

## **ESTABLISHING A TIME-BAR ON AN OWNER'S RIGHT TO RECLAIM UNCLAIMED PROPERTY FROM THE STATE IS BOTH UNNECESSARY AND CONTRARY TO THE PURPOSES OF THE UNCLAIMED PROPERTY LAWS**

### **BACKGROUND**

Custodial unclaimed property laws first were enacted in the early 1900s, although it was not until the 1960s that a majority of states operated what are viewed as “modern” unclaimed property programs. Under a custodial unclaimed property law, the state assumes custody, but not the title to reported assets. All of the Uniform Unclaimed Property Acts (which date back to 1954) presume that an owner (or heir) can claim property from the state in perpetuity, regardless of when the property was transferred to state custody.

Escheat laws, which predate custodial unclaimed property laws, are different. Historically, most Americans did not possess financial assets of any material value. Accordingly, there was little in the way of “intangible personal property” that could become “lost.” Some individuals did own real property as well as tangible property, which would typically be passed on to heirs (through either probate or operation of law) upon the owner’s death. For those owners whose heirs could not be located, the state succeeded to the rights of ownership. A formal legal process of “escheat,” involving both notice and a judicial ruling transferring ownership to the state, was undertaken. In assuming ownership, the state cut off the rights of all other claimants. Most states still have “true escheat” statutes, but their application is limited to situations where the owner has died and there is no other identified party to succeed to ownership. Because real property (other than safe deposit box contents) is outside the scope of custodial unclaimed property laws, escheat is principally used to address real estate assets.

State unclaimed property laws have been enacted nationwide for the primary purpose of protecting consumers. The state assumes custody of intangible personal property to both safeguard it, and to attempt to locate the missing owner; the state makes use of the property until the owner is found. Owners may recover their property at any time. Under the unclaimed property laws, the states take custody of unclaimed property in order to preserve the entitlements of missing owners, and to prevent a “holder” from converting the asset to its own property. Until such time as the owner may be located, any “windfall” from the unclaimed property inures to the benefit of the state and not private parties. As the Uniform Law Commission explained at the time it adopted the 1995 Uniform Unclaimed Property Act: “The state benefits from unclaimed property only because it acts as the perpetual custodian for the real owners. If at any time a rightful owner comes forward to claim property, the state must transfer it to the rightful owner.”

Most states do not hold the unclaimed property in trust or otherwise segregate funds, until missing owners are located. Rather, a majority of states take unclaimed property collections into general revenue at the conclusion of a fiscal year. The liability to pay reappearing owners is acknowledged; however, claimants are typically paid from current receipts. Because some percentage of property is never claimed, states have generally not encountered cash flow issues under this model. While some states initially did create “trust funds” in which all unclaimed assets were maintained, over time they

have been viewed as holding “surplus” funds, which have been redirected in part by state legislatures. As a result, the trusts have technically become underfunded, but in reality solvency is not a risk because (a) not all unclaimed property will be paid to rightful owners and (b) as time elapses, the probability that an asset will be claimed substantially decreases.

#### THE CURRENT CONCERN OF SOME STATE OFFICIALS

Aside from the few states that have maintained unclaimed property trusts that are fully funded, for other states unclaimed property liabilities are expressed in two different numbers. The first is the total unclaimed property collected since the inception of the program that has not been returned to owners. The second number is a subset of the first: the total unclaimed property collected since the inception of the program that has not been returned to owners, but is likely to in fact be claimed. For most states, it is only the second number that matters, since this is the “true liability” in terms of likely state exposure. Nonetheless, some state budget officials have become concerned that the first number—the total property collected but unclaimed—has grown too significantly, and although the liability is purely contingent, the liability should be eliminated. An approach that has been proposed in some states is to limit the amount of time in which an owner can file a claim, after which time a claim would be disallowed (along with the associated state liability). In addition to concerns over the total amount of uncollected property, some state officials have expressed concern over the volume of uncollected small-dollar properties. In response, some states have considered proposals to put a time limit on when owners can claim such *de minimis* properties.

