SPECIAL REPORT

TAX ANALYSTS

PROVIDING PROTECTION IN STATE UNCLAIMED PROPERTY AUDITS

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The author also wishes to thank Juan Keller of Bryan Cave LLP, Jennifer Borden of Ernst & Young, and Diane Smith of the Committee On State Taxation, who provided useful comments.

This report identifies problems unclaimed property holders face in state audits under the current statutory schemes in place in many states. The report suggests that new procedures for unclaimed property audits should define the scope and manner of these audits and provide more confidentiality for audited entities and their customers. In addition, the report advocates procedures to insure greater auditor objectivity and state administrative review of audit results, especially where the state uses private for-profit auditors.

This report has been written with a grant from the American Tax Policy Institute. The American Tax Policy Institute is a nonprofit organization that seeks to advance sound tax policy by supporting objective and nonpartisan research on tax and economic policy matters. The Institute's financial support should not be understood to be an endorsement of the positions that appear in its sponsored research papers.

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Every state requires businesses to report and deliver to the state property that remains unclaimed for a specified period of years. Common types of unclaimed property that must be reported and paid to the state include dormant bank accounts, uncashed payroll or accounts payable checks, securities, unredeemed gift certificates, safe deposit boxes, and dividends. The state holds the property in its custody for the benefit of the rightful owner who may claim the property from the state.

Collection of unclaimed property is a significant source of revenue for the states.[1] The National Association of Unclaimed Property Administrators (the NAUPA), an association of state officials, estimates that states currently hold more than $10 billion in unclaimed property,[2] although other experts believe the

[1]Indeed, the commissioners drafting the 1954 Uniform Disposition of Unclaimed Property Act noted that the possibility of owners actually claiming their abandoned property from the state is not great. *See* 8A U.L.A. 216, 217 (1983).

[2]*See* National Association of Unclaimed Property Administrators Web site (printed March 9, 1999) at http://www.unclaimed.org/pubinfo/press.html. The NAUPA maintains a Web site with links to Web sites for all states that currently have unclaimed property Web sites. On the linked state Web sites, owners can check owner lists to see whether any state is holding property on their behalf. *See* Joan Caplin, "Your Dollars," *Money,* December 1997, at 106.

amount is closer to $35 billion.[3] States receive an estimated additional $2 billion each year.[4] Only a small percentage of the property reported and paid to the states is actually reunited with the rightful owners, and as a result states are left with sizable funds which they invest for their own benefit.[5] If one credits state auditors' estimates, private businesses are holding another $100 billion in unreported unclaimed property. With these high stakes, it is not surprising that states are rapidly increasing the number of unclaimed property audits commenced each year to ensure compliance with unclaimed property reporting requirements.[6]

Two reports within the last several years present some rare publicity for an increasingly frequent process — states are conducting more active and intrusive audits, and requiring companies to make their records available for inspection to find unreported unclaimed property.[7] In September 1996, the State of Indiana sued a large mail-order company charging that the company had not complied with state unclaimed property laws, and asked the court to order the company to open its books and records for audit. When Indiana notified the mail order company of its intention to conduct an unclaimed property audit, the mail order company refused to submit to an audit, partially on grounds that the state had no authority to intrude into the company's private records.[8] In August 1997, the State of Kentucky sued a Kentucky hospital to require the hospital to open its books and financial records for an unclaimed property audit. Kentucky officials had notified the hospital of its plans to conduct an audit on the basis of the hospital's failure to report unclaimed property to the state while other businesses similar to the hospital in size and business objectives reported significant amounts of unclaimed property. A hospital spokesman stated that the hospital attempted to work with the state, but that the state made unreasonable requests for information, for instance, demanding unlimited access to patient, employee, and accounting records and refusing to keep confidential the information contained within such records.[9]

