

State & Local Tax **Alert**

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Delaware Fundamentally Changes Unclaimed Property Law, Makes VDA Permanent

On July 22, 2015, Delaware Governor Jack Markell signed legislation which makes fundamental changes designed to improve the state's unclaimed property law.¹ This recent legislation follows a number of legislative changes made since 2012 in response to the general negative perception of Delaware's unclaimed property law and its administration.² Both the recent legislation and legislation enacted in January 2015³ adopt most (but not all) of the recommendations made by Delaware's Unclaimed Property Task Force. The Task Force was formed in June 2014 to recommend improvements to the state's unclaimed property program⁴ and issued its final report in December 2014.

VDA Program Made Permanent, Look-Back Period Reduced

When auditing a holder of unclaimed property, Delaware has traditionally reviewed books and records beginning with calendar year 1981, or in certain circumstances, calendar year 1986 (the "look-back" period). The State Escheator, operating through the Department of Finance, had also long offered a voluntary disclosure agreement (VDA) program.⁵ Those who entered into the State Escheator's VDA program were offered a shorter look-back period beginning with calendar year 1991. However, the State Escheator's VDA program suffered from a general perception of being so difficult as to be little better than an audit.

To encourage holders to enter into VDAs, the state offered a new VDA program administered by the Delaware Secretary of State.⁶ The Secretary of State VDA program was originally closed to new entrants on September 30, 2014.⁷ Those who had entered the VDA program between July 1, 2014 and September 30, 2014 were offered a reduced look-back period beginning with calendar year 1993.⁸

Under the recent legislation, the Secretary of State's VDA program is now made permanent, so that holders meeting the program's requirements will be allowed to enter

¹ S.B. 141, Laws 2015.

² See, e.g., Douglas L. Lindholm and Ferdinand S. Hogroian, *COST Scorecard on State Unclaimed Property Statutes*, Council on State Taxation, Oct. 2013, grading Delaware a D-minus.

³ S.B. 11, 2015.

⁴ S. Con. Res. 59, Laws 2014.

⁵ DEL. ADMIN. CODE 12-100-000.

⁶ DEL. CODE ANN. tit. 12, § 1177(a).

⁷ DEL. CODE ANN. tit. 12, § 1177(b)(2).

⁸ *Id.*

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into a VDA at any time.⁹ Generally a holder may enter the Secretary of State's VDA program unless it previously entered the State Escheator's VDA program, received a notice of examination from the State Escheator,¹⁰ or now under the recent legislation, either formally withdrew or was removed from the Secretary of State's VDA program.¹¹

Importantly, those who had previously entered the VDA program by September 30, 2014 (and had initially been offered a look-back period beginning with calendar year 1993) will now have that look-back period reduced to calendar year 1996. Further, those who enter the VDA program through December 31, 2016 will also have a look-back period beginning with calendar year 1996.¹² Those who enter the VDA program on or after January 1, 2017 will have a 19-year look-back period.¹³

Holders that enter the VDA program must make "payment in full or enter 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 Secretary of State."¹⁴

No Audit Without Opportunity for VDA

Importantly, effective July 1, 2015, the State Escheator will not be allowed to audit a holder unless the holder is first notified in writing by the Secretary of State that the holder may enter into an unclaimed property VDA.¹⁵

Holders must respond to the Secretary of State's offer to enter into a VDA within 60 days of the mailing of the offer or else be referred to the State Escheator for audit.¹⁶ The State Escheator may also audit a holder if the holder fails in its responsibilities under the Secretary of State VDA program.

Audit Look-Back Period Reduced

Effective as of the date of enactment of the legislation,¹⁷ for any ongoing audits the look-back period is reduced to begin with calendar year 1986. For any audit initiated from the date of enactment through December 31, 2016, the audit look-back period is reduced to begin with calendar year 1991.¹⁸ For any audit initiated on or after January 1, 2017, the audit look-back period will be 22 years prior to the report year for which the State Escheator provides written notice of examination.¹⁹

⁹ DEL. CODE ANN. tit. 12, § 1177(b).

¹⁰ DEL. CODE ANN. tit. 12, § 1177(d)(2), (3).

¹¹ DEL. CODE ANN. tit. 12, § 1177(d)(4).

¹² DEL. CODE ANN. tit. 12, § 1177(c)(2).

¹³ DEL. CODE ANN. tit. 12, § 1177(c)(3).

¹⁴ *Id.*

¹⁵ DEL. CODE ANN. tit. 12, § 1155(c).

¹⁶ DEL. CODE ANN. tit. 12, § 1177(b).

¹⁷ Presumably, the date of enactment is July 22, 2015 (date that S.B. 141 was signed by the governor).

¹⁸ DEL. CODE ANN. tit. 12, § 1155(d).

¹⁹ DEL. CODE ANN. tit. 12, § 1155(e).

