

# PUBLICATION

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## Spotlight on Unclaimed Property: Exercise Diligence When Seeking Voluntary Disclosure and Settlement of Unclaimed Property Liabilities

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**Caution:** Don't expect a state to routinely accept a Voluntary Disclosure Agreement (VDA) and settlement of your outstanding unclaimed property liabilities without question or audit. A number of states, including Delaware, provide VDA programs for holders with unclaimed property liabilities. However, the recent settlement of a case in Delaware Chancery Court illustrates holders must exercise caution and perform their own due diligence prior to participating in these programs.

### State Unclaimed Property VDAs

Unclaimed property VDAs are available for holders that have not reported unclaimed property to a state and are not undergoing an unclaimed property audit. These programs offer various benefits to holders. For example, interest and penalties may be abated or waived, audits may be preempted, a holder may be able to establish its own timetable for compliance and avoid laborious auditor requests, the accuracy of financial statements may be improved, and the process may help the holder institute effective unclaimed property record retention and reporting procedures.

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Initial VDA Offer \$684,036, Final VDA Offer \$3,585,000, Final Settlement \$17,650,000

Delaware, like many states, provides a VDA program that allows holders of unreported unclaimed property due Delaware to come forward voluntarily and report the unclaimed property for a limited reporting period. In the absence of having filed Delaware unclaimed property reports, the Delaware Division of Revenue will audit a holder's records using estimation methods to determine the amount of unclaimed property due back to 1981 (and may impose interest and penalties that can equal as much as 75 percent of the liability). Delaware's VDA shortens the reach-back period to 1991, and releases the holder from all claims, interest, and penalties. Nonetheless, a certain Stipulation of Settlement filed February 12, 2010, in *CA, Inc. v. Pfeiffer*, No. 4111-CC (Del. Ch., filed Oct. 22, 2008), shows that a Delaware unclaimed property VDA is not simply making an offer and then negotiating with the Division of Revenue to arrive at a "right number."

The timeline of how the holder in the *CA Inc.* case went from an initial Delaware VDA offer of \$684,036 to a final settlement of litigation of over \$17 million is instructive:

- In 2004, CA retained an accounting firm and made an initial contact with Delaware to disclose it had not filed unclaimed property reports for 1991-2004.
- CA's initial VDA presentation to Delaware was made in 2005, and CA reported its unclaimed property liability for 1991-1999 as \$684,036. Delaware disagreed and asked CA to recalculate its liability.

- In 2006, CA returned with a second offer of \$775,275. Negotiations ensued, and Delaware requested standard accounting records, including accounts receivable aging reports, general ledgers, bank statements and reconciliations.
- In 2007, CA made a third offer, this time of \$2.225 million, followed by two additional offers of \$2.239 million and \$2.323 million, respectively. Delaware rejected these offers and contended CA had ignored its requests for the accounting records and additional information.
- In 2008, after using an estimation method based on the information available, Delaware sent CA its report indicating an unclaimed property liability of \$7.628 million and requesting CA to sign a final VDA. CA refused and countered with an offer of \$2.475 to settle.
- Also in 2008, Delaware contended that CA had not been forthcoming in producing the requested records and information and issued a formal assessment, with interest, of \$8.218 million. CA objected, made a final VDA offer of \$3.585 million, but Delaware issued a formal audit notice to CA.
- Further in 2008, CA then brought an action in Delaware Chancery Court seeking an order compelling the state to accept its final VDA offer. Delaware retained the law firm of Skadden, Arps, Slate, Meagher & Flom LLP, counter-claimed, and moved to compel production of the accounting records and other information previously requested. The motion to compel was granted. As a result of discovery by Delaware, the Stipulation of Settlement indicates that there were "previously undiscovered facts and circumstances."
- In 2010, the parties settled the litigation, and CA agreed to pay Delaware \$17,650,000 in settlement of its unclaimed property liabilities, including penalties and interest, for the 1991 to 2010 period.

Holders considering approaching states to enter unclaimed property VDAs should be prepared to undertake their own self-audit prior to approaching the state. Among other items, this should include assessing areas of exposure, reviewing available records (e.g., payroll, accounts receivable, accounts payable, general ledgers, bank statements and reconciliations, equity and transfer agent reports), evaluate unclaimed property reporting to other states, and mitigate exposure by identifying applicable exemptions and possibly returning abandoned property to known owners prior to instituting the VDA process. This effort will better prepare the holder to negotiate the VDA and respond to the state in what may be, in effect, a voluntary unclaimed property audit.

If you would like to discuss the matters addressed in this Spotlight, please contact an attorney in the Firm's Tax Department.