Although unclaimed property audits represent a significant source of state revenue, many states do not have adequate resources to handle the increase in audits properly, and take various approaches to this problem. Some states conduct combined audits of businesses, automatically auditing for unclaimed property and auditing for other purposes, such as sales tax reporting compliance.[10] More often, states that lack in-house auditors for unclaimed property — and more than half of the states fall into this category — hire private outside auditors that often work on commission and thus benefit in proportion to the amount of unclaimed property they "find."[11] Because many businesses hold property that may be reportable to more than one state, a private auditor who has authority from one state to conduct an audit will often contact other states seeking authority to act as their auditor, even where the other states would otherwise not have audited the business.[12]

State unclaimed property audits present several problems. First, there appears to be little justification or reasonable cause for the unclaimed property audit in states where an unclaimed property audit is conducted on behalf of the state as part of a combined audit, or where a number of states give authority to private auditors who are already conducting an audit on behalf of another state. Second, due to the revenue windfall that states realize, it is in their interest to

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[3]*Id.* There is a broad range in the amount of unclaimed property held by the states. The states with the largest holdings are New York ($3.9 billion), California ($2.1 billion), and Texas ($700 million), while smaller states, such as Vermont, hold only $7 million. *Id.*

[4]*Id.*; *see* Judy Fays, "You, Too, Could Be Due a Windfall: Thousands of People Come Into Unexpected Money via Unclaimed Property Agency," *The Salt Lake Tribune*, Dec. 7, 1999, at C1.

[5]Some state unclaimed property statutes do not give the owners the right to interest collected on their property. *See, e.g.*, Ala. Code section 35-12-35 (1998); Cal. Civ. Proc. Code section 1563 (1999); 765 Ill. Comp. Stat. Ann. 1025/15 (West 1993); N.Y. Aband. Prop. Law section 1405(1)(a) (McKinney's 1991).

[6]In 1998, the Comptroller's office, which has the responsibility to enforce the Texas unclaimed property law, increased its audit staff from 10 to 35 full-time auditors and planned to train 280 additional auditors to audit unclaimed property as part of its regular sales and franchise tax audits. *See* Farley P. Katz, "The Texas Unclaimed Property Law: A Sleeping Giant Awakens," *Wall Street Journal*, Sept. 16, 1998, at 5. "*See also* Michael Quinlin, "Amendment Passed on Unclaimed Money Audits," *The Courier-Journal*, Mar. 14, 1998, (Kentucky's hiring of outside auditing firms resulted in greater collection in one year than the previous four combined).

[7]Indeed, the states are publicizing their aggressive enforcement. *See* Katz, note 6 *supra* (citing *Wall Street Journal* (Texas ed.), Feb. 26, 1997, at T2 (an official with the Texas comptroller's office has stated that their enforcement will be "aggressive")).

[8]Caplin, note 2 *supra*.

[9]Patricia B. Limbacher, "Records Battle: Kentucky, Hospital Duel Over Unclaimed Funds Data," *Modern Healthcare*, Aug. 25, 1997, at 20.

[10]Craig S. Ey, "Businesses Looking for Relief From State Auditors," *Baltimore Bus. J.*, May 9, 1997, at 5.

[11]Caplin, note 2 *supra.*

[12]In 1999, the NAUPA launched an amnesty program under which businesses and financial institutions that voluntarily report overdue unclaimed property to the appropriate state agencies may qualify for a waiver of penalties and interest. *See* Karen Nakamura, "Amnesty Program Broadens as States Join Unclaimed Property Voluntary Compliance Program," 30 *The Tax Adviser* 595 (1999). More than 35 states and the District of Columbia have offered amnesty programs, and some states have extended the amnesty period beyond the NAUPA's proposed January 1, 1999 through October 31, 1999, deadline. *See* National Association of Unclaimed Property Administrators Web Site (printed March 9, 1999) at http://www.unclaimed.org/pubinfo/press.html; National Association of Unclaimed Property Administrators Web Site (printed November 15, 1999) at http://www.unclaimed.org/pubinfo/press.html.

conduct audits under a liberal interpretation of the state unclaimed property law. Accordingly, compared with tax audits, which involve taking property belonging to the business itself, states may proceed with unclaimed property audits, which involve taking property belonging to third parties, with a smaller concern for due process or general fairness to the audited business. Finally, because a majority of the states rely on private auditors who generally work on commission, businesses are subjected to audits that are effectively private money-making activities rather than a necessary public function.

