

SOVOS

2023

The State of **Unclaimed Property**

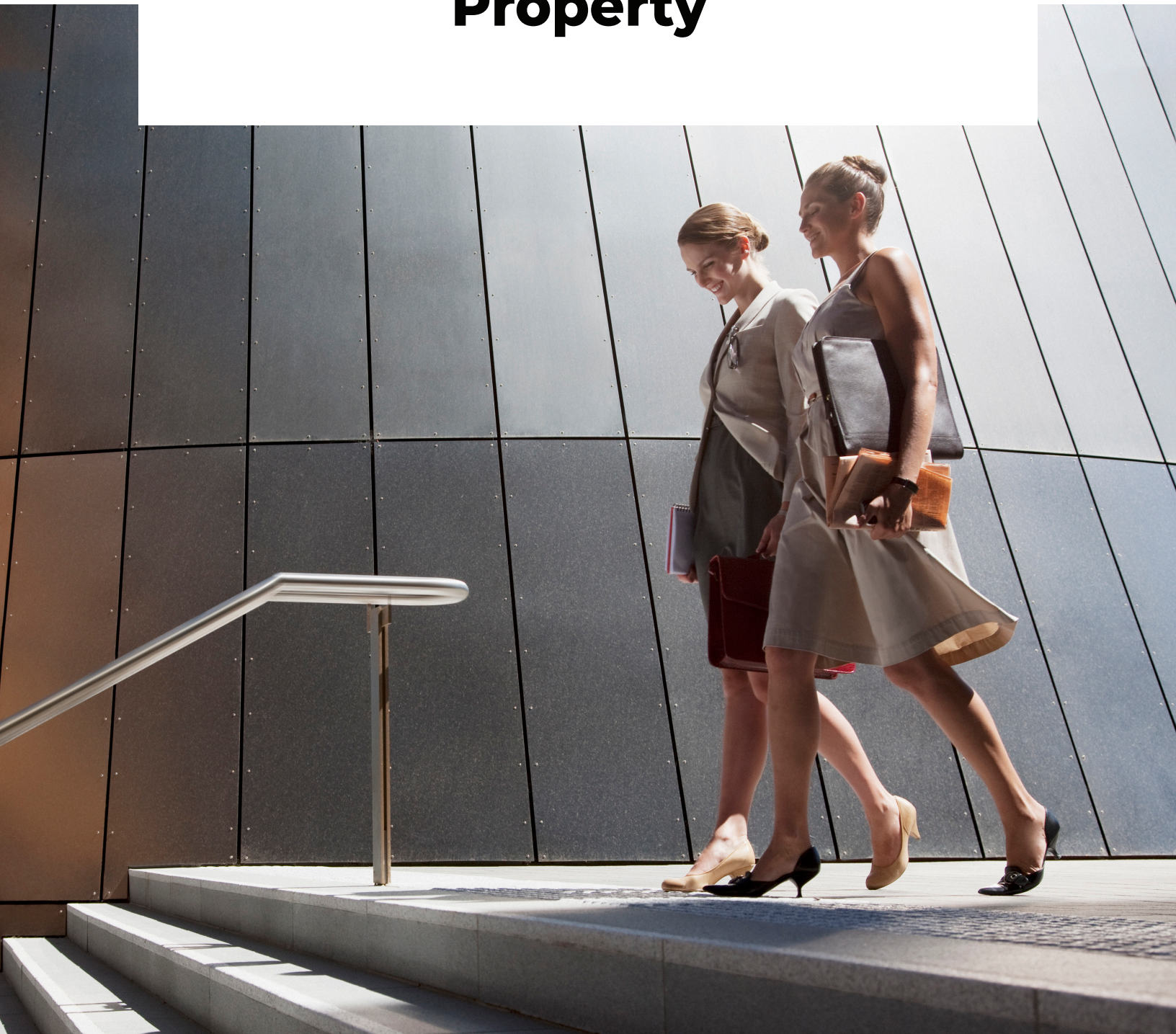


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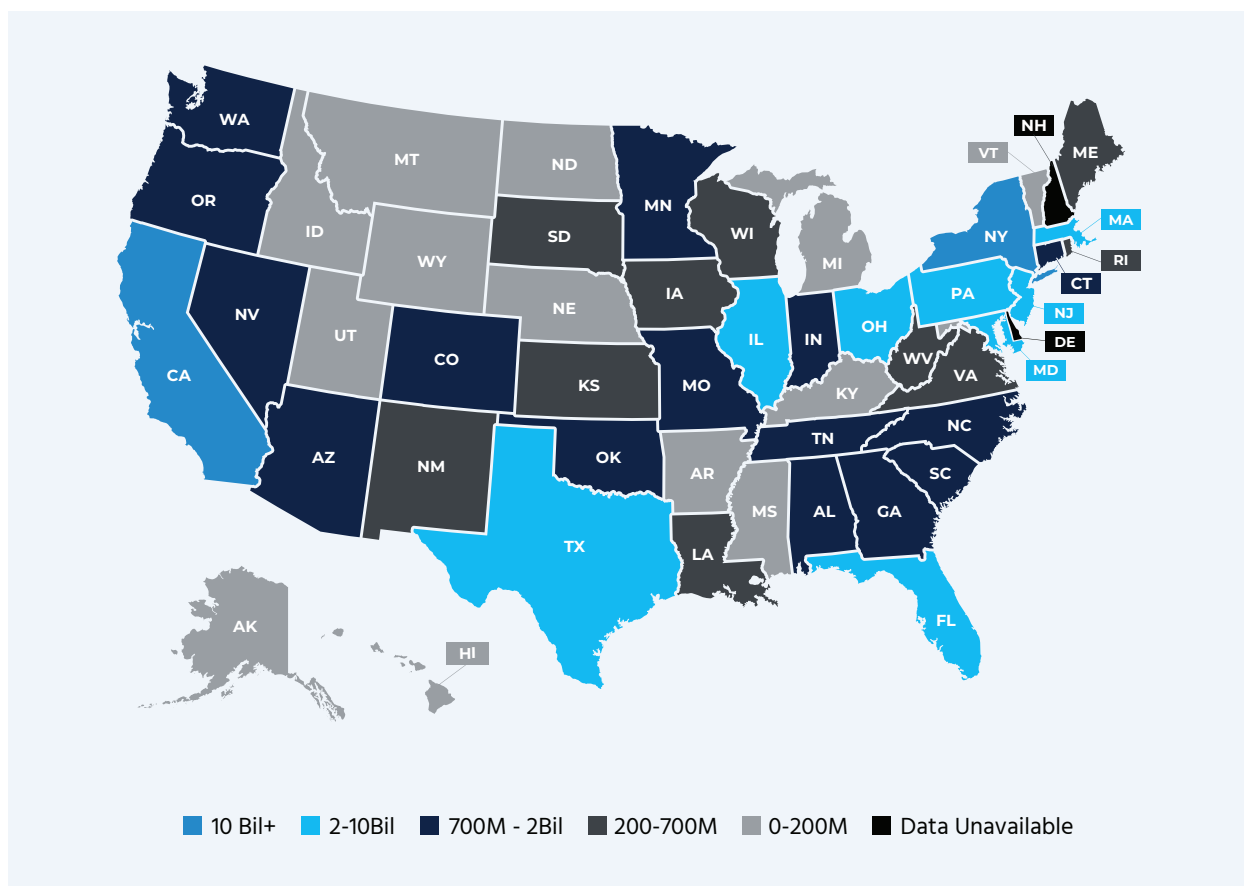
Introduction