#### WHY LIMITING THE AMOUNT OF TIME AN OWNER CAN CLAIM IS CONTRARY TO THE PRINCIPLES UPON WHICH THE UNCLAIMED PROPERTY LAWS ARE FOUNDED

As stated above, unclaimed property programs have been enacted and promoted on the basis that the state is safeguarding the assets of missing owners. Generally, the states have made this representation affirmatively, and without qualification.

The Uniform Law Commission recently updated the Uniform Unclaimed Property Act, culminating in the 2016 Revised Uniform Unclaimed Property Act. During the meetings of the drafting committee, numerous holders (i.e., reporters of unclaimed property) asserted that they were better suited to maintain a missing owner’s unclaimed assets than the states. While the Uniform Law Commission disagreed, it did so under the assumption that states would honor a missing owner’s claim in perpetuity. See Prefatory Note to Revised Uniform Unclaimed Property Act (“The state merely holds possession of the property, indefinitely, as custodian for the benefit of the owner or the previous owner’s successors-in-interest or legal heirs.”). The view of the Uniform Law Commission would quite likely have been different, if states established a bar date for owner claims.

While it is correct that the vast majority of owners claiming property do so within five years of the state assuming custody, some owners (or their heirs) do so decades later. The reasons for not claiming property more timely are potentially numerous, but in most cases it is likely that the owner was unaware of the existence of property in state custody and thus failed to act until they learned of their

entitlement. Although, as discussed further below, there is no real upside to a state in terminating an owner's right to claim, the impact on an individual is potentially significant. In addition to the possible financial loss to the owner, such actions contribute to the distrust in government. This is sufficient reason in and of itself not to cut off an owner's right to recover his or her property.

There is indeed a reasoned argument that there is a substantial *downside* to states in limiting the amount of time that an owner has to recover unclaimed property. Since the state is no longer acting in the best interests of missing owners, the credibility of state programs will be damaged. Additionally, many holders who are already critical of state efforts to return property to missing owners will be provided with an additional argument for legislatively reducing the scope and effectiveness of unclaimed property laws. States programs have spent considerable time and effort refuting the specious argument that unclaimed property is simply a governmental "money grab," operating through the "seizure" of individual's assets. While it may be a stretch to suggest that limiting the time in which an owner may claim property illegitimizes unclaimed property programs, such a move would not be beneficial to either the states or the individual owners that continue to come forward to claim their property many years after it has been turned over the state.

#### WHY LIMITING THE AMOUNT OF TIME AN OWNER CAN CLAIM IS NOT NECESSARY

The issue of proper accounting treatment for unfunded or underfunded unclaimed property liabilities was reviewed by the Governmental Accounting Standards Board (GASB) in 1993. The result was the adoption of Statement No. 21, "Accounting for Escheat Property."<sup>1</sup> Statement No. 21 was subsequently amended in June 2001.<sup>2</sup>

Under the Standard, a liability only need be reported "to the extent that it is probable that escheat liability property will be reclaimed and paid to claimants. The liability should represent the best estimate of the amount ultimately expected to be reclaimed and paid, giving the effect to such factors as previous and current trends in amounts reclaimed and paid relative to amounts escheated, and anticipated changes in those trends."<sup>3</sup> GASB developed this standard in consideration of the following:

The most significant factor considered by the Board in developing this Standard is the nature of escheat property. As a practical matter, for most governmental entities, escheat property consists of two elements: (a) amounts that will be reclaimed by rightful owners of their heirs and (b) amounts that will never be reclaimed and instead will be used by the governmental entity to assist with financing activities. This is so even though the laws of many governmental entities permit escheat property to be reclaimed in perpetuity. In essence, once

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<sup>1</sup> Notwithstanding the discussion included in the "Background" section of this white paper, it is common that unclaimed property held by a state in a custodial capacity is referred to as "escheat property," even though the state has not assumed title to the property. The "escheat property" characterization was utilized by GASB in this Standard, although it is technically incorrect.

<sup>2</sup> The amendments to Statement No. 21 were included in Statement No. 37. These amendments relate to the manner in which a state escheat liabilities should (or should not) be reported in a government's accounting statements, and did not alter the view that unclaimed property liabilities should only be addressed in terms of amounts likely to be claimed.

