

The Exacting Unclaimed Property Exemptions

By Karen Anderson

While wading through the myriad of state unclaimed property laws and regulations, one will inevitably discover that there are some exemptions to state requirements. The exemptions are either for particular property types or transactions, dollar values or they can be "industry-specific". However, it is important to carefully study the criteria surrounding an exemption to determine its applicability and whether it warrants a business' time and attention.

Types of Exemptions

The following are the most common types of unclaimed property exemptions:

- Business to Business ("B2B")
- De Minimis
- Gift Certificate or Card
- Industry-Specific

As a refresher, remember that the item for which an exemption is being considered must be owed or due to an owner/payee/creditor whose last known address is located in the state that has a law or regulation authorizing the exemption. (This is due to the 1965 United State Supreme Court's determination in *Texas v. New Jersey*¹, which states that the law of the state of the owner's last known address is the applicable law.)

If the last known address is in a state that has an exemption, it is important to consider the property type and the dates of the transactions when determining whether the exemption applies. If exempt, the business is not required to perform due diligence, report, or remit the exempted item. However, while the item may be exempt for unclaimed property purposes, the obligation itself may not be extinguished.

Business to Business ("B2B") Exemptions

This exemption involves transactions between two "business associations," while the property in question is either exempt or is not included in the state's definition of presumptively abandoned or unclaimed property. About 12 states have some type of B2B exemption, which usually applies to credit memos, sometimes to credit

balances and, in a few states, applies to vendor checks as well. In considering the applicability of B2B exemptions it is essential to know the state's definition of business association, the criteria for the applicable transactions, and the effective date of the exemption.

Examples of states with business to business exemptions are Ohio and North Carolina. Ohio has one of the broadest exemptions. For the purpose of the exemption, Ohio law defines "business association as:

"Any corporation, joint venture, business trust, limited liability company, partnership, association or other business entity composed of one or more individuals, whether or not the entity is for profit". Ohio Unclaimed Funds Law Section 169.01 (B) (2)

The type of transactions to which the exemption applies are:

"(b) Any payment or credit due to a business association from a business association representing sums payable to suppliers, or payment for services rendered in the course of business, including but not limited to, checks or memoranda, overpayments, unidentified remittances, nonrefunded overcharges, discounts, refunds, and rebates:

(c) Any payment or credit received by a business association from a business association for tangible goods sold, or services performed, in the course of business, including but not limited to, checks or memoranda, overpayments, unidentified remittances, nonrefunded overcharges, discounts, refunds and rebates." Ohio Unclaimed Funds Law section 169.01 (B) (2) (emphasis added).

In 2006, Ohio further refined "services rendered in the course of business" for purposes of the exemption by promulgating the following administrative rule:

"Services rendered in the course of business," as used in division (B)(2) of section 169.01 of the Revised Code, means services for which the business association purchasing the service (buyer) has issued a purchase order to the business association selling the service (seller) to perform the requested service. The seller then performs the service and issues an invoice to the buyer who then makes payment to the seller and enters the payment as an expense in buyer's accounting records. The seller may enter the sale as income in their accounting records upon issuance of the invoice or upon receipt of the payment from the buyer. Services which do not meet this definition shall not be considered services as that term is used in division (B) (2) of section 169.01 of the Revised Code." Ohio Administrative Code, Section 1301:10-1 (M).

In a guide linked to the Ohio Unclaimed Funds website, it is stated that the exemption does not apply to equity, dividend and interest payments, and payments from a business association to a business association that do not result from wholesale trade. In addition, payments due from or received by a business association from a customer that is a private individual remain reportable unclaimed funds.

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With regard to the dates of the transactions or which items can be exempted, note that Ohio's B2B exemption became effective on September 14, 2000 and is retroactive and prospective from that date.

The North Carolina B2B exemption is much more limited than the Ohio B2B exemption. The North Carolina unclaimed property statute defines business association as:

"Business association" means a corporation, joint stock company, investment company, partnership, unincorporated association, joint venture, limited liability company, business trust, trust company, land bank, safe deposit company, safekeeping depository, financial organization, insurance company, mutual fund, utility, or other business entity consisting of one or more persons, whether or not for profit." North Carolina Unclaimed Property Act, Section 116B-52 (2).

The transaction criteria is set forth in Section 116B-54(e) of the North Carolina Unclaimed Property Act and it limits the exemption to credit balances "for the benefit of another business association" and defines credit balances as "items such as overpayments or underpayments on the sale of goods or services". The North Carolina B2B exemption became effective on Jan. 1, 2000 and applies to transactions dating from Jan. 1, 1995 and forward.

De Minimis Exemptions

There are a few states that have de minimis exemptions, which means that items of a particular property type and that are valued under a certain dollar amount are exempt from the state's unclaimed property requirements. For example, the states of Kentucky, Michigan and Ohio have exemptions for payroll items valued at \$50.00 or less.

Colorado has a de minimus exemption that allows the deduction of 2 percent of the property's value or \$25 per item, more or less dependent upon the property type. (Colorado Unclaimed Property Act, 38-13-112(1) (b) (I). The Colorado unclaimed property website includes a "PDF" dormancy table document that includes the deduction rules by property type. For example, for "MS08 - Accounts Payable" or "CK13- Vendor Checks" the designation is "more," meaning the deduction would be for 2 percent of the item or \$25, whichever is more. Note, however, that Colorado requires that the item be reported and that the deduction be taken from the value shown on the unclaimed property report.