WHAT IS UNCLAIMED PROPERTY (UP)?

According to the [National Association of Unclaimed Property Administrators](#), unclaimed or “abandoned” property refers to property, including accounts, held by financial institutions or companies—in which there has been no customer-generated activity (or contact with the owner) or an owner’s property remains outstanding for a period of time, which is known as the dormancy period. For some accounts, not only must they be considered inactive, but there must also be a demonstration the owner is truly lost. The most common example is that mail sent to the owner has been returned as undeliverable. Types of unclaimed property include uncashed payroll, vendor checks, accounts receivable credits, securities, unredeemed gift cards, as well as inactive checking, savings and brokerage accounts. Holders of unclaimed property are required to report unclaimed property across all states in which the owners of the abandoned property have had a last known address.

ARE COMPANIES GENERALLY COMPLIANT WITH UP LAWS?

Research conducted by Sovos found that there are upwards of \$77 billion in UP assets currently in the United States.



Introduction

Despite the amount of unclaimed assets, UP is often overlooked by many companies or considered to be immaterial and inconsequential. However, a lack of compliance with UP laws can lead to costly audits, significant UP liability, large interest assessments, fines and damage to a company's reputation.

With so much at stake, logic dictates that companies have robust compliance processes in place to avoid potential interest and penalties. However, research tells a very different story. It has been estimated by the states and their third-party audit firms that less than 20% of organizations are in full compliance with UP laws. While the states' estimate of compliance is extremely low, the actual rate of compliance is probably a bit higher. It is generally known that the states' calculation of non-compliance is based on some misleading statistics. For instance, states have calculated non-compliance based on the amount of employee identification numbers (EINs) registered in a state versus the amount of EINs actually reporting. However, the calculation does not take into account inactive EINs, EINs with no property to report or that one EIN may be reporting on behalf of many subsidiaries and affiliates with separate EINs. Despite the states' misleading statistics, overall compliance is low.

Low rates of compliance typically stem from the fact that companies across numerous industries often fail to fully understand their UP obligation until they find themselves under audit or receiving a compliance notice from a state. Recognizing the gaps in compliance, unclaimed property audits administered by third-party, contingent fee audit firms are continuing to increase. States understand that a very low percentage of UP is claimed by the owners of the property and that those funds are often appropriated to state budgets. As a result, UP is a prime target for recouping revenue through compliance enforcement. Indeed, as states look for new ways to generate revenue to shrink tax gaps and close budget shortfalls, they are retaining more third-party audit firms that are employing increasingly aggressive audit tactics.

This report will discuss why managing UP is important for businesses and what steps they can take to ensure compliance and avoid lengthy and costly audits.





Why Unclaimed Property is a Priority for States

Closing the ever-widening budget gap has become a priority for states. Currently there is perceived widespread non-compliance of unclaimed property laws leading regulators to dramatically increase the number of compliance efforts and audits they conduct. With budget deficits continuing to grow, companies should expect states to take a more urgent and aggressive position towards unclaimed property compliance to ensure they are maximizing liability.

For example, Delaware counts unclaimed property as its [third highest revenue driver](#). In an effort to increase this lucrative revenue generator, some states are increasing and enforcing their interest assessments against organizations found to be out of compliance.

WHO IS IMPACTED BY UNCLAIMED PROPERTY?

No industry is immune from the statutory and regulatory requirements of unclaimed property. For retail organizations, unclaimed property can present itself through transactions such as customer refunds, uncashed payroll checks, unused prepaid deposits, credit balances or even unused gift cards. Financial institutions may discover unclaimed property in the form of dormant demand deposit accounts, unclaimed securities, loan overpayments, safe deposit box contents and health savings accounts. Even [cryptocurrency](#) is subject to UP, as states increasingly update their regulations to include inactive wallets holding virtual currency as reportable property.

To further complicate matters, organizations must follow [reporting requirements in each state they do business](#). For example, let's say a retailer is based in Massachusetts and sells goods to customers in Alaska, Colorado and Rhode Island. That retailer must follow UP reporting requirements for each of those four states if the last known address was with a customer or vendor in those respective states. The retailer cannot assume that each of those states has similar reporting requirements to Massachusetts as no two state regulations are the same.

UNCLAIMED PROPERTY 101

At its most basic level, unclaimed property is an outstanding liability owed by a company (holder) to an individual or entity (owner) where there has been no activity or contact for a specified period of time (dormancy). Outstanding amounts could be due to a customer, employee, vendor, investor, creditor, etc. Each state has laws directing holders on what to do with this unclaimed property. States often charge interest and penalties for late or incorrect unclaimed property filings. Ultimately, it is reported and turned over to the respective states that hold the unclaimed property in a perpetual trust. Except for states like Arizona that employ true escheat. In Arizona, a claimant must file a claim for their property within 35 years, otherwise the property becomes that of the state. Unclaimed property laws are intended to be consumer protections to reunite owners with their property.

Unclaimed Property is the law and is governed and enforced at the individual state level. No two state laws are identical and laws are frequently changing. As a result, it is imperative that companies stay on top of legislative changes or work with a partner who does. Before property is turned over to the states, companies must perform outreach to the apparent owner of the property; a process known as due diligence. The requirements around due diligence are statutorily mandated and often include requirements that are completed with a prescribed time frame by first class or certified mail to the owner's last known address.

Make sure your company is in full compliance with each state's unclaimed property laws and regulations to avoid potentially serious penalties, interest or audits. As an individual, check to see if you're the one in 10 that [have unclaimed property](#) due to them.