Targeted businesses have few protections against intrusive and overreaching audits and little opportunity to contest the findings of such audits. State statutes provide for advance notice of audits, but little more. A refusal to consent to an audit will leave the target subject to a court order with few defenses. Industries are thus resigned to fight the audits in the legislature. Indeed, a number of states recently proposed bills that would limit the states' ability to perform an unclaimed property audit.[13] Furthermore, once the target is audited, state unclaimed property laws provide little in the way of protective administrative procedures to assure that the action is not arbitrary. For example, most states do not permit requests for redeterminations or administrative appeals. Targeted holders are compelled to conduct costly and time-consuming court litigation to protect their rights.[14] Finally, private auditing firms are not subject to any state audit controls that may inure to state-employed auditors. The lack of any meaningful regulation of these private auditors further necessitates workable and protective administrative procedures that are currently lacking in state unclaimed property laws.

This article will suggest procedures that would act to protect businesses in the course of unclaimed property audits. The first part will provide a brief background of the history of unclaimed property law, including the Uniform Unclaimed Property Acts, which many states have adopted. The second part describes the current status of auditing for unclaimed property and argues that there are significant constitutional and fairness problems with the current system. The last part discusses provisions of the Internal Revenue Code and the Model State Administrative Procedure Act that provide a model for pre-audit, audit, and post-audit procedures that would protect the rights of holders and the states.

I. Unclaimed Property Law in General

A. Codification History

Current state unclaimed property laws are based on the doctrines of escheat and *bona vacantia* taken from English common law. These principles permitted the English crown to take title to unowned real and personal property.[15] American states adopted these broad doctrines into a unified doctrine of escheat. However, in their modern form, state escheat laws differ from their English predecessors in two major respects. First, modern statutes add a presumption of abandonment. Property becomes deliverable to the state after it has remained unclaimed for a specified period of time; that is, the property is presumed to be abandoned after the lapse of the specified period. Unclaimed property statutes are thus based on abandonment of property rather than intestate succession or escheat. Moreover, the presumption applies to intangible property such as the amounts represented by checks and bank accounts, not merely tangible property. Second, the states retain a custodial claim over the property, holding the property for the benefit of the owner, rather than a claim of absolute title to the property.[16]

A number of rationales support state collection of unclaimed property. First, holders of unclaimed property should not receive the benefit of property belonging to third parties; any benefit should go to all of society.[17] Second, state custody protects the owner's rights. Most state statutes place an obligation on the state to attempt to locate the missing owner.[18] States also are safer custodians of unclaimed property than

[13]Examples are Kentucky, California, Missouri, and Maryland. *See* Quinlan, note 6 *supra* (reporting on bill transferring unclaimed property authority from state Treasurer, who had been using outside auditors, to the state Department of Financial Institutions); Peter Sinton and Greg Lucas, "State Unclaimed Property Bill Stopped by Wall of Opposition," *S.F. Chron.*, May 22, 1998, at B3 (reporting on failure of bill dubbed "unclaimed property holders bill of rights"); Ey, note 10 *supra* at 5 (reporting on passage of bill in Maryland General Assembly that "tones down" Maryland's abandoned property law); Missouri House Bill 590, 1999 General Assembly.

[14]*See, e.g.*, Tex. Property Code Ann. section 74.709 (1997) (providing that the state attorney general may bring suit against a holder to compel delivery of property and that a holder may be liable for attorney's fees, penalties, and interest).

[15]Under the English common law doctrine of escheat, unowned real property that failed to pass under a will when a tenant died intestate automatically reverted to the tenant's lord. The doctrine of *bona vacantia* dictated that the English crown could claim unowned personal property, often consisting of personalty remaining in an estate when the real property was escheated, but also applying to personal property held in a failed trust or that remained after dissolution of a corporation. *See generally* Note, "Unclaimed Billions: Federal Encroachment on States' Rights in Abandoned Property," 33 *B.C. L. Rev.* 1037, 1041-49 (1992).