Annual Filing Reminder Notice

Although Delaware does not require most holders to file an unclaimed property report if there is no amount due (a “negative report” is only required from banking organizations),²⁰ the State Escheator will now send a notice to all holders that have filed a report in the past five years notifying the holder of its apparent obligation to file a report.²¹ The notice will be sent to holders no later than 120 days prior to the annual report due date of March 1.²²

Reinstatement of 0.5 Percent Interest

Historically, Delaware had the authority to impose both penalty and interest on unreported unclaimed property. In May 2014, the state reduced the penalties for failure to file a report to the lesser of 5 percent if the failure is not more than one month, with an additional 5 percent for each additional month, not to exceed 50 percent in total, or a flat penalty of \$100 per day up to \$5,000.²³ Penalties for failure to pay remained at 0.5 percent if the failure is not more than one month, with an additional 0.5 percent for each additional month, not to exceed 25 percent in total.²⁴ At the same time, the state also eliminated the imposition of interest.²⁵

However, in exchange for providing the holder accommodations, Delaware reinstated the imposition of interest. For any late-filed report filed on or after March 1, 2016, in addition to the penalties that may be imposed, interest will be imposed at 0.5 percent per month, up to 25 percent in total, on outstanding unpaid amounts from the date the amounts were due until paid.²⁶ Penalties and interest will not be imposed if the failure to file or pay is due to reasonable cause and not willful neglect.²⁷

Designation of Holder Contact for All Communication

The legislation provides that holders must designate an individual employee to serve as the contact for all correspondence with the state related to reporting and remittance of unclaimed property.²⁸

Remaining Delaware Task Force Recommendations

On December 23, 2014, the Delaware Unclaimed Property Task Force made a number of important findings, namely that unclaimed property is a major source of revenue for Delaware and that despite some improvements made in recent years, the holder community continues to have concerns about the law and administration.²⁹ The Task Force made a number of recommendations, many of which were adopted by the recent

²⁰ DEL. CODE ANN. tit. 12, § 1171(h).

²¹ DEL. CODE ANN. tit. 12, § 1199(a).

²² *Id.*

²³ DEL. CODE ANN. tit. 12, § 1159(a), as amended by S.B. 228, Laws 2014.

²⁴ DEL. CODE ANN. tit. 12, § 1159(b).

²⁵ S.B. 228, Laws 2014, repealing DEL. CODE ANN. tit. 12, § 1159(d).

²⁶ DEL. CODE ANN. tit. 12, § 1159(d).

²⁷ DEL. CODE ANN. tit. 12, § 1159(a), (b), (d).

²⁸ DEL. CODE ANN. tit. 12, § 1199(a)(4).

²⁹ Final Report of the Task Force to Study and Make Findings and Recommendations to Improve Fairness and Compliance in Delaware’s Unclaimed Property Program, at 8, Dec. 23, 2014.

legislation as discussed above. In addition, Delaware adopted four other important recommendations in legislation³⁰ that was enacted in January 2015:

- Delaware created more balance in its use of contract auditors by mandating that the State Escheator may not allow any contract auditor to be assigned more than 50 percent of all examinations undertaken after January 1, 2015, and that no contract be for a term of more than five years.³¹
- Delaware instituted a “cooling off” period for its senior employees by requiring its contract auditors to not hire any employee of the Division of Revenue or Department of Finance who functions in a senior supervisory role, for a period of two years from when the employee leaves the employ of the state.³²
- Delaware provided a more central role for third-party review in its appeals process by requiring that the independent reviewer’s decision be final as to the Department of Finance, unless the Department or the holder appeals the decision to the Court of Chancery. The Court’s review is limited to whether the independent reviewer’s decision was supported by substantial evidence.³³
- By December 31, 2015, the Department of Finance is directed to publish a detailed audit manual containing procedural audit guidelines, using input from stakeholders and interested parties, and must ensure that contract auditors comply with the manual. The Department of Finance must also update its regulations to provide holders greater transparency and predictability as to what to expect during an audit.³⁴

Also, although not required to do so by legislation, the Department of Finance is apparently beginning the process of improving the reunification process for owners of unclaimed property.³⁵

However, Delaware has not yet adopted the following important recommendations of the Task Force:

- Modification of the statute of limitations to confirm that there be indicia of fraud in the past six years of filed reports before a holder can be audited for earlier years; and
- Hiring of more staff by the Department of Finance and Department of State to bring audits and VDAs in-house and reduce reliance on contract auditors.³⁶

Commentary

The recent legislation and the legislation enacted in January 2015 made fundamental improvements to Delaware’s unclaimed property program, which should encourage more holders to come into compliance with Delaware’s unclaimed property law. Although

³⁰ S.B. 11, Laws 2015.

³¹ DEL. CODE ANN. tit. 12, § 1155(b).

³² DEL. CODE ANN. tit. 12, § 1155(b)(2).

³³ DEL. CODE ANN. tit. 12, § 1156(j).

³⁴ S.B. 11, Laws 2015, § 2.

³⁵ Final Report of the Task Force to Study and Make Findings and Recommendations to Improve Fairness and Compliance in Delaware’s Unclaimed Property Program, at 78, Dec. 23, 2014.

³⁶ *Id.* at 9, 78.

generally holders will not be audited if they choose to enter into a VDA, Delaware will continue to seek out noncompliant holders. Unlike a typical tax VDA, a Delaware unclaimed property VDA is a very long, complicated process, and holders will often require the full two years provided for completion. Because of the still very long 19-year look-back period, holders can still face substantial liabilities. Holders should therefore take their unclaimed property requirements very seriously and consider contacting a specialist to help guide them through the process.

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