EXAMPLES OF UNCLAIMED PROPERTY

Unclaimed property can be intangible, which is the most common, or tangible. Some of the common forms of unclaimed property include:

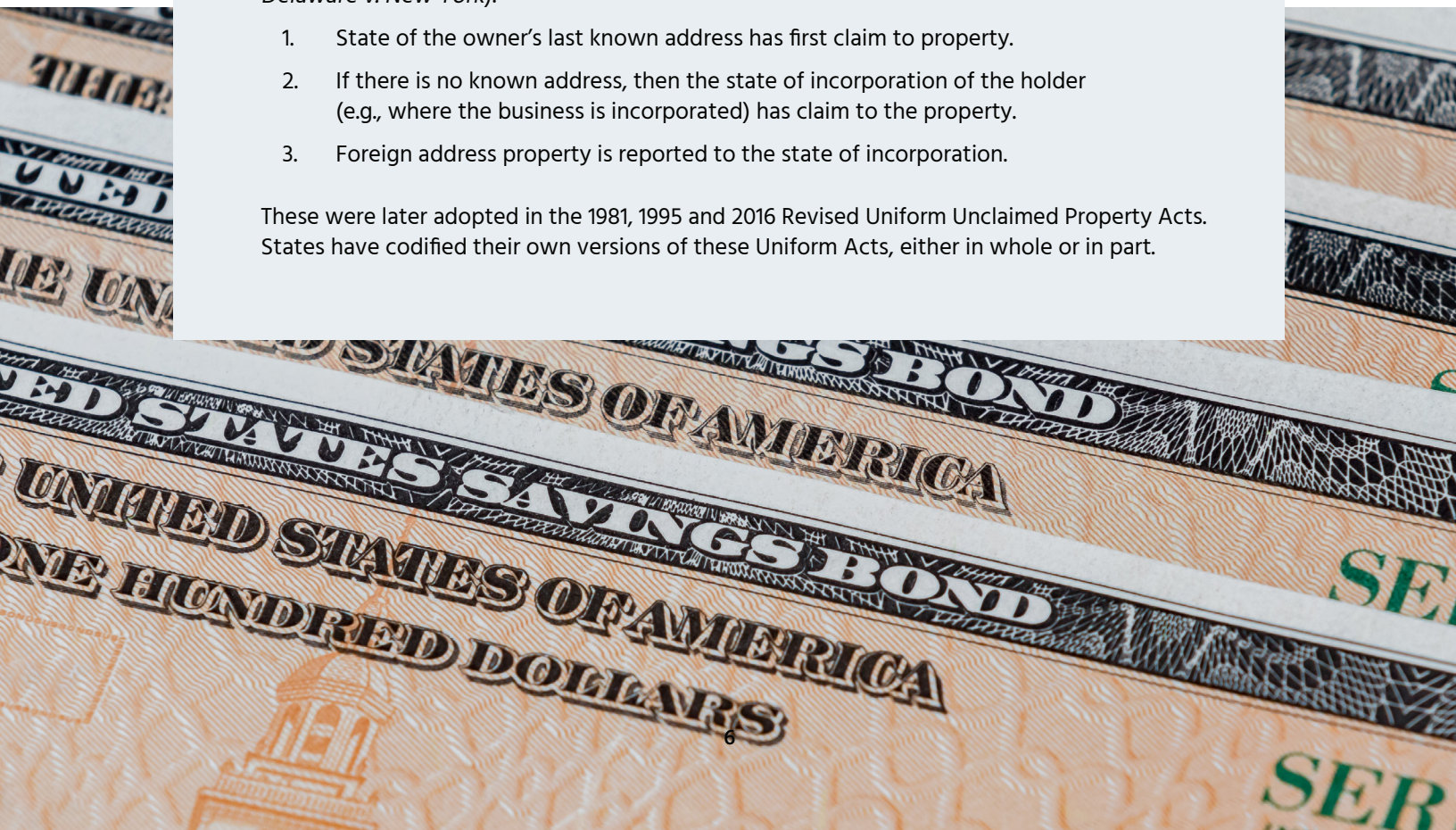
- Checking or savings accounts
- Stocks
- Uncashed dividends or payroll checks
- Refunds
- IRAs
- Unredeemed money orders or gift certificates (in some states)
- Customer overpayments
- Contents of safe deposit
- Insurance payments or refunds and life insurance policies
- Cryptocurrency (in some states)

UP RULES OF JURISDICTION

Priority rules established and upheld in U.S. Supreme Court cases (*Texas v. New Jersey*; *Delaware v. New York*):

1. State of the owner's last known address has first claim to property.
2. If there is no known address, then the state of incorporation of the holder (e.g., where the business is incorporated) has claim to the property.
3. Foreign address property is reported to the state of incorporation.

These were later adopted in the 1981, 1995 and 2016 Revised Uniform Unclaimed Property Acts. States have codified their own versions of these Uniform Acts, either in whole or in part.





Due Diligence - What is it?

State unclaimed property laws require holders of property presumed to be abandoned to make a good-faith effort to reach the owner of the property before turning it over to the state. This process, known as due diligence, notifies owners of presumed abandoned property of the upcoming transfer of property from the organization to the state and requests a response from the owner. Each state has its own unique requirements regarding the format, value thresholds, content and timing of this communication. Due diligence is commonly required between 60 and 120 days prior to the date that the report is due to the state to minimize escheat liability. The goal is to allow the property owner time to respond and potentially claim their property.

WHY IS DUE DILIGENCE IMPORTANT?

Due diligence is important because, in all jurisdictions, it is the law and required component of being in compliance. Non-compliance can result in penalties and the overreporting of property. Failure to perform due diligence can jeopardize the indemnity states offer for holders facing wrongful escheat claims after reporting in good faith.

NOTABLE DUE DILIGENCE REQUIREMENTS

Pre-presumption outreach, electronic due diligence and advertising requirements are unique unclaimed property requirements that vary significantly from state to state. Pre-presumption outreach occurs before a property becomes classified as abandoned or eligible for unclaimed property due diligence mailing. Like due-diligence mailings, pre-presumption outreach's goal is to reconnect owners with their property and to generate activity on an otherwise inactive account. Multiple states also require electronic due diligence in addition to the typical first class mail requirement. While some states are pushing electronic due diligence, others require print advertising in applicable newspapers.

New York is an example of a state that requires advertising in addition to an unclaimed property due diligence letter. Financial institutions, insurance and utility companies are required to publish unclaimed property information in newspapers for records worth more than \$50.

