

## Unclaimed Property Laws: Gift Card Stocking Stuffers Can Become Lumps of Coal for Unwary Retailers

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According to the National Retail Federation's 2010 holiday survey, total gift card spending for 2010 is estimated to reach \$25 billion.<sup>1</sup> According to the survey, gift cards will be the most requested gift for the 2010 holiday season, with 77% of shoppers planning to buy at least one gift card. Although it is generosity that motivates purchasers to give gift cards, the state unclaimed property or escheat issues associated with gift certificates or gift cards can create significant frustration for retailers. The way in which certain states, particularly Delaware, conduct aggressive unclaimed property audits can lead to large, and sometimes unexpected, assessments for unwary retailers.

### What Is Unclaimed Property?

Although many individuals will receive a gift card this holiday season, not all will redeem the gift card for products or services. Where the gift card is not redeemed, the laws of unclaimed property or escheat become operative. Under English common law, unclaimed property in the custody of another (the holder) could not be retained by the holder for his or her own benefit. Modern unclaimed property laws typically require a holder to locate the rightful owner of unclaimed property within a certain period of time (the dormancy period); otherwise, the holder must turn over or "escheat" such property to a particular state.

As applied to gift cards, once the dormancy period has lapsed, in some instances a retailer may be required to turn over all amounts that it has been paid for gift cards that were never redeemed. Ostensibly, the state is safeguarding the property until it can be claimed by the rightful owner (i.e., the individual who was given the gift card or the individual who purchased the gift card); however, from a practical perspective, many states view unclaimed property as a significant revenue source. As a result of the priority rules that have been established by the U.S. Supreme Court (discussed below) for when intangible property will escheat to a particular state, certain states, namely Delaware, have been more aggressive in their efforts to acquire revenue through unclaimed property audits.

### Priority Rules for Unclaimed Property

The U.S. Supreme Court has defined cascading custody rules that determine the state to which unclaimed property is reported.<sup>2</sup> Under the 1993 case *Delaware v. New York*, intangible unclaimed property, which includes consideration paid for unredeemed gift certificates and gift cards, is reported to the state of the

<sup>1</sup> National Research Federation Holiday Survey, Nov. 17, 2010, available at [www.nrf.com](http://www.nrf.com).

<sup>2</sup> *Texas v. New Jersey*, 379 U.S. 674 (1965); *Delaware v. New York*, 507 U.S. 490 (1993).

owner's last known address as it appears in the records of the holder of the unclaimed property. If the holder's records do not disclose a last known address, the property is subject to the laws of the state of the holder's domicile, which, for corporations, is likely the state of incorporation.<sup>3</sup> Under this custody regime, when a retailer receives consideration for a gift card that is never redeemed, and lacks information about the owner, the consideration will most often be reportable to its state of incorporation.

A number of states have adopted unclaimed property laws that either exclude gift certificates and gift cards from escheat or exclude them from the definition of property subject to escheat.<sup>4</sup> Incorporating a subsidiary that manages gift card operations in one of these states may be beneficial to retailers because they may be able to retain consideration from unredeemed gift cards and avoid aggressive unclaimed property audits from states such as Delaware.

### **Delaware's Aggressive Pursuit of Unclaimed Property**

Given that many corporations choose to incorporate in Delaware, that state's unclaimed property rules are important to understand, particularly for companies such as retailers, which encounter significant intangible unclaimed property in daily operations.

Subject to narrow exceptions,<sup>5</sup> the Delaware law defining "property" subject to escheat includes "amounts received in consideration for gift certificates which are unredeemed."<sup>6</sup> In Delaware, consideration paid for unredeemed gift certificates and gift cards will escheat to the state five years from the date of issue or, if the gift card is good for less than five years, at its expiration date less one day.<sup>7</sup> Also, Delaware has enacted limitations on contracts that attempt to achieve private escheat to the issuer.

To monitor compliance, Delaware requires that holders of unclaimed property file an annual report on or before March 1 of each year.<sup>8</sup> Once a report is filed, the state is allowed three years to audit the report unless it finds an omission of greater than 25% of the value of property disclosed in a report, in which case the statute of limitations is six years.<sup>9</sup> However, if a report is not filed, the statute of limitations remains open indefinitely. For corporations that have never filed a Delaware annual report for unclaimed property, the statute of limitations for assessment likely is open as far back as 1981, when Delaware enacted its unclaimed property statute.

As part of its auditing efforts, it is not uncommon for Delaware to retain the services of third-party auditors that are paid on a contingency basis. During audit, if the holder's records are insufficient to permit preparation of a report, the state may require the holder to report an amount based on estimates of unclaimed property calculated by the auditor.<sup>10</sup> Not surprisingly, these estimates often are much larger than holders anticipate.

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<sup>3</sup> *Delaware*, 507 U.S. 490.

<sup>4</sup> For example, Kansas has amended Kan. Stat. Ann. § 58-3934(o) to exclude gift cards and gift certificates from the definition of property subject to escheat. As another example, Florida has adopted Fla. Stat. § 717.1045, which states that an "unredeemed gift certificate . . . is not required to be reported as unclaimed property."

<sup>5</sup> Under Delaware law, no reporting is required solely by virtue of holding consideration paid for (1) unredeemed gift certificates that in the aggregate, for the reporting period, have a face value of less than \$5,000, or (2) gift certificates having a face value of \$5 or less issued by a restaurant or other eating establishment as defined by Delaware law. 12 Del. Code Ann. § 1199(g).

<sup>6</sup> *Id.* § 1198(11).

<sup>7</sup> *Id.* § 1198(9)(b).

<sup>8</sup> *Id.* § 1199(a).

<sup>9</sup> *Id.* § 1158(a).

<sup>10</sup> *Id.*