[16]Some states apply escheat, in which case the ownership of the property becomes immediately vested in the state at the time of escheat and the former owners cannot thereafter reclaim the property. *See, e.g.*, Cal. Civ. Pro. Code section 1513 (West 1990); Ky. Rev. Stat. Ann. section 393.020 (Michie 1994). Other states provide that unclaimed property delivered to the state will escheat to the state after a specified period of time. *See, e.g.*, Idaho Code section 14-523 (1997) (unclaimed property delivered to the state will become the property of the state after a period of 10 years).

[17]*See* Prefatory Note to 1954 Uniform Disposition of Unclaimed Property Act, 8A U.L.A. 215, 217 (1983).

[18]For example, the Louisiana Department of Revenue must take all reasonable steps needed to reunite state held unclaimed property with the rightful owner. *See* La. Rev. Stat. Ann. section 9:162(B), as amended by S.B. 368 (enacted June 11, 1999).

businesses that may dissolve, go bankrupt, or misuse the property. Finally, state control benefits the holder by relieving it of responsibility and liability related to accounting for the unclaimed property.[19]

Holders also face potential state claims to the same intangible property by multiple states. Unclaimed property laws have caused problems by giving both the state of the property owner's domicile as well as the state of the holder's domicile authority to claim abandoned property. This has prompted a "race to escheat" between states.[20] By taking custody of property, a state assumes the responsibility of defending claims that other states may make against that property; and so potential multi-state claims have become a real concern. The problem of multi-state claims prompted the development in 1954 of the Uniform Disposition of Unclaimed Property Act (the 1954 Unclaimed Property Act).[21] The premise of the 1954 Unclaimed Property Act was that personal jurisdiction over the holder was necessary for escheat. In 1965, the Supreme Court provided further guidance on multi-state claims when it established a rule in *Texas v. New Jersey* that the state of the owner's last-known address has the priority claim to escheat unclaimed intangible property.[22] However, revisions to the 1954 Unclaimed Property Act failed to reflect the new priority rules adopted in *Texas v. New Jersey*.[23] It was not until 1981 that the National Conference of Commissioners on Uniform State Laws added priority rules in the 1981 Uniform Unclaimed Property Act (the 1981 Unclaimed Property Act) to conform with *Texas v. New Jersey*.[24]

In addition to addressing priority rules to resolve multi-state claims, the 1981 Unclaimed Property Act authorized uniform reporting forms and joint agreements between states for collection of property. The preface to the 1981 Unclaimed Property Act specifically recognized that several states had combined forces to conduct joint audits.[25] The promotion of state cooperation and avoidance of multi-state problems is reflected in the most recent uniform act, the Uniform Unclaimed Property Act of 1995 (the 1995 Unclaimed Property Act). To date, nearly all the states have adopted either the 1954 Unclaimed Property Act as revised in 1966, the 1981 Unclaimed Property Act, or the 1995 Unclaimed Property Act. Of those states that have adopted the Unclaimed Property Act, the overwhelming majority have adopted a version of the 1981 Unclaimed Property Act; while five have adopted the 1995 Unclaimed Property Act. Accordingly, the article will concentrate on the provisions of the 1981 and 1995 Unclaimed Property Acts (the Unclaimed Property Acts).

B. Statutory Requirements

The Unclaimed Property Acts require "holders" — i.e., persons, businesses, or any legal or commercial entity that is obligated to hold for the account of, or pay or deliver to, the owner of the property — to report and pay to the state's custody all tangible and intangible property that is held, issued, or owing[26] in the ordinary course of the holder's business and has remained unclaimed for a specified period of time after the property has become payable or distributable.[27] The periods for the presumption of abandonment generally have been shortened with each of the succeeding uniform acts.[28]

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[19]*See* 33 *B.C. L. Rev.*, note 15 *supra*, at 1048 n. 101 and text therein.

[20]This problem is exacerbated by the fact that the 53 jurisdictions (all 50 states, the District of Columbia, Guam, and Puerto Rico) each have different unclaimed property laws. *See* Karen J. Boucher, et al., "Unclaimed Property Audits," 30 *The Tax Adviser* 9 (1999).