<sup>3</sup> Statement No. 21 of the Governmental Accounting Standards Board, "Accounting for Escheat Property," October 1993, p. 2.

the property escheats to the governmental entity, the entity has an accounting liability for the amounts that ultimately will be reclaimed and paid. Thus, the *accounting* liability (which takes into consideration the probability of payment) represents that portion of the *legal* liability (which exists into perpetuity) that is to be expected to be reclaimed and paid.<sup>4</sup>

In those few states that have considered establishing a time bar for an owner's recovery of unclaimed property, the time bar discussed is typically many years following the state's receipt of assets, e.g. 20 years. However, within five years following receipt, a majority of owner claims that will be made have already been paid. In year six and later following a state's receipt of property, claims fall-off precipitously. While claims to property are still being made 20 years after property is received by a state, the actual incidence (and value) of such claims is low.<sup>5</sup> Under the GASB approach,<sup>6</sup> the state need only identify a liability for those amounts that there is a probability will be claimed, and not those amounts unlikely to be paid to reappearing owners.

#### WHY EFFECTIVELY LIMITING THE AMOUNT OF TIME AN OWNER CAN CLAIM MAY CONCERNS BE DIFFICULT AND COSTLY TO ACCOMPLISH

Because unclaimed property is received by the state in its capacity as a custodian, and the state does not take title to the property, unclaimed property remains the property of individual owners. To the extent that a state effectively cuts-off an owner's right to claim the property, the state may be subject to an argument that it has engaged in an improper taking of private property.

In certain circumstances a state may in fact "take" private property, but under the Fifth and Fourteenth Amendment to the U.S. Constitution (as well as many state constitutions) a state must provide due process. The specific steps that a state must undertake to take title to unclaimed property have not been addressed by the U.S. Supreme Court; however, the 2006 decision in *Jones v. Flowers*, 547 U.S. 220, is potentially instructive. In that case, a certified letter sent to a homeowner was deemed insufficient in order for the state to subject the owner's home to public sale due to unpaid property taxes. The Court discussed a need to perform "additional reasonable steps" to notify an owner of property that is to be taken, where past efforts to notify the owner have failed. Without a definitive ruling on this issue, a state enacting a statute that establishes a time limit on the right of owners to claim their property after it has been turned over to the state may be subject to legal challenges by both holders and owners of unclaimed property on constitutional grounds.

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<sup>4</sup> *Id.*, p. 5 (emphasis in original).

<sup>5</sup> While the incidence of claims being filed several decades after property received by a state is low, it does occur, and those claimants are paid. While both legal and empirical arguments exist as to why an owner's claim should not be time-barred, there is additionally the argument of fundamental fairness. When viewed from the standpoint of a disenfranchised owner, the government assumption of title to personal property is repugnant.

<sup>6</sup> The GASB approach is consistent with the approach taken in the private sector with respect to contingent, remote liabilities. See Financial Accounting Standards Board, "Exposure Draft, Revenue from Contracts with Customers," November 14, 2001, p. 51. This standard was adopted as ASU 2014-09 (Topic 606) and IFRS 15 and became effective December 15, 2016.

In addition to potential arguments regarding the legally-required procedures for cutting-off the claims of missing owners, it should be noted that a state enacting such a cut-off may also need to consider whether other provisions of its unclaimed property law might require revision. As previously noted, state unclaimed property laws are constructed in a manner that presumes an owner may reclaim property at any time. By way of example, most state statutes authorize that a holder, after transferring property to state custody, may pay a missing owner, and then seek reimbursement from the state. Consideration of whether a holder could continue to do so, or whether such arrangements would likewise be barred, would need to be addressed. Other provisions impacted by a time-bar to owner claims would also need to be identified and potentially revised.

In addition to the foregoing, to the extent that state officials have proposed establishing a time bar limited to small-dollar claims, this can raise concerns over how to identify and treat multiple, related properties that individually may be under an established threshold but collectively are not. Similar concerns exist over multiple small-dollar properties belonging to the same owner that in the aggregate exceed any proposed threshold. Given the unclaimed property laws underlying purpose of safeguarding and protecting owners' property in perpetuity, enacting a time bar even for small-dollar claims is problematic. Increasingly, states have found ways to efficiently and cost-effectively handle these types of properties, such as automatically issuing checks to owners for whom an address can be identified, or other simplified claims processes.