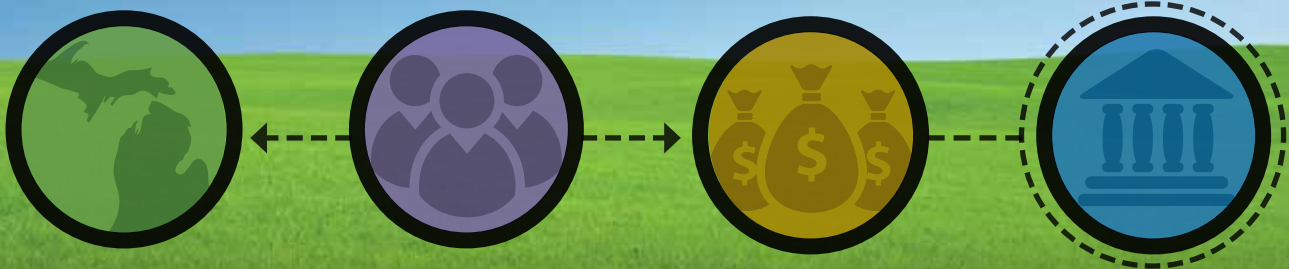


A CONTINUATION OF THE JULY 2012 TAX LAW THEME ISSUE

# How the Gold Gets in the Pot at the Rainbow's End

## An Attorney's Guide to Unclaimed Property Compliance in Michigan



By Carolee Kvoriak Cameron and Jackie J. Cook

**A**ccording to Irish legend, fairies fill the elusive pot at the end of the rainbow with gold. The Irish legend does not reveal where the gold comes from. That part of the legend—in the context of unclaimed property reporting—is our topic. In particular, this article discusses how unclaimed “gold” is discovered, disclosed, and remitted to the state of Michigan.

The elusive pot of gold at the end of the rainbow is waiting at Michigan's Money Quest,<sup>1</sup> the state of Michigan's web page set up for claiming “millions of dollars in lost or forgotten assets from dormant bank accounts, uncashed checks, valuables left in safe deposit boxes and stock certificates.”<sup>2</sup> You may find gold—maybe a refund check from the cable company that was lost in the mail after you moved out of your college dorm years ago—by searching your name on the website. While entertaining to imagine what little pots of gold may be discovered online, the focus of this article is on the reporting side.

### Why is Unclaimed Property in the News Today?

Although unclaimed property collection is not technically a tax, cash-strapped states have turned to it in recent years to increase state revenue. Many “holders” of property have not been aware of unclaimed property laws until recently because, historically, states have not enforced them. But states have been in-

creasingly looking at unclaimed property collection as a potential pot of gold. Delaware, for instance, lists unclaimed property as its third biggest source of revenue. Michigan's legislature similarly had fiscal considerations in mind when it amended Michigan's unclaimed property laws in 2010, shortening the period for turning over property as unclaimed to the state and accelerating the annual due dates for unclaimed property reports. The Department of Treasury estimated that these measures would generate \$229 million in new revenue by 2012.<sup>3</sup> The act specifically provided for \$4.8 million of the new revenue to be used to increase public awareness of the new filing and compliance requirements before September 30, 2012.<sup>4</sup>

Aggressive legal positions, audit by sampling, and demands for documentation not likely kept in the ordinary course of business can inflate the size of that pot of gold tremendously. Some of these techniques “uncover” unclaimed property that cannot even be traced to an actual owner. Some states have also used third-party contingent fee auditors with a direct financial interest in the amount of unclaimed property discovered—a practice that outrages many in the business community. Michigan currently uses third-party contingent fee auditors to conduct unclaimed property audits. However, pending legislation would ban this practice. House Bill 5524, introduced on March 29, 2012, would prohibit the state from hiring an auditor on a contingent fee basis

**Fast Facts:**

Every state requires the reporting of unclaimed property; every business, regardless of size, should have internal procedures in place to comply with these reporting requirements.

States have become increasingly aggressive in enforcing unclaimed property laws.

A holder's duty to report unclaimed property may also have to be balanced against other legal obligations, such as an attorney's ethical obligation to safeguard client property.

or "other similar method that may impair an auditor's independence or the perception of independence by the public."<sup>5</sup>

Unclaimed property laws were originally enacted by states as a measure to protect consumers. States are required to act as custodians of unclaimed property until the owner comes forward to claim the property. States are never actually entitled to the property, and the owner may step forward at any time to claim the property (usually with interest). Every state has unclaimed property laws, as do some U.S. territories and Canadian provinces. Fifteen states, including Michigan,<sup>6</sup> have adopted some version of the Uniform Unclaimed Property Act, completed by the Uniform Law Commissioners in 1995. In recent years, states have been reviewing and revising these laws with an eye toward increasing revenue by shortening dormancy periods, using estimates in audits, and broadening the types of property subject to the act.