[21]Specifically, the Supreme Court decisions in *Connecticut Mut. Life Ins. Co. v. Moore*, 333 U.S. 541 (1948), and *Standard Oil Co. v. New Jersey*, 341 U.S. 428 (1951).

[22]*Texas v. New Jersey*, 379 U.S. 674 (1965).

[23]The revisions were enacted as the 1966 Uniform Disposition of Unclaimed Property Act.

[24]The priority rules set out in the 1981 Unclaimed Property Act in response to *Texas v. New Jersey* were reaffirmed by the Supreme Court in *Delaware v. New York*, 507 U.S. 490 (1993). The test was clarified as follows:

> First, we must determine the precise debtor-creditor relationship as defined by the laws that create the property at issue. Second, because the property interest in any debt belongs to the creditor rather than the debtor, the primary rule gives the first opportunity to escheat to the State of the "the creditor's last known address as shown by the debtor's books and records." [citations omitted] Finally, if the primary rule fails because the debtor's records disclose no address for a creditor or because the creditor's last known address is in a State whose laws do not provide for escheat, the secondary rule awards the right to escheat to the State in which the debtor is incorporated.
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> *Id.* at 499.

[25]*See* 1981 Unclaimed Property Act, 8A U.L.A. 572 (1983).

[26]The debt must be one that is not in dispute. If the holder does not admit or recognize that a liability exists it will not be required to report the disputed sums. *See Allstate Ins. Co. v. Eagerton*, 403 So.2d 172, 177 (Ala. 1981) (unclaimed checks for settlement of insurance claims not unclaimed property because insurance company retained right to litigate claims not "settled" by cashing of checks; thus, the checks were not acknowledgment of liability). *See also Kane v. Insurance Co. of N. America*, 392 A.2d 325, 329 (Pa. 1978).

[27]1981 Unclaimed Property Act section 2; 1995 Unclaimed Property Act section 2. The 1995 Unclaimed Property Act specifically provides an explanation of when property is "unclaimed" as follows:

> Property is unclaimed if, for the applicable period set forth in subsection (a), the apparent owner has not communicated in writing or by other means reflected in a contemporaneous record prepared by or on behalf of the holder, with the holder concerning the property or the account in which the property is held, and has not otherwise indicated an interest in the property. A communication with an owner by a person other than the holder or its representative who has not in writing identified the property to the owner is not an indication of interest in the property by the owner.
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> 1995 Unclaimed Property Act section 2(c).

[28]Most property covered under the 1954 and 1966 Unclaimed Property Acts was presumed abandoned after seven years. The 1981 Unclaimed Property Act shortened the period for most property to five years and the 1995 Unclaimed Property Act shortened it to three years.

Intangible property includes property that is referred to or evidenced by, for example, money, checks, drafts, credit balances, unpaid wages, interest, and dividends.[29] Pursuant to Supreme Court rulings, the Unclaimed Property Acts provide that a state is generally entitled to custody if the last-known address of the owner is in that state or where the last address is unknown and the holder is domiciled in that state.[30]

The holder of property presumed abandoned must file a verified report to the appropriate state department containing specific property-identifying information.[31] Within a specified period of time before filing the report, the holder must send written notice to the last-known address of the apparent owner informing the apparent owner that the holder is in possession of property for the purpose of reuniting the owner with the property.[32] After filing the report, the holder must then pay or cause to be delivered all property that is required to be reported. The holder must deliver the property to the state unless the owner has in the meantime claimed the property from the holder, or it appears for some reason that the presumption of abandonment is erroneous.[33] Once paid to the state, the state assumes obligations of safekeeping the property and reuniting apparent owners with their property.[34] The holder who delivers the property to the state in good faith is relieved of all liability arising thereafter with respect to the property.[35]

States determine compliance with their unclaimed property laws by means of statutorily authorized audits and examinations. In all its various versions, the Uniform Unclaimed Property Act has always contained a provision specifically authorizing the unclaimed property administrator to examine the holder's books. Section 30(b) of the 1981 Unclaimed Property Act provides for "Requests for Reports and Examination of Records" in these terms:

