible for their contributions. *Don't slip into taking on their responsibilities.*

3. Deep Dive: Issues in Unclaimed Property Law

Unclaimed Property 101

- *What* is unclaimed property?
  - High-level definition: tangible or intangible personal property that has gone unclaimed by the rightful owner after a specified period of time (i.e., the "dormancy period")
  - Roots are in English common law:
    - Escheat vs. Custodial
  - Governed and enforced at the state level
  - Fifty-four (54) reporting jurisdictions including all 50 states plus DC, Puerto Rico, Guam and U.S. Virgin Islands
    - Though there are uniform acts, no two laws are exactly the same

Unclaimed Property 101

- ***What*** **is unclaimed property?**
  - Unclaimed property can be tangible (safe deposit box contents) or intangible property (securities-related property and general ledger property) due and owing to a third party (the owner) where there has been no contact with the owner for a specific period (dormancy period).
  - Non-exhaustive list of property types:
    - Un-cashed checks
    - Deposits
    - Customer credits
    - Refunds
    - Unapplied payments
    - Dormant accounts
    - Benefit payments
    - Accounts receivable
    - Accounts payable
    - Escrow Accounts
    - Cryptocurrency

- Un-exchanged shares
- Unpaid dividends
- Underlying stock
- Other general ledger items
- Tangible property
- Commissions
- Rebates
- Payroll
- Unidentified cash/credits
- Life insurance proceeds

Unclaimed Property 101

- *Who* has the obligation to report unclaimed property?
  - The "holder" of the property is required to report and remit the property
  - The "holder" generally means the person or entity that is indebted to the owner with respect to the property
  - A holder is analogous to a taxpayer
  - Holders can be any type of business or financial organization (but generally <u>not</u> an individual person)

Unclaimed Property 101

- *Why* do these laws exist?
  - A place (State) to report/remit funds
  - Reunite lost owners with their property
  - Prevent unjust enrichment of companies
  - Benefit all citizens of a particular state
  - Release/Indemnification for holders

Unclaimed Property 101

- ***Where*** must unclaimed property be reported/remitted?
  - SCOTUS established the common law jurisdictional rules in *Texas v. New Jersey* (1965), as follows:
    - The state in which the owner is located, if known to the holder ("primary rule")
    - If the owner's address is unknown, the state of domicile of the holder of unclaimed property ("secondary rule")
    - If neither rule applies, many states provide that the state in which the transaction occurred, though this rule has been held to be likely unconstitutional by one federal court
  - NOTE: Congress can preempt the federal common law rules and has done so on one occasion (*see* Disposition of Money Orders and Traveler's Checks Act)
  - Several states have provisions that the secondary state has jurisdiction to escheat property if the address of the owner is in a foreign country

Unclaimed Property 101

- *What do unclaimed property laws require?* All states have an unclaimed property law. While these laws vary, all laws:
  - Establish time periods after an obligation becomes "due and payable" when it will be "presumed abandoned" by owner, if not claimed/paid
  - Require holders to perform "due diligence" to attempt to locate owners of property that is presumed abandoned
  - Require reporting and payment to the state of obligations that are presumed abandoned and owner cannot be located
  - Require state to maintain custody of property and pay it to owners who subsequently come forward to claim the property
  - Provide some provision for failure to report or remit property on a timely basis, including penalties and/or interest

Unclaimed Property 101

- ***When must holders file a report?***
  - On an annual basis
    - Most states have an October 31/November 1 deadline for property escheatable as of June 30 that year
    - A handful of states have spring or summer deadlines (including Delaware, Michigan, Pennsylvania, and Texas)
    - Certain states have different deadlines for different holder types; e.g., D.C.:
      - Before November 1 for general holders
      - Before May 1 for insurance companies
  - The typical dormancy period is either 3 or 5 years for most property types, though there can be variation (e.g., 1 year for payroll in many states; 15 years for traveler's checks; 7 years for money orders; etc.)

UP: From Theoretical to Practical

- Standard compliance – all companies are likely holding unreported unclaimed property and thus have an obligation to file reports with states on an annual basis.
- Receipt of audit notice – most states enforce their laws through the use of third-party auditors. Typical audits include multiple states (as many as 35-40).
- Discovery of UP issues in due diligence – similar to tax issues, due diligence incorporate deals can uncover potentially significant unclaimed property exposure.
- Receipt of VDA invitation or other self-audit request – states are increasingly trying to encourage companies to come into compliance without going through a formal audit.

