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Delaware Softens Unclaimed Property Audit Posture

By Stanford Stevenson

In the two decades subsequent to the United States Supreme Court decision in *Delaware v. New York*,¹ Delaware maintained what was generally recognized as the broadest and most aggressive abandoned and unclaimed property audit program in the country. In *Delaware v. New York*, the United States Supreme Court confirmed the state of incorporation as the second priority state as it relates to state's claims to escheat dormant unclaimed property held by a corporate holder. Thus, in the case of dormant unclaimed property held by a Delaware incorporated holder for which such holder does not have a last known address for the rightful owner on its books and records, Delaware is the state with the highest claim to escheat and take possession of such property. As

Delaware remains the preeminent state for incorporation, escheat has not surprisingly become a significant source of funds to Delaware.

According to the most recent projections by the Delaware Economic Financial Advisory Committee (DEFAC), in the fiscal year running from July 1, 2015, to June 30, 2016, Delaware is expected to collect approximately \$475 million of unclaimed property. This represents the third-largest source of state revenues to Delaware, behind only corporate franchise tax and personal income tax. For the upcoming fiscal year, unclaimed property collections represent approximately 13 percent of all Delaware revenues collected. While Delaware remains legally obligated to return all dormant unclaimed property that it collects to the rightful owner, in actuality only a small percentage of collected property is returned to the rightful owner; thus, unclaimed property serves as a source of revenue to the Delaware general fund.

Background

Over the years, however, complaints from the corporate community regarding perceived over-aggressiveness and potential unfairness in Delaware's unclaimed property audit program began to swell. A common complaint related to the length of the audit "look-back period"—the period that Delaware would audit in the absence of any previously filed annual unclaimed property

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reports. By practice, Delaware traditionally would audit back to transactions occurring as early as 1981. Significantly, this audit starting point had not been adjusted by the Delaware Department of Finance as result of the passage of time.

In order to maintain its reputation as a responsive pro-business jurisdiction, Delaware recently began to take steps to permit entities a more reasonable opportunity to resolve their escheat obligations rather than a lengthy audit conducted by a contract auditor. In 2012, Delaware created a temporary unclaimed property voluntary disclosure program (VDA Program) run through the Office of the Secretary of State of Delaware.² This program provided fewer years of potential liability to participating holders as well as certain other benefits. However, that VDA Program had been set to expire on June 30, 2016. Notwithstanding the creation of the VDA Program, the corporate community continued to express dissatisfaction with Delaware's continuing audit regime tactics and estimation methods.

Thus, pursuant to Senate Concurrent Resolution No. 59 passed in June 2014, the Delaware General Assembly established a legislative task force to examine and consider unclaimed property fairness and compliance issues, with such task force comprised of Delaware legislators, members of the Delaware executive branch, as well as representatives of the holder community. The task force met and discussed various issues related to Delaware unclaimed property during the fall of 2014; its findings were issued at the end of 2014 and included various proposed legislative reforms. In January 2015, Delaware enacted Senate Bill 11,³ which addressed certain procedural aspects of Delaware unclaimed property law, such as the percentage of audits that could be assigned to any particular contract auditor and the required promulgation of an audit procedures manual. However, the more significant issues, such as the reduction of the potential audit "look-back period," were postponed until later in the Delaware legislative session.

The New Legislation

Introduced in early June 2015, Delaware Senate Bill 141 was enacted by both houses of the Delaware General Assembly early in the morning of July 1, 2015, proposing to make many significant changes to the existing Delaware unclaimed property audit and administration regime. Written with input from several former task force members, the proposed legislation provided for significant benefits to the holder community. In general, a company may be subject to a Delaware unclaimed property audit if it is formed under Delaware law or if it conducts any trade or business activities in the State of Delaware. As previously noted, in the absence of any filed annual unclaimed property reports that may have triggered an applicable statute of limitations, Delaware historically has audited companies with respect to unclaimed property liability all the way back to transactions occurring as early as 1981. The key components of the proposed legislation are described below.

Immediate Reduction of the Audit "Look-back Period" for Existing Audits

Effective upon enactment and applicable to all existing and pending audits, the statutory "look-back period" would extend only to transactions in 1986 and after. Previously Delaware had audited companies back to transactions occurring in 1981. Delaware previously had temporarily limited the "look-back period" commencement date to 1986 by regulation. The regulation was set to expire on June 30, 2015. The legislation would make that temporary "look-back period" reduction to 1986 permanent.

Reduction of the Audit "Look-back Period"

With respect to audits commenced after enactment but before December 31, 2016, the beginning of the possible "look-back period" would be moved from 1981 to 1991. As most property is subject to a five-year period of dormancy under Delaware law, the first likely year of liability for holders would be 1996 under the proposed legislation (rather than

1986). For audits commenced on or after January 1, 2017, the legislation would provide for a rolling 22-year “look-back period” of review (thus a 17-year period of potential liability).

Future Audit Procedural Limitation

Effective upon enactment, the proposed legislation would provide that Delaware will not initiate an audit of a holder until such holder has first been invited to participate in an Unclaimed Property Voluntary Disclosure Program. This is an intriguing provision which, in essence, will provide companies a last warning shot to possibly avoid an audit by electing to enter the VDA Program. In the past, however, the Office of the Secretary of State had sent out hundreds of letters inviting companies to enter the VDA Program, and the majority of them were ultimately ignored. Under the terms of the legislation, any company that previously received such a letter but did not enter the VDA Program would be immediately eligible for audit.

Unclaimed Property Voluntary Program Continued

The previously enacted Delaware Secretary of State Unclaimed Property VDA Program had been scheduled to sunset on June 30, 2016. The legislation makes that program permanent.

Reinstitution of Interest on Late Remitted Unclaimed Property

The Delaware escheat statute previously had provided for underpayment interest at the rate

of 0.5 percent per month (capped at 50 percent) on late remitted unclaimed property. In 2014, the provision was deleted. The proposed legislation would reinstitute underpayment interest at the rate of 0.5 percent per month but capped at 25 percent of the underlying liability rather than 50 percent. The legislation provides that underpayment interest is applicable to unclaimed property remitted after March 1, 2016. However, as a result of its prior complete elimination, certain retroactivity issues may be raised.

Administrative Changes

To increase future annual compliance, the proposed legislation provides that the Delaware Department of Finance must require the designation of a contact person by the holder on a filed annual report, and the Department of Finance must send a notice to such contact person in advance of the annual filing deadline if that holder is a regular Delaware filer.

Conclusion

The legislation is expected to be signed by Governor Markell shortly. It will represent a significant benefit to Delaware corporations and companies conducting trade or business activities in the State of Delaware.

Notes

1. 507 U.S. 490 (1993).
2. See 12 Del. C. § 1177.
3. 80 Del. Laws, c.2 .

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