> The administrator, at reasonable times and upon reasonable notice, may examine the records of any person to determine whether the person has complied with the provisions of this Act. The administrator may conduct the examination even if the person believes it is not in possession of any property reportable or deliverable under this Act.[36]

Provisions granting state administrators the authority to examine a holder's books and records have been upheld, and the authority of the administrators is fairly clear.[37] At least half of the states rely on private auditors for part or all of their unclaimed property examinations.[38] This widespread practice resulted in the addition of a provision in the 1995 Unclaimed Property Act, which specifically authorizes states to enter into contracts with outside auditors. Section 20(b) of the 1995 Unclaimed Property Act includes the following authorization: "The administrator may contract with any other person to conduct the examination on behalf of the administrator."[39] Courts have routinely upheld the use of private examiners in state tax audits.[40]

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[29]*See* 1981 Unclaimed Property Act section 1(10); 1995 Unclaimed Property Act section 1(13).

[30]1981 Unclaimed Property Act section 3; 1995 Unclaimed Property Act section 4. These sections provide additional priority rules for those instances where the first two rules are unavailable.

[31]1981 Unclaimed Property Act section 17; 1995 Unclaimed Property Act section 7. However, a number of states permit holders to report property below a certain amount in the aggregate without providing identifying information for each owner.

[32]1981 Unclaimed Property Act section 17(e); 1995 Unclaimed Property Act section 7(e). Notice must be sent only where the property is valued at $50 or more and where the claim of the apparent owner is not barred by a statute of limitations. *Id.*

[33]1981 Unclaimed Property Act section 19; 1995 Unclaimed Property Act section 8.

[34]1981 Unclaimed Property Act section 18; 1995 Unclaimed Property Act section 9.

[35]The holder will be liable if it breached a fiduciary duty with respect to the property or did not have a reasonable basis for believing that the property was presumed abandoned. *See* 1981 Unclaimed Property Act section 20(e)-(f); 1995 Unclaimed Property Act section 10(a)-(b).

[36]Some states have adopted provisions requiring the state administrator to assert liability against a holder for unclaimed property within a specified period of time. *See, e.g.*, Idaho Code section 14-529(2) (1997) (three years); Ariz. Rev. Stat. Ann. section 44-329 (West 1991) (five years); D.C. Code Ann. section 42-229(b) (1988) (10 years). These statutes of limitation generally begin to run from the date of the filing of the unclaimed property report. *See* D.C. Code Ann. section 42-229(b).

[37]The issue of states' authority to audit has been raised in situations where the holder is a federal or quasi-federal entity. For example, in *United States v. Alabama*, 434 F. Supp. 64 (M.D. Ala. 1977), the court rejected the argument made by the National Credit Union Administration (the NCUA) that the State of Alabama could not constitutionally audit a federal credit union because the NCUA retains the exclusive right to conduct such examinations under the National Credit Union Act. The court found that the National Credit Union Act did not preempt the state unclaimed property law. *Id.* at 67. Similarly, courts have found that state audits of national banks were not the exercise of visitorial powers and not preempted by federal laws vesting the Comptroller of the Currency with powers and duties for the administration of the national banking laws. *Minnesota v. First Nat'l Bank*, 313 N.W.2d 390, 394 (Minn. 1981); *Clovis Nat'l Bank v. Callaway*, 364 P.2d 748 (N.M. 1961). The fact that state audits may duplicate the efforts of national examiners is not, alone, an adequate ground for preemption. *First Nat'l Bank*, 313 N.W.2d at 395.

[38]*See* Caplin, note 2 *supra*.

[39]The full text of section 20(b) of the 1995 Unclaimed Property Act states:

> The administrator, at reasonable times and upon reasonable notice, may examine the records of any person to determine whether the person has complied with this [act]. The administrator may conduct the examination even if the person believes it is not in possession of any property that must be reported, paid, or delivered under this [act]. The administrator may contract with any other person to conduct the examination on behalf of the administrator.