Another interesting de minimis exemption is the Florida "credit balance" exemption. Florida's unclaimed property law exempts credit balances, customer overpayments, security deposits, and refunds having a value of less than \$10. (Florida Disposition of Unclaimed Property Act, Section 1717.117 (1) (h).

Gift Certificate or Card Exemptions

Many states have gift certificate and/or card exemptions that either fully restricts, or partially restricts, or a combination of both. The exemptions vary dramatically from state to state. Some apply to the entire value of the property while others apply to a portion.

On the other hand, some states' exemptions apply only if the card or certificates have no expiration date and/or if they have no dormant service charges that are applicable. For example, the Nevada law requires that if the card does not expire it does not become reportable unclaimed property. However, if the card has an expiration date and the card is issued or sold in Nevada, then 60 percent of the unredeemed or uncharged value remaining is presumed abandoned and subject to the Nevada unclaimed property statute upon the expiration date. (Nevada Uniform Unclaimed Property Act, Section 120A.520)

Another interesting example is the unclaimed property treatment of gift cards and certificates under Alabama law. Under the Alabama law if a gift card, certificate or in-store credit is issued by a person engaged primarily in selling tangible personal property at retail, it is exempted. All other types of gift cards are reportable unclaimed property at 100 percent face value unless redeemable only in merchandise, then 60 percent of the value is reportable unclaimed property. Alabama law has no restrictions on expiration or dormant service fees in connection with gift cards or certificates. (Alabama Uniform Disposition of Unclaimed Property Act, Sections 35-12-72 (a) (17) and 35-72-73(b) (1).

A third example of unclaimed property gift card exemptions is the Tennessee exemption. Under Tennessee law, a gift card/certificate is exempt if it was issued after 12/31/1998, the issuer of the certificate/card imposes no dormancy charges and the gift certificate/card conspicuously states that the gift certificate does not expire, bears no expiration date or states that an expiration date is not applicable in Tennessee. (Tennessee Uniform Disposition of Unclaimed Property Act, Section 66-29-135).

Industry-Specific Exemptions

A few states exempt entire industries or industry-specific property types from unclaimed property law requirements. For example, Kentucky exempts money, funds, or any other property held by or owing to any nonprofit, Internal Revenue Code Section 501(c)(3), tax-exempt hospital, or to bonds of counties, cities, school districts, or other tax-levying subdivisions in Kentucky. (Kentucky Uniform Disposition of Unclaimed Property Act, Section 393.010 (2).

Another example is the Illinois Unclaimed Property Act exemption for capital credits or patronage capital retired, returned, refunded or tendered to a member of an electric cooperative or a telephone or telecommunications cooperative. (765 ILCS 1025, Ch. 141, par. 104 (c)).

A third example is Florida's exemption of credit balances, overpayments, refunds,

or outstanding checks owed by a health care provider to a managed care payer with whom the health care provider has a managed care contract. This exemption may apply so long as the credit balances, overpayments, refunds, or outstanding checks become due and owing as a result of the managed care contract. (Florida Disposition of Unclaimed Property Act, Section 1717.117 (7) (c)).

Practice Note

Minimizing reportable unclaimed property by applying exemptions, as appropriate, is a strategy that can save a business time and money. However, considering the various types of unclaimed property exemptions, the complexity of the criteria for applying exemptions, and the possibility of exemption applications being overturned in an audit, it is important for the practitioner to have a clear understanding of exemptions that may be applicable to his or her business. If a business decision is made or a minimization strategy is implemented that requires the business to consider and to possibly avail itself of particular exemptions, legal counsel should be contacted to interpret the exemptions and the exemption criteria and to provide guidance on their application to particular transactions.

Careful interpretation and application of exemptions could prevent additional liability in an unclaimed property audit. Most auditors working on behalf of states will question exempted items and require the exemption rationale and evidence that exempted items/transactions meet the state's criteria. If the auditor determines that the exemption was inappropriately applied, the property in question could be "past due" and subject the business to liability for the item(s) plus possible interest and penalties.

Another area of concern with regard to exemptions is when a business is incorporated in a state that does not allow for the specific exemption that the state of the last known address of the owner permits. To illustrate, consider the following scenario:

The vendor does not cash a check issued by a business and the vendor's last known address in the business' records is in Illinois, the Illinois B2B exemption may apply. However, the state of incorporation of the business is in Delaware, which does not have a B2B exemption.

It may be argued that Delaware unclaimed property law applies and that Delaware can claim the unclaimed property. In other words, the business' state of incorporation may attempt to claim the exempt property under the third rule issued by the United States Supreme Court in *Texas v New Jersey* . This rule states that if the state claiming the property under the primary rule has no applicable law, the law of the business' state of incorporation controls. In practice, this argument has not been prominently asserted by states but could be a future issue.

For these reasons, thoughtful interpretation of exemption criteria by legal counsel and application of exemption criteria by knowledgeable practitioners is critical when employing exemptions as a component of a minimization strategy and to avoid

future risk.

Note: ¹ *Texas v. New Jersey*, 379 U.S. 674 (1965)

Karen Anderson is Senior Compliance Advisor with [Abandoned Property Services, LLC \(APS\)](#), which serves the unclaimed property compliance needs of all types of businesses. APS provides policy/procedure and liability prevention consulting, audit defense and compliance maintenance via its annual reporting and due diligence services. Annual reporting and due diligence services are facilitated by APS's specially devised and perpetually updated in-house systems.

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