UP: From Theoretical to Practical

- **Standard compliance**
  - Who in your organization is responsible for preparing and filing unclaimed property reports?
  - What lines of business/internal divisions could be holding potentially escheatable property? Are they providing all of the relevant data?
  - How to go about starting to file – consider a software vendor? Consider a full-scope compliance provider?
    - Does your organization have existing relationships with service providers that provide UP/escheatment services?
  - Who is responsible for tracking statutory/regulatory changes and ensuring those are incorporated in the escheat process?
    - Legal?
    - Compliance?
    - Outside counsel?
  - Non-compliance with UP laws could lead to interest and/or penalties
    - E.g., D.C. = 10% interest per year plus a maximum penalty of $5,000

UP: From Theoretical to Practical

- **Receipt of audit notice**
  - First, don’t panic.
  - Review the notice carefully – who is the assigned audit firm? What is the stated scope of the audit (i.e., is it limited in any way)? What is the company instructed to do next? Does the letter contain a directive on pre-submitting or holding reports?
  - Start to assemble the audit defense team, typically consisting of:
    - Legal
    - Compliance
    - Accounting
    - And you (tax)
  - Await outreach from the audit firm and/or receipt of additional state notice letters.
  - Depending on resources, start to “knock on doors” and ask what issues the company may have; start to get a better understanding of the company’s compliance history/standing; etc.

UP: From Theoretical to Practical

- **Discovery of UP issues in due diligence**
  - UP can often be secondary to tax and other liabilities that are discovered in M&A due diligence, but if not dealt with appropriately, these issues can be just as impactful if not more so given successor liability principles.
    - Is the deal a stock sale or an asset sale? That can matter.
  - Develop a due diligence checklist that includes UP issues.
  - Watch items include:
    - Does the target have significant amounts of “breakage” revenue from prepaid cards/similar products?
    - Has the target filed unclaimed property reports?
    - Does the target have any active audits/VDAs?
  - Not always the best fit to include UP in the definition of “tax” – often makes sense to consider more surgical/precise approaches.

UP: From Theoretical to Practical

- **Receipt of VDA/self-audit invitation**
  - States are increasingly "inviting" holders to participate in VDA or self-audit programs in lieu of audit.
  - Delaware in particular has been administering its VDA program for almost 10 years.
  - Time is often of the essence – consider whether there are deadlines for "accepting" the VDA/self-audit invitation.
  - Similar to audits, it will be crucial to assemble the right team and determine who to talk to internally.

[D.C. Spotlight] Performing a Self-Review

- **Self-Review Steps**
  - Analyze corporate structure
  - Understand and document the current and historical policies and procedures
  - Document and review historical unclaimed property reporting history
  - Identify potential types of unclaimed property your company may generate
  - Quantify the potential liability for each property type
  - Research items to verify that they are unclaimed and pay owner where possible

[D.C. Spotlight] Performing a Self-Review

Getting Started

1. *Assign responsibility for UP compliance*. Designate an escheat coordinator to work with the various departments that may generate potential UP including, but not limited to, accounts payable, accounts receivable, payroll, and potentially human resources and risk management.
2. *Identify unclaimed property*. Most companies understand that unresolved liabilities such as uncashed checks, unredeemed gift cards or customer credit balances can result in UP, however there are other not-so-common areas that need to be considered. Keep an eye out for liabilities assumed in an acquisition, self-insured third party benefit plans, small dollar write-off accounts and more.