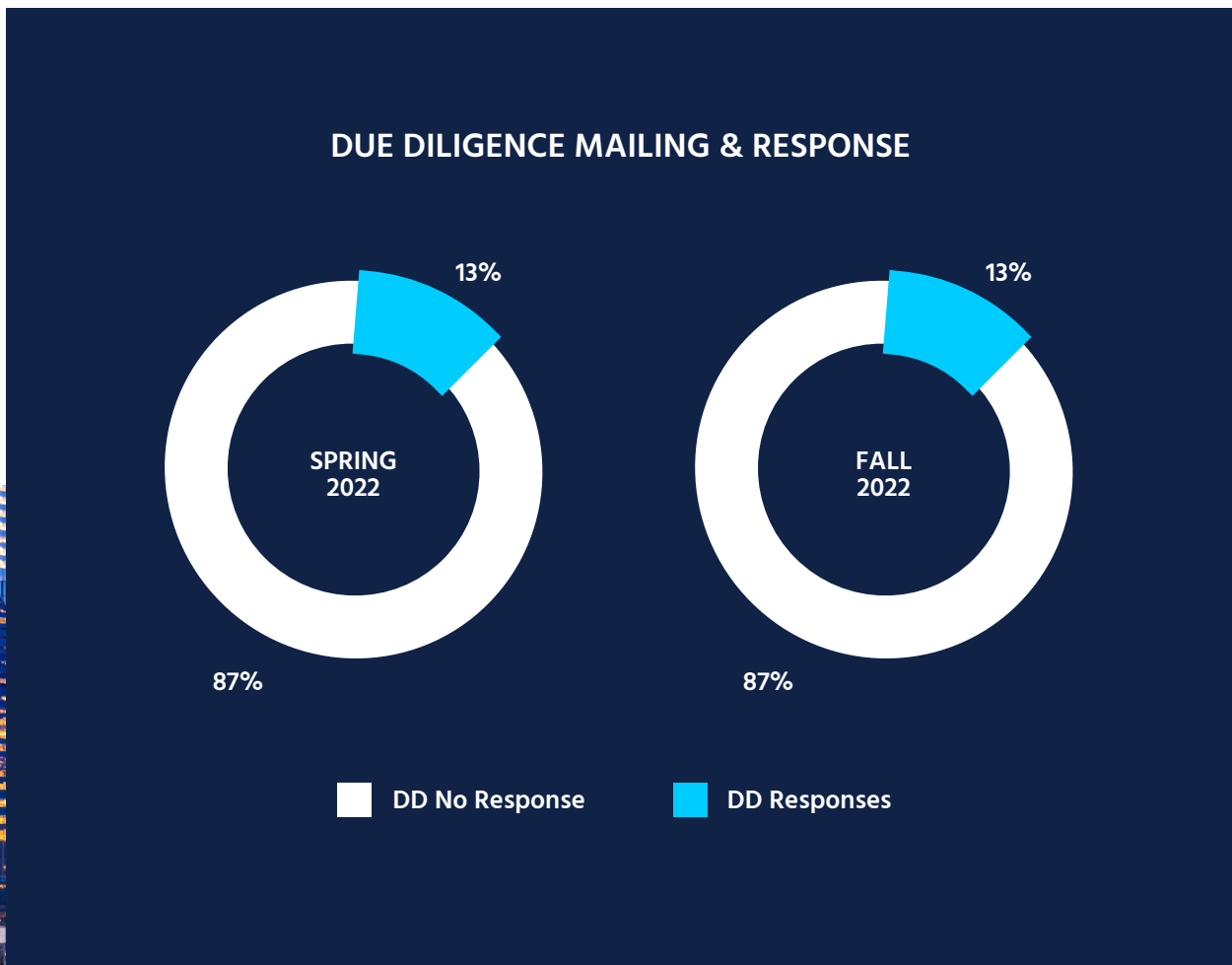
California also has unique requirements. In California, a two-tiered escheat reporting system is used. The Holder Notice Report is the first step of this process, and is due before November 1 of each year. The State Controller's Office then sends its own form of due diligence to owners, informing them to claim their property after which a company must file a final report and remit the unclaimed funds. That final report is due by the end of June of the year following the Notice Report.



Due Diligence - What is it?

DUE DILIGENCE BENCHMARKING

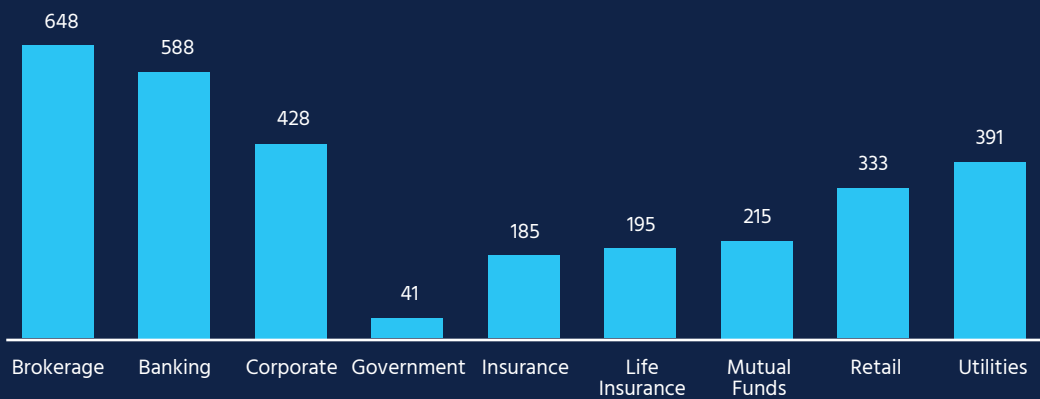
Sovos sampled over 800,000 due diligence letters broken down by season and industry to better understand volume and responses. The analysis showed 40% of due diligence letters sent out in the spring and the remaining 60% sent out in the fall. This makes sense as far more states require UP to be reported by October 31 or November 1. Overall, there was a 13% response rate to due diligence letters.



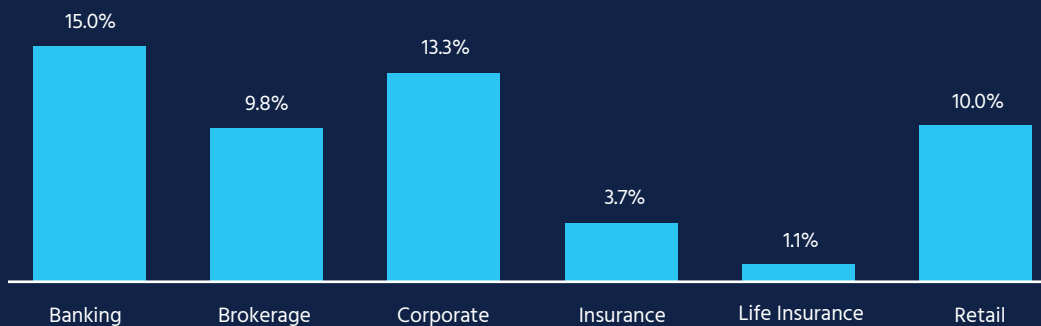
Due Diligence - What is it?