Michigan has recently become fairly active in unclaimed property audits and collections. Many large companies in the state are currently being audited for the first time for unclaimed property. Michigan also recently offered a "voluntary disclosure" program. The Department of Treasury sent letters to a large number of corporations, requiring them to report any unclaimed property or file a report attesting to the fact they had nothing to report by January 31, 2012. Those who complied were offered a waiver of interest and penalties on any property voluntarily remitted to the state.

The Council on State Taxation, a national organization representing the interests of more than 600 member companies on state and local tax issues, published an article reviewing each state's unclaimed property laws.<sup>7</sup> Each state was graded on the basis of how balanced, fair, and effective its unclaimed property laws are perceived to be by the business community using several factors.<sup>8</sup> Michigan received a C-, a grade largely based on the absence of a business-to-business exemption. The Michigan legislature recently remedied this with the passage of two bills: (1) Public Act 144 of 2012, signed into law on May 24, 2012, which allows a partial exemption from the Michigan Unclaimed Property Act for "business-to-business" transactions; and (2) Public Act 292 of 2012, signed into law on August 1, 2012, which shortens the statute of limitations from 10 years to 5 years for all "business-to-business" transactions.

## What is Unclaimed Property?

Property held by one person but legally owned by someone else, such as a check issued but never cashed, must be turned over to the state if the owner cannot be located.<sup>9</sup> The person in possession of unclaimed property is a "holder," a term broadly defined. Under the Michigan Unclaimed Property Act, a "holder" means a person, wherever organized or domiciled, in possession of property belonging to another in the ordinary course of business.<sup>10</sup> These laws apply not only to large corporations but to anyone holding property for another, including solo attorneys or small law firms. Unclaimed property laws require holders to report and deliver unclaimed property to the state.

## When is Property Considered Unclaimed?

Property is presumed abandoned if it is "held, issued, or owing in the ordinary course of a holder's business and remains unclaimed by the owner for more than 3 years after it becomes payable or distributable..."<sup>11</sup> Property must be delivered to the Department of Treasury if it is presumed abandoned and if Michigan has priority to the property as opposed to another state.<sup>12</sup>

Most types of property have a three-year dormancy period in Michigan, although shorter or longer dormancy periods may apply to specific types of property.<sup>13</sup> Statutes of limitations for unclaimed property are generally long or nonexistent. Adding together the general 3-year dormancy period and Michigan's 10-year statute of limitations, holders under audit may have to produce detailed documentation, such as bank reconciliation statements and records of cashed checks, going back at least 13 years. Under law before 2011, this look-back period could be as long as 25 years. Many company record-retention policies only retain this type of detailed documentation for 7-10 years.

## Why Should Attorneys and Law Firms Be Concerned About Unclaimed Property?

Law firms and solo practitioners often hold client property and may be required to report that property when it goes unclaimed. One example of property held by an attorney that could potentially end up unclaimed is an unapplied refundable retainer.

After unclaimed property is reported, a holder must maintain a record of the name and last known address of the owner of any unclaimed property for 10 years after the property is reported.

If a client pays a \$10,000 retainer and the attorney performs \$9,000 of legal work for the client, the remaining balance of \$1,000 could end up unclaimed if not returned to the client or applied to legal services rendered. Although the initial work performed has concluded, an attorney might hold the \$1,000 balance in case there is any additional work to be performed. Attorneys should consider the potential unclaimed property consequences for this scenario and implement practices to minimize this potential exposure, such as sending “our legal relationship has concluded” letters and refunding any remaining retainer (if refundable) within a reasonable period after completing the work they were hired to perform.

Other examples of unclaimed property commonly in the hands of attorneys include property held in trust or for safekeeping for clients, ERISA plan contributions, and employee wages. Law firms should consider establishing internal accounting practices, reviewing items such as the following for unclaimed property:

- Outstanding checks on the general bank account, payroll bank account, or trust (IOLTA) accounts
- Trust liability report for accounts with no recent activity
- Unapplied cash

Unlike other holders of unclaimed property, attorneys have an additional ethical duty to safe-keep client property held in trust. An attorney is ethically responsible for making “reasonable efforts” to locate a client when holding trust account funds for a client who cannot be located.<sup>14</sup> “Reasonable efforts” are defined in Michigan Ethics Opinion RI-38 as follows:

At a minimum, (1) determining whether the client left a forwarding address with the U.S. Postal Service; and (2) sending a letter to the client’s last known address by regular mail and by certified return receipt.