[D.C. Spotlight] Performing a Self-Review

Getting Started

3. *Develop effective policies and procedures*. Policies and procedures should include high-level narratives of the company's policy regarding UP. The narratives should address the organization's reporting responsibility, summarize the reporting process, assign an escheat coordinator, describe areas where UP may arise within in the company, set materiality limits and record retention rules.
4. *Develop a compliance calendar. Just like your tax filing calendars, a UP compliance timeline is critical for smooth efficient flow of processes and should govern activities for all departments and individuals involved. Since UP has various reporting periods and different due diligence letter mailing timelines depending upon the jurisdiction, a compliance calendar should capture all action steps and due dates for areas where you have reporting responsibilities.*

[D.C. Spotlight] Performing a Self-Review

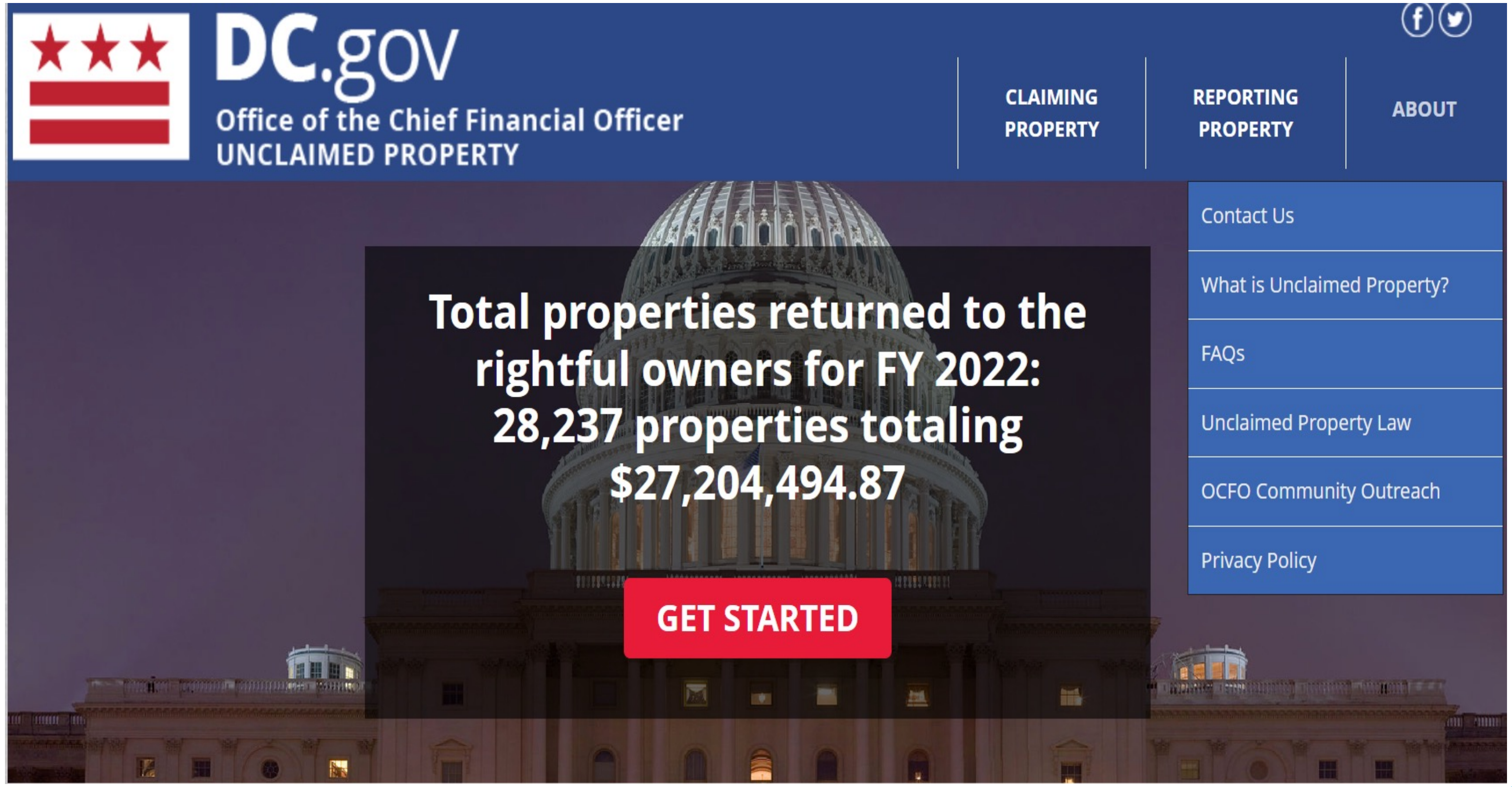
- **Gathering Relevant Data**
  - Corporate Structure
  - Merger & Acquisition History
  - General Ledger / Chart of Accounts
  - Bank Reconciliations / Outstanding Check Lists
  - Journal Entries
  - Accounts Receivable Aging Reports
  - Automatic system write-offs