On average, banking holders sent the most due diligence letters annually (648), followed by brokerage (588) and corporate (428). Due diligence response rates for banking averaged 15% and 13.3% for corporate, while brokerage only averaged 9.8% (which could be attributable to the pre-presumption mailings required by the Securities Exchange Commission).

DUE DILIGENCE LETTERS AVERAGE LETTERS MAILED ANNUALLY BY HOLDER



DUE DILIGENCE AVERAGE RESPONSE RATE BY HOLDER TYPE





Unclaimed Property Types by Industry

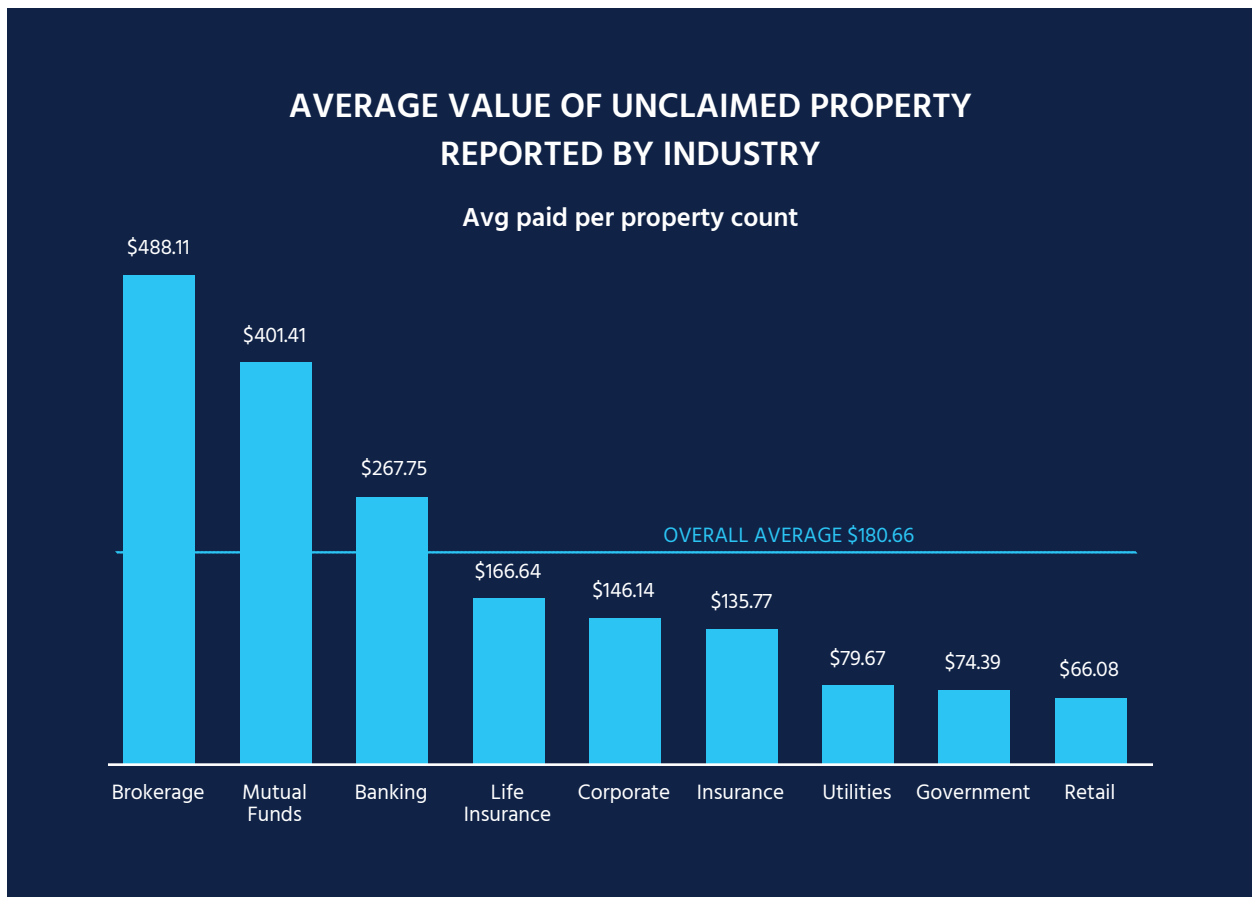
“The [Sovos] team has vast knowledge of the unclaimed property laws in every state and is quick to respond to any questions or issues we may have. My team contact has been exceptional. I highly recommend Sovos Unclaimed Property Solutions and am confident you will be as satisfied as we have been with their services.”

Christopher Welcomer, CEO, DecisionHR

Unclaimed property can be found in any industry, with each sector having its own unique reporting requirements. But are there certain industries that are more prone to generating reportable UP?

Sovos sampled over 4,500 employer identification numbers (EINs), broken down by holder type, to better understand the different UP property types by industry.