“Reasonable steps” will vary according to the stage of the case, whether other parties have a claim on a portion of the funds held, and the amount of money held. For instance, if taking steps beyond the required minimum will expend the entire amount held, other steps are not necessary. If, however, a large sum of money is held, additional steps corresponding to the balance are indicated, such as attempting to locate the client through any known relation, employer, neighbor, or friend of the client, publication of notice in locations where the client might be present, hiring an investigator, or tracking the client through the Social Security Administration.

Judgment should be used in determining methods of locating the client. If the matter for which the lawyer was hired is embarrassing to the client or of a highly private nature, it would not be prudent to contact the client’s employer or neighbor.

Similarly, if the fund sum is large, it should be deposited in a segregated trust account and not remain in the commingled client trust account. “Reasonable steps” should be taken not only at the time the representation is concluded, but also at the end of the dormancy period before escheat.

A lawyer may be reimbursed from the funds held for the expenses and costs of locating a missing client. The lawyer has the burden of showing such costs are reasonable. MRPC 1.5.<sup>15</sup>

When law firms conduct internal accounting reviews for unclaimed property, they must comply with ethical requirements under MRPC 1.15 as well as unclaimed property laws. Unclaimed property implications are averted when the retainer is nonrefundable, but the client must, of course, agree in writing to the retainer being nonrefundable.<sup>16</sup>

## What Should You Do if You Have Unclaimed Property to Report?

Unclaimed property must be reported and delivered to the state of Michigan on July 1 of each year for the 12-month period ending on the immediately preceding March 31.<sup>17</sup> Michigan also has a “negative” reporting requirement—the Department of Treasury may require a report to be filed even if the person does not have any unclaimed property to report.<sup>18</sup> After the property is delivered, the state liquidates any noncash property (other than securities) at public auction within three years.<sup>19</sup> Securities are sold within one year at the prevailing price if listed on an established stock exchange or, if unlisted, by another method considered “advisable” by the Department of Treasury.<sup>20</sup>

After unclaimed property is reported, a holder must maintain a record of the name and last known address of the owner of any unclaimed property for 10 years after the property is reported.<sup>21</sup> If this information is not documented, the auditor can assess any amount “as may reasonably be estimated from any available records.”<sup>22</sup>

Before reporting and transferring unclaimed property to the state of Michigan, holders must make one last attempt to locate the actual owner not less than 60 days or more than 365 days before reporting the property as unclaimed and, more importantly, before delivering the property to the state.<sup>23</sup> Failure to do so may subject the holder to liability should the owner come back and find the property not only in the hands of the state but also sold and liquidated into cash proceeds, a particularly sticky situation in the case of securities. The state of Michigan almost immediately liquidates securities; the owner is not entitled to any appreciation in value once the securities are delivered to the state.<sup>24</sup> Although the Michigan Unclaimed Property Act provides

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indemnification for holders who deliver property to the state in good faith, what constitutes good faith—particularly in the context of a large corporation—is up for interpretation.<sup>25</sup> Of course, holders are free to make as many attempts to locate the owner as they would like before the end of the three-year dormancy period. Holders of unclaimed securities should attempt to find owners as early as possible, as it becomes harder to track them down the longer the property is unclaimed.

### What if I Have Unclaimed Property That I Failed to Report?

In Michigan, penalties and interest apply if unclaimed property is not timely delivered and reported.<sup>26</sup> Many states, including Michigan, give the administrator of the unclaimed property laws wide discretion to waive penalties and interest.<sup>27</sup> In Michigan, penalties will be waived if the holder comes forward on a voluntary basis.<sup>28</sup> A word of caution: some states have very formal voluntary disclosure programs that require extensive self-audits.<sup>29</sup> The results of these self-audits may not be honored under a later audit, particularly if the auditor is a third party being compensated under a contingent fee arrangement.

The best strategy is to resolve as many issues as possible during the audit; there is no administrative review in the state of Michigan for unclaimed property, which is also true in many other states. A holder's only recourse to appeal by a decision of the administrator is to bring an action in circuit court within 90 days of the administrator's decision.<sup>30</sup>

### Conclusion

A holder does not need luck to comply with unclaimed property reporting requirements. A holder needs only due diligence in accounting and recordkeeping practices. But when it comes to being a gold seeker looking for long lost property at Michigan's Money Quest, we could all use a little luck of the Irish. ■



*Carolee Kvorciak Cameron is in-house tax counsel for Consumers Energy in Jackson and currently serves as public policy liaison for the State Bar's Taxation Section. She has practiced federal, state, and local tax law for more than 11 years and served as a law clerk to Michigan Supreme Court Justice Marilyn Kelly.*