[D.C. Spotlight] Performing a Self-Review

- **Quantifying the Potential Liability**
  - Identify periods where detailed records are available
  - Research items to determine if they represent a fixed and certain obligation
  - Review records and schedule items that are potential unclaimed property. For example:
    - Stale dated outstanding checks
    - Voided checks that were not reissued
    - Stale dated credit balances

[D.C. Spotlight] Performing a Self-Review

- **Filing Report through Web Portal** – Let's walk through the process



[D.C. Spotlight] D.C. Contacts

Lynn Hall - Manager

lynn.hall@dc.gov

Eric Eichler – Supervisor

eric.eichler@dc.gov

Chardonnay Rawlings - Supervisor

chardonnay.rawlings@dc.gov

District of Columbia Unclaimed Property

www.unclaimedproperty.dc.gov

Other UP Resources/Information

Unclaimed Property Professional's Organization (UPPO)

www.uppo.org

National Association of Unclaimed Property Administrators (NAUPA)

www.unclaimed.org

4. Wrap Up/Q&A

Questions?

Katie Friel
Entergy Services, LLC
kfriel@entergy.com
314-504-8779

Lynn Hall
D.C. Unclaimed Property Unit
lynn.hall@dc.gov
202-442-8181

Michael Giovannini
Alston & Bird LLP
michael.giovannini@alston.com
704-444-1189

Mary Ann Horgan
RELX Inc.
maryann.horgan@relx.com
617-630-2210

5. Unclaimed Property Addendum

Uniform/Model Acts

- Revised Uniform Unclaimed Property Act (RUUPA)
  - Adopted by the ULC in August 2016
  - Not approved by the ABA
  - Enacted in Colorado, D.C., Illinois, Indiana, Kentucky, Maine, North Dakota, Tennessee, Utah, Vermont, Washington (eff. 1/1/2023), and Wisconsin
  - Contains provisions addressing IRAs, stored-value cards, securities, UTMA accounts, education and healthcare savings accounts, etc.
  - Requires holders to send electronic due diligence in addition to U.S. mail
  - Requires state administrator to hold securities for a period of time prior to liquidation
  - Expressly authorizes estimation and third-party audits
  - Implements 10-year statute of limitations (5 years if filed non-fraudulent report)
- Draft Model Unclaimed Property Act – being considered by ABA

Industry-Specific Issues

- **Retail/gift cards**
  - Although a handful of states escheat gift cards, a majority do not; however, many exemptions premised in card not expiring or imposing fees
  - New York and Delaware are two major states that escheat all gift cards (Delaware allows holder to retain profit margin)
  - Establishing special purpose entities in escheat-favorable states has become a common planning technique
  - Can you get a refund on gift cards and merchandise credits previously reported?
    - See *Bed Bath & Beyond* litigation in California and New Jersey

Industry-Specific Issues

- **Financial services**
  - Escheat of securities/brokerage accounts
    - Returned mail vs. inactivity standards
  - Special issues related to IRAs, Roth IRAs, and other similar accounts
    - Interplay of federal tax law
    - CARES Act, SECURE Act, SECURE 2.0 Act, etc.
  - Health and education savings accounts
  - What is “owner-generated activity”?
  - Stock liquidation requirements
  - Are holders potentially liable for “erroneous” escheatment?
  - State claims to foreign-owned property
    - Delaware and other states assert jurisdiction under secondary rule
    - However, constitutional basis is highly suspect

Industry-Specific Issues

- **Virtual currency**
  - RUUPA defines “property” to include “virtual currency,” which means “a digital representation of value used as a medium of exchange, unit of account, or store of value, which does not have legal tender status recognized by the United States.”
    - Excludes “game-related digital content,” “loyalty cards,” and “the software or protocols governing the transfer of the digital representation of value”
  - RUUPA does not provide rules regarding when virtual currency will be escheated
  - RUUPA also does not specify how virtual currency should be transferred to the state
    - A few states (including IL, KY, and WV) do expressly require holders to liquidate prior to transfer
  - Other states are rapidly moving to escheat virtual currency either through legislation or attempting to apply existing laws