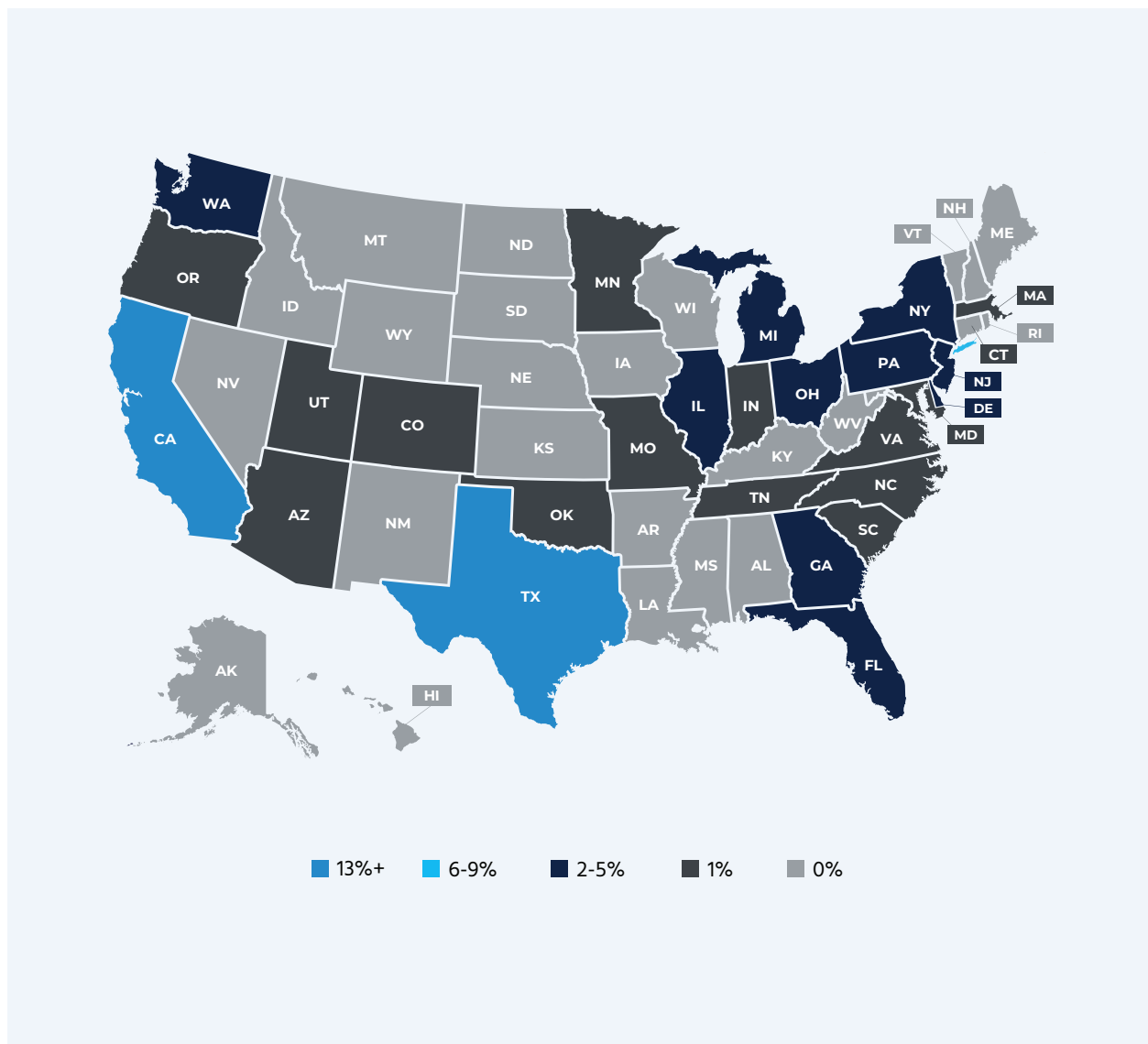
When it comes to the average value of individual properties reported, brokerage firms had the highest valued accounts with \$488.11. Mutual funds (\$401.41), banking (\$267.75) and life insurance companies (\$166.64) were the next highest averages.



UP Property Types by Industry

PROPERTY REPORTED TO STATES

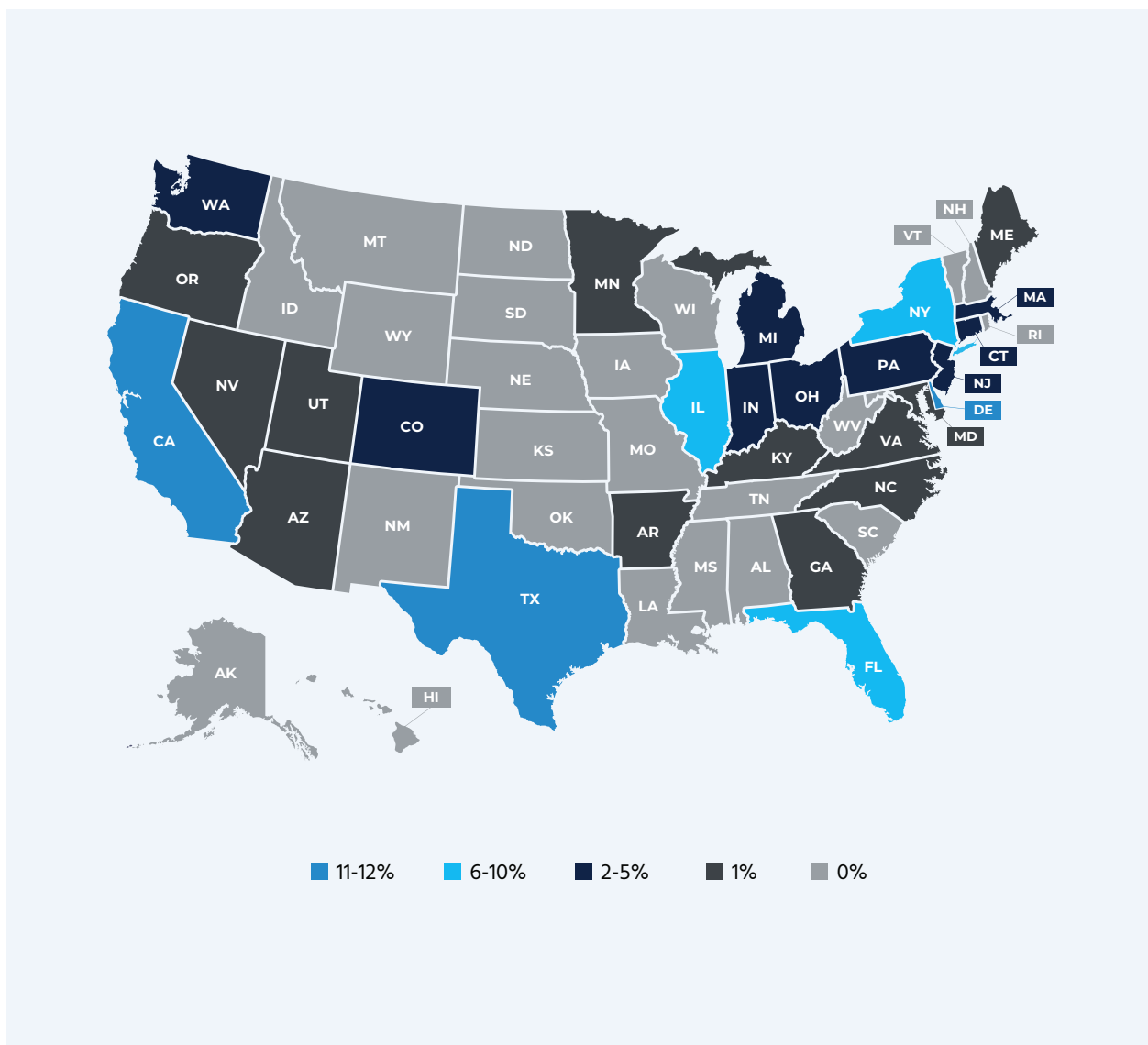
Sovos also reviewed the annual reporting submitted to the states, minus consideration for funds collected through audit or voluntary disclosure programs. Texas accounted for 20% of total property reported, followed by California (18%), Florida (5.5%) and Ohio (5%). This is likely due in large part to population size in these states.