*Jackie J. Cook is an associate in the state and local tax practice at Miller Canfield in Detroit. She represents clients on a broad range of state and local tax issues before the Michigan Supreme Court, Court of Appeals, Court of Claims, Tax Tribunal, and local boards of review. She is the current chair of the State and Local Tax Committee of the State Bar's Taxation Section.*

### FOOTNOTES

1. Department of Treasury, *Michigan's Money Quest* <<http://www.michigan.gov/treasury/0,1607,7-121-44435-7924-,00.html>>. All websites cited in this article were accessed September 3, 2012.
2. *Id.*
3. See Senate Fiscal Analysis, HB 6421, September 22, 2010, available at <<http://www.legislature.mi.gov/documents/2009-2010/billanalysis/Senate/pdf/2009-SFA-6421-S.pdf>>; see House Legislative Analysis, HB 6421, September 14, 2010, available at <<http://www.legislature.mi.gov/documents/2009-2010/billanalysis/House/pdf/2009-HLA-6421-1.pdf>>.
4. *Id.*
5. HB 5524, available at <<http://www.legislature.mi.gov/documents/2011-2012/billintroduced/House/pdf/2012-HIB-5524.pdf>>.
6. MCL 567.221 *et seq.*
7. See Leslie, *The Best and Worst of State Unclaimed Property Laws—Scorecard on State Unclaimed Property Statutes: The Holders' Perspective* (Council on State Taxation, 2009), available at <<http://www.cost.org/WorkArea/DownloadAsset.aspx?id=71960>>.
8. The factors evaluated by the Council on State Taxation study were the following: (1) whether business-to-business transactions are subject to escheat, (2) whether a period of limitations for unclaimed reporting requirements exists that corresponds with state tax laws and normal business practices, (3) whether an independent administrative appeals process is available for holders, (4) whether gift certificates are subject to escheat, (5) whether the state treats both the payment of interest to property owners and the assessment of interest against holders equitably, and (6) whether the state engages contingent-fee auditors in its administration of unclaimed property. *Id.*
9. Generally, property that is less than \$50 is either not reportable at all, depending on the type of property, or may be reported in the aggregate. MCL 567.236(2); MCL 567.238(2)(a) and (d).
10. See MCL 567.222(h); see also MCL 567.223 (describing the general rule applicable when property is presumed abandoned).
11. MCL 567.223(1).
12. See MCL 567.224.
13. MCL 567.223(1); see, e.g., MCL 567.225 (establishing a 15-year dormancy period for traveler's checks); MCL 567.229 (establishing a 1-year dormancy period for utility deposits); MCL 567.236 (establishing a 1-year dormancy for unpaid wages).
14. Michigan Ethics Opinion RI-38, available at <[http://www.michbar.org/opinions/ethics/numbered\\_opinions/ri-038.htm](http://www.michbar.org/opinions/ethics/numbered_opinions/ri-038.htm)>; see also MRPC 1.15(b).
15. Ethics Opinion RI-38.
16. See, e.g., Michigan Ethics Opinion RI-67 (allowing a legal services organization to use client consent agreements that any unclaimed client funds may be used for legal representation of indigent clients), available at <[http://www.michbar.org/opinions/ethics/numbered\\_opinions/ri-067.htm](http://www.michbar.org/opinions/ethics/numbered_opinions/ri-067.htm)>.
17. MCL 567.238(4).
18. MCL 567.251(1).
19. MCL 567.243(1).
20. MCL 567.243(2) and (3).
21. MCL 567.252(1). For additional record retention requirements for traveler's checks, money orders, or similar written instruments, see MCL 567.252(2).
22. MCL 567.251(5).
23. MCL 567.238(5).
24. MCL 567.243(3).
25. See generally *Vondjdis v Hewlett Packard Corp.*, 168 Cal App 4th 921; 85 Cal Rptr 3d 806 (2008).
26. MCL 567.255(1) and (3).
27. MCL 567.255(5).
28. Department of Treasury, *Frequently Asked Questions* <<http://www.michigan.gov/treasury/0,4679,7-121-3220-247262-F,00.html>>.
29. Examples include the states of Pennsylvania, Illinois, and Tennessee. For information about Pennsylvania's voluntary compliance program, see <<http://www.patreasony.gov/unclaimedproperty.html>>. For information about Illinois' voluntary compliance program, see <[http://icash.illinois.gov/return\\_assets\\_useful\\_links.asp](http://icash.illinois.gov/return_assets_useful_links.asp)>. For information about Tennessee's voluntary compliance program, see <<http://www.treasury.state.tn.us/unclaim/CDA.html>>.
30. MCL 567.247.