



Unclaimed Property ADVISORY ■

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The First State Gets Serious About Unclaimed Property Reform

On June 18, 2015, the Delaware Senate passed Senate Bill 141 (S.B. 141), which if signed into law will have a dramatic impact on Delaware's right to conduct audits of holders' unclaimed property compliance as well as the underlying methodology of such audits. S.B. 141 will also make the Department of State's voluntary disclosure program (which was scheduled to sunset in 2016) permanent. Finally, S.B. 141 will modify the lookback periods that apply both to voluntary disclosure agreements and audits. This bill has its roots in a two-year-long process undertaken to review Delaware's controversial administration of its Escheats Law (the "Abandoned Property Law"). It also introduces a sea change in how Delaware-domiciled holders will assess their potential unclaimed property exposure and ongoing compliance.

The Delaware Task Force and Genesis of S.B. 141

On June 26, 2014, the 147th Delaware General Assembly unanimously passed Senate Concurrent Resolution No. 59, establishing an "Unclaimed Property Task Force" to "inquire into, examine, study and make findings and recommendations to improve fairness and compliance in the State's unclaimed property program." The Task Force was established, in part, in response to growing criticism of the state's enforcement practices as well as issues raised by pending litigation.¹ The first tangible result from the Task Force was the enactment of Senate Bill 11 (S.B. 11), which implemented some less controversial recommendations of the Task Force.²

Most notably, S.B. 11 limited the number of audits undertaken by a single outside audit firm after January 1, 2015, to 50 percent of total authorized audits and limited the length of an outside audit firm's contract to five years. The legislation also provides for a two-year cooling-off period for senior state unclaimed property employees before they can work for an outside audit firm. In addition, as a result of S.B. 11, decisions made by the independent reviewer in any administrative appeals are now binding on the Secretary of Finance unless properly appealed to the Delaware Court of Chancery.³

¹ See, e.g., *Delaware ex rel. French v. Card Compliant, LLC*, No. N13C-06-289-FSS (Del. Sup. Ct.); *Temple-Inland, Inc. v. Cook*, 1:14-cv-00654-SLR (D. Del.).

² 80 Del. Laws c. 2 (2015). For additional information, see Mayrack and Hedstrom, "Delaware Unclaimed Property Law: Recent Developments and the 2014 Unclaimed Property Task Force," *Bloomberg BNA* (Feb. 27, 2015).

³ The legislature revised the Abandoned Property Law in 2010 to provide for an administrative appeal process, including an independent reviewer outside of the Department of Finance. See 77 Del. Laws 417 (2010).

Although S.B. 11 implemented several of the Task Force's recommendations, it did not address a number of key holder concerns, some of which were addressed by the Task Force, including Delaware's lengthy audit lookback period to 1981.

On June 16, 2015, S.B. 141 was introduced in the Delaware Senate, which passed the measure on June 18. This bill does what S.B. 11 failed to do in many respects—that is, address various key holder concerns with Delaware's administration of its Abandoned Property Law. If ultimately signed into law, S.B. 141 would fundamentally overhaul such administration. This legislation has bipartisan support and has a strong chance of being enacted, likely before the legislature adjourns on June 30, 2015.

Significant Changes to the Delaware Audit Program

While all of the provisions within S.B. 141 are noteworthy, arguably the most significant provision contained within the bill is the requirement that for periods *beginning July 1, 2015*, all holders must first be notified by the Delaware Secretary of State (SOS) that it may enter into the SOS's voluntary disclosure agreement (VDA) program before being subject to audit by the Department of Finance. In this regard, S.B. 141 permanently extends the current VDA program, which was initially established in 2012.

If a company does not enter into the VDA program within 60 days after receiving an invitation to participate by the SOS, the company "will be referred to the State Escheator for examination." However, S.B. 141 also shortens the audit lookback periods generally—a reform that holders and industry groups have advocated for many years. S.B. 141 would establish a 1986 lookback for pending audits, essentially codifying the audit lookback regulation.⁴ Audits beginning after July 1, 2015, but on or before December 31, 2016, would have a lookback to 1991. Audits beginning after January 1, 2017, would have a lookback of 22 years prior to the calendar year in which a holder receives an audit notice (three years longer than the corresponding lookback for a holder under a VDA). Thus, under S.B. 141, audits beginning in 2017 would look back to 1995, not 1981, as they would under current audit practice. Moreover, the lookback period will roll forward rather than having a fixed date.

The shortening of the lookback periods was likely done in response to widespread holder criticism and pending litigation, which has often focused on the length of the lookback period and the attendant estimation of liability. Indeed, Delaware legislators themselves have hailed S.B. 141 as legislation that will make the administration of the Abandoned Property Law "more legally sustainable, more legally justifiable."⁵ While the shortened lookback period is certainly an improvement, it bears mentioning that it still generally exceeds all other state lookback periods, even beginning in 2017, including those periods set forth in the various versions of the Uniform Unclaimed Property Act. Further, Delaware has yet to enact meaningful record retention requirements, and the use of estimation on audit will likely continue given that most companies will not retain complete records for 22 years, especially absent a clear statutory requirement to do so.