UP Property Types by Industry

CASH REMITTED TO STATES

For cash remitted to states, California (23%) and Texas (13%) led the way. Delaware has the most companies incorporated within the state. This large number of companies incorporated in Delaware means that it receives the majority of foreign addressed unclaimed property and unclaimed property where the owner's last known address is unknown.





How and Why Companies Land on the Radar of Regulators

Frequently, companies ask what triggers an audit or outreach from the states regarding their unclaimed property compliance efforts. This is especially true once a company receives an audit notification letter or an invitation to participate in the Delaware voluntary compliance program. While there is no single reason for an audit to be triggered, there are a few common situations that can increase the likelihood that a company could land on the states' radar.

For example, states pay close attention to market leaders across different industries to better understand behaviors and patterns as it relates to compliance, including unclaimed property compliance. When they discover irregularities or potential compliance gaps within a particular industry, other companies providing similar services can quickly find themselves under increased scrutiny from regulators. The insurance industry experienced this when questions began to arise around the usage of the death master file to identify potentially deceased policy holders. We also see states and auditors focus on industries on a cyclical basis circulating between financial institutions, broker-dealers, mutual funds, oil and gas, healthcare and other sectors on a repeat basis.

States are also improving the computing capabilities of their internal systems, which affords them the opportunity to conduct in-depth analysis to identify companies that report inconsistently or may be missing property types that are common to their industry. Delaware's verified report outreach appears to be an example of this in action. Companies that reported to Delaware in the past, but don't continue to do so in subsequent years, could find themselves receiving the verified report letter.

Corporate activity that generates attention within the media is another reason a company could land on the radar of regulators. Activities such as mergers and acquisitions, inquiries from other regulatory agencies such as the SEC or FINRA, headlines concerning potential fraudulent activities, and company shake-ups can create concern from the regulators regarding the handling of unclaimed properties in these situations.

State unclaimed property officials also use information gathered through compliance with other state taxes to identify companies that may be out of compliance. For example, if a company files sales and use tax filings each year with the state, and their numbers are significant enough to generate potential unclaimed property, the state will look for unclaimed property reports filed for that company. If there's been no filing, the company could find itself as the recipient of a self-review invitation. California recently added questions to its annual Corporate Income Tax reports regarding compliance with unclaimed property reporting. Information gathered through this effort may be used to identify companies that may be targeted for the recently approved voluntary compliance program.

Finally, a sure-fire way to land on the state's radar is to claim unclaimed property being held by the states on behalf of an organization without filing unclaimed property reports to the state. By doing so, a company demonstrates that it's aware of unclaimed property, but is neglecting its responsibilities to come into compliance. Always verify that your books and records are in compliance with state unclaimed property requirements before claiming unclaimed property funds from the state.

There are a multitude of reasons why a company may fall on the radar of an unclaimed property regulator. While a company cannot control when it receives a notice from the regulators, it can control and be prepared for such a review by implementing comprehensive processes and procedures to address unclaimed property compliance.

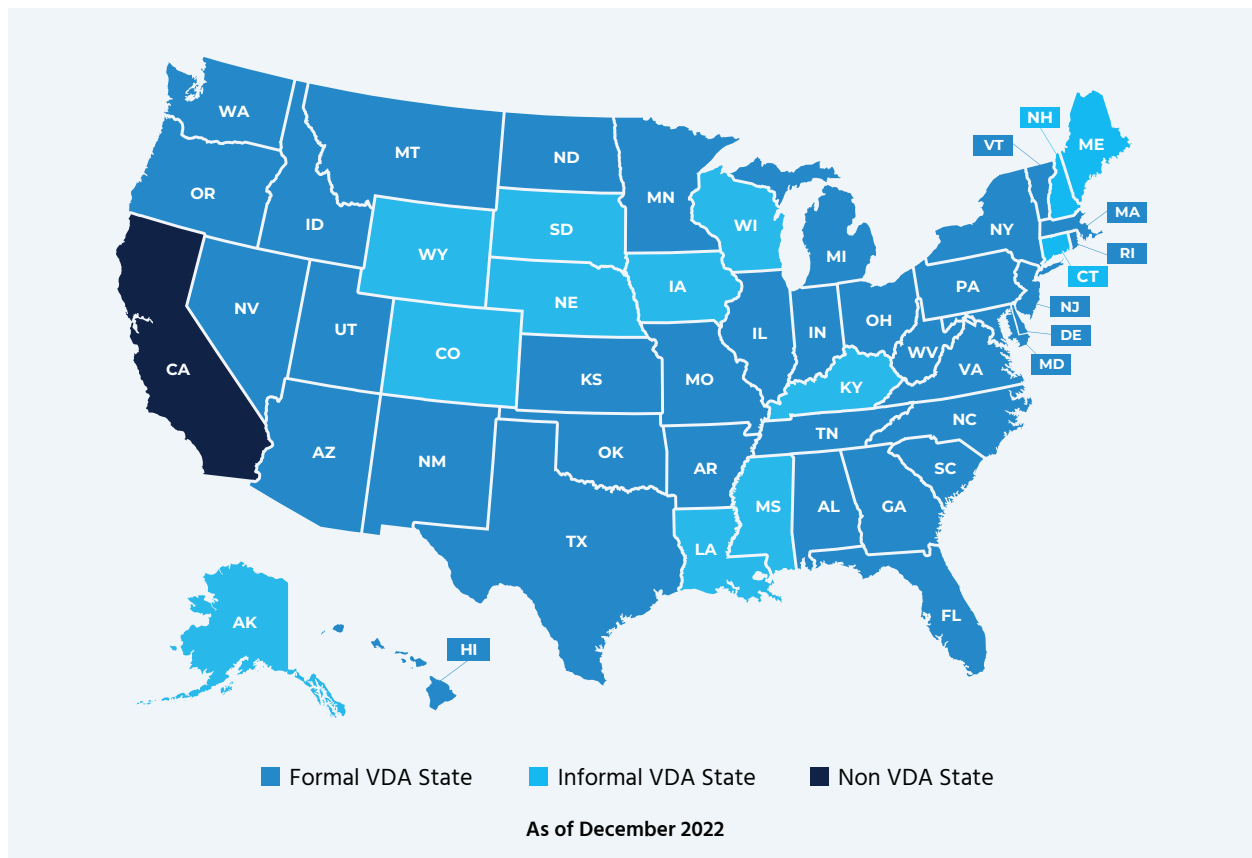


Voluntary Disclosure Agreements

A voluntary disclosure agreement (VDA) is a means for holders to come into voluntary compliance with a state's unclaimed property regulations. By entering into a VDA, businesses can recognize their state unclaimed property exposure and willingly remit any outstanding past due unclaimed property to reduce the risks of a potential audit. With states becoming more aggressive and cracking down on unclaimed property compliance, businesses with past due liabilities can no longer fly under the radar.

States have invested heavily in technology, making it faster and easier than ever to match records and search for inconsistencies. If they find something unusual, they will quickly notify you and may request that you submit documentation supporting a self-review or self-audit of your books and records, which is often times managed by a third party. Some states will skip the self-directed process and refer you for audit, which may be conducted by a contingency-fee auditor. This is a key reason for being proactive about outstanding liabilities. If you realize your company has past-due unclaimed property, filing a VDA may be the most advisable move for your business.

If you are under an audit, it is too late to experience the benefits of a VDA program. Once a state or third-party auditor contacts you, the ability to file voluntarily is extinguished. The process of enrolling in a VDA differs state by state, with most states having some form of a formal VDA program.



Voluntary Disclosure Agreements

BENEFITS OF FILING A VDA:

- Reduces the risk of future audit assessments
- Lowers business costs and reduces deferred liabilities from your financial statements
- Limits the look-back period
- Reduces or eliminates penalties and interest
- Saves time compared to an audit

VDAs give you the chance to report acquired liabilities and/or right your wrongs if you find you have not properly identified and reported your unclaimed property historically. Playing “audit roulette” with the government is a game that companies will almost always lose. Companies should prioritize compliance within each state’s unclaimed property rules to avoid costly penalties and unwanted audits.

- **“I believe being with Sovos has allowed my department to take on additional business without adding employees.”**

• Shannon Morris, senior tax analyst, Nationwide Financial

- **“Sovos listens to our feedback and makes improvements on the service based on that input. They provide both quality products and services, as well as an exceptional staff that delivers on their promises. Sovos feels more like a partner to our business than just a vendor.”**

• Sara D. Smith, chief financial officer, ALPS Corporation





Best Practices for Audit Preparation

Within the past year we have seen a marked increase in the amount of enforcement efforts employed by states to ensure ongoing compliance with unclaimed property requirements, including new self-review programs and an increase in new audits. While today's unclaimed property audits can be a long and complicated process, with costly repercussions for organizations, the self-review programs can be much easier to complete if your organization is prepared. The key difference between traditional audits and the new self-review process centers on who is gathering and evaluating the information needed to determine compliance with unclaimed property requirements. Both programs involve intricate data requests, comprehensive interview schedules and rigorous data analysis. However, with the self-review process, work efforts are conducted in-house versus a third-party audit firm. In both situations, there are several key best practices and recommendations to follow that can ease the unclaimed property compliance process.

First, comprehensive unclaimed property policies and procedures demonstrate the efforts employed by the organization to remain in compliance and will be requested in both audits and self-reviews. Having and maintaining detailed policies and procedures highlighting efforts taken by each area within the organization that could produce potential unclaimed property exposure provides assurance that all aspects of compliance are addressed.

Executing a non-disclosure/confidentiality agreement (NDA), with the third-party audit firm or firm assigned by the states to oversee their self-review programs, before any confidential company is provided is extremely important in the effort to protect confidential information. It is also important to confirm that the NDA also limits the usage of the information learned through the audit or self-review so that it cannot be used for purposes outside of review at hand.

Developing timelines can assist in an on-time and efficient audit completion. Furthermore, appointing a project manager who can work with all areas in treasury and accounting will help ensure complete and researchable data is being leveraged.

Reviewing and verifying record retention policies is also very beneficial. In the event of an audit or self-review, records are needed to demonstrate compliance for the scope of the review that often includes 10 reportable years plus dormancy, depending on the participating state(s). Having sufficient documentation can help avoid the use of estimation for determining unclaimed property liability.

Your business should also employ strategies to potentially reduce unclaimed property exposure. This includes identifying any applicable state exemptions and remediating the high dollar value properties first.

Conducting statutory due diligence and enhanced remediation efforts prior to agreeing to the final schedule of findings will also help to ease the compliance burden.

Remember to respond to auditor requests in a timely manner. However, if more time is needed, ask for an extension. At the completion of the audit, ask the auditor to provide a closing agreement identifying the years, entities and property types included in the review.

Finally, engage the support of experienced unclaimed property consultants who can help navigate the complexities intrinsic to the audit and self-review process. Having professionals available to provide guidance and answer questions can save your organization time and money in the long run.

Increased enforcement efforts are expected to continue as states expand their scrutiny of data available to them. As such, it's only a matter of time before they come knocking on your door. Being prepared with comprehensive unclaimed property policies and procedures and knowing how to address such situations will enable your organization to manage audits and self-reviews efficiently and effectively, while also limiting potential exposures due to the states.





Conclusion – What’s Next on Your Journey?

As companies look to implement a cohesive strategy to better manage UP obligations, there are a set of variables that need to be accounted for to ensure that your solution to the problem doesn’t create bigger issues down the road.

- **Security:** Your reporting solution must be secure and safe from infiltration attempts.
- **Reliability:** Your system is of no value if it’s unreliable and doesn’t work how and when you need it to.
- **Automation:** The goal is to automate your process to increase efficiency and reduce time spent on UP reporting.
- **Support:** No matter how good your system is, there will be times you may need help. In the event of a problem, how quickly can you get your questions answered and have your system functioning properly again?
- **Validation checks:** Ensuring the correct data has been sent to the right recipient, in the right format is critical. Having the right monitoring system in place will reduce the risk of human error.
- **Process notifications:** Real-time notifications to the proper parties keep them fully informed and able to react accordingly.

As states continue to recognize UP as a revenue driver organizations can expect increased scrutiny and more demanding reporting. Make sure your business is taking the necessary steps to stay in front of this trend.





Sovos offers reliable, secure unclaimed property solutions that build compliance with all regulations so you don't have to.

Acknowledgments

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