Holders have long criticized both the audit selection process and Delaware's practices on audit. This year's legislative changes would certainly answer some of the concerns by essentially making Delaware's audit regime *optional*, albeit holders would be required to complete the VDA program or be subject to referral to the State Escheator for audit.

⁴ 16 DE Reg. 530.

⁵ <http://www.delawareonline.com/story/firststatepolitics/2015/06/18/senate-unclaimed-property/28943771/> accessed June 22, 2015).

Permanent Enactment of (and Revisions to) the Secretary of State's VDA Program

S.B. 141 will make permanent the SOS's VDA program, which was scheduled to sunset in 2016. Significantly, the bill will exclude any holder from participating if the holder has already participated in the program but formally withdrew or was removed for failure to work in good faith to complete the requirements. In addition, holders participating in the VDA program are/would be subject to the following lookback periods:

- January 1, 1996, for those holders that have entered the VDA program on or before September 30, 2014, and enters an unclaimed property voluntary disclosure agreement and makes payment in full or enters into a payment plan no later than June 30, 2016.
- January 1, 1996, for those holders that have entered the VDA program after September 30, 2014, and on or before December 31, 2016, and enters an unclaimed property voluntary disclosure agreement and makes payment in full or enters into a payment plan within two years from the date the holder's intent to enter into an unclaimed property voluntary disclosure agreement was accepted by the SOS.
- January 1 of the year that is 19 years prior to the year in which the holder enters the VDA program for entrants on or after January 1, 2017.

Current VDA program participants that entered the VDA program after June 30, 2013, are currently entitled to a lookback to 1993. However, if S.B. 141 passes, those holders would also be entitled to the 1996 lookback—three years shorter than the current period. Holders with a filing deadline of June 30, 2016, that are considering filing their VDAs early (i.e., on before June 30, 2015) should discuss with their advisors the benefits of waiting until July to see whether S.B. 141 becomes law in order to take advantage of the potentially shortened lookback period. S.B. 141 also imposes a requirement on holders participating in the program to enter into an agreement with the SOS and make payment in full (or enter into a payment plan) within two years, but the bill permits the SOS to extend such deadline. However, failure to complete the VDA program requirements by the deadline still means that the holder "shall" be referred to the Department of Finance for an audit. This provision applies regardless of whether a holder receives a letter from the Secretary of State. Accordingly, holders that participate in the program "voluntarily" (i.e., without receiving a letter from the Secretary of State) should ensure that they are able to commit the necessary resources to complete the VDA in a reasonable amount of time or else risk subjecting themselves to audit.

Interest Assessment

S.B. 141 does, unfortunately, contain one holder-unfavorable provision—the reenactment of Delaware's statutory interest provision. Delaware previously repealed that provision in 2014.⁶ Specifically, S.B. 141 would reinstate Delaware's ability to impose interest at a rate of 0.5% per month on outstanding unpaid amounts of unclaimed property, with a cap of 25% of the amount required to be paid. The inclusion of this provision was seen as a necessary component given the other holder favorable provisions. Historically, interest and/or penalties were imposed on audits in limited instances and only when the holder demonstrated a lack of "cooperation." Given the impact S.B. 141 will have on Delaware's annual budget, it remains to be seen whether Delaware will start enforcing the interest provision as a matter of normal course in an effort to generate additional revenue for the state. Clearly, this provision will make the VDA program, which provides for waiver of penalties and interest, more attractive.

⁶ 79 Del. Laws c. 278 (2014).

Conclusions and Observations

If a holder has not yet been subject to audit but received a letter from the Secretary of State urging it to participate in the ongoing SOS-sponsored VDA program, the legislation suggests that it is mandatory that the holder will be referred to the Department of Finance for audit if the holder does not elect to participate in the VDA program. However, all other holders that have not yet received audit notices or “invitations” to participate in that VDA program will discover that they have a much more flexible set of options, and thus may be accorded better treatment by the state. While this proposed legislation undoubtedly represents much needed change to numerous controversial practices, key issues related to Delaware’s administration of its Abandoned Property Law still remain unaddressed and holders may still seek to challenge those issues in court. For example, the legislation does little to answer the questions raised related to estimation and/or the retention of records. It is also not clear that participation in the VDA program will yield a better result for holders. On the one hand, an option to participate in the VDA program in lieu of audit gives holders an opportunity to resolve their issues first through the VDA program, and holders may well conclude that they are better off proceeding down that path first, and then later taking their chances on audit if they are unable to secure agreement with the Secretary of State on key issues in the VDA program. On the other hand, it may take a significant amount of time and resources to proceed through the VDA program before it becomes clear that the holder is not going to receive a resolution of its potential escheat issues.

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