[40]*See, e.g.*, *General Motors Corp. v. State Tax Comm'n*, 504 N.W.2d 10 (Mich. 1993).

II. Problems With Current Procedures

Standing alone, a state's use of a private agent to perform unclaimed property audits is not a cause for concern. States often use private agents to act on their behalf. Nevertheless, when a state delegates its authority it must provide appropriate safeguards to protect against overreaching on the part of the private auditor. Currently, few procedural safeguards exist in the area of unclaimed property audits. Procedural safeguards should, therefore, be put into place to protect targets from overreaching on the part of state employees as well as private auditors. Due to the nature of the private auditing industry, however, this discussion focuses on the need for procedural safeguards from the problems posed by private auditors. A suggested procedural framework is discussed in Section III.

A. Lack of Target Selection Criteria

The Unclaimed Property Acts do not specify factors that would trigger the state's authority to examine the books and records of a business for unclaimed property. A holder targeted for an unclaimed property audit first learns of an unclaimed property examination by a letter from the state or an outside auditor informing the entity that it will be the subject of an audit. The target's natural first reaction will be: Why is it being selected? Were there adequate grounds for its being selected? In many instances, the answer will be clear enough. Common events triggering most state-initiated audits include: (1) failure to report for several years or failure to ever report; (2) submitting negative reports (i.e., no abandoned property to report); (3) failure to report types of property that are common to the target's specific industry; and (4) reporting amounts inconsistent with industry expectations.[41]

The last two factors — the failure to report property generally reported in the industry, and reporting amounts inconsistent with other companies in the industry — require making reporting comparisons between similar business entities or industries, for example, by comparing the history of a particular bank with that of other banks. Indeed, states often conduct industrywide audits of particular industries based on comparisons with the reporting behavior of that industry in other states.[42] In upholding the state's authority to audit, the circumstances the Oklahoma Supreme Court identified in *Lincoln Bank and Trust v. Tax Comm'n*, as supporting a reasonable basis to target the defendant bank are instructive:

> The evidence relevant to this inquiry consists of, for example, testimony by a witness for the Commission that "non-compliance" with the requirements of the Unclaimed Property Act is "widespread" among banks in this state. According to undisputed testimony an "audit" program began in 1982 when the legislature appropriated funds sufficient to boost the enforcement effort. Once the inspections started, the number of reporting banks tripled. Lincoln's own reporting history contributed to the need for examination. Of the reports that it had submitted, reference was made only to checking and savings accounts and, on occasion, to "interest checks," while reports from other banks referred to one or more of the following additional sources: cashiers' checks, certificates of deposit, safe deposit boxes, collateral and escrow accounts.
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> At the time of trial 42 percent of Oklahoma's banks did not submit any reports, and, of the 260 banks that did, 48 indicated an absence of unclaimed property. Out of the 75 banks that have been examined, all had unreported abandoned property. This is perhaps the strongest indication that the Commission's state wide inspection program is not tainted by any discriminatory enforcement criteria or motives.
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> Lincoln does not argue, and the record is devoid of any indication, that the Commission chose to investigate the Bank based on any *non-neutral* source. Moreover, the evidence considered today is undisputed. We conclude that the Commission had reason to believe Lincoln failed to comply with the Unclaimed Property Act. The burden of showing a neutral, *nondiscriminatory* pattern of enforcement has been met, and Lincoln's district court challenge to the predispute inspection process in suit must hence fail.[43]

Evidence of industry noncompliance supports an audit of a company in that industry because the choice is a neutral, nondiscriminatory one.

1. The selection of audit targets by private auditors. States regularly rely on private auditors to examine a business, and when they do so the target may have a more compelling basis to question the audit than the Lincoln Bank did. Although states may hire a private auditor when they believe an audit is necessary,[44] the

[41]O. Ronald Gray, Kimberly Frank, Richard Calvasina, and Fil Juadines, "Finders Keeper's? Unclaimed Properties," *Management Accounting*, December 1998, at 49.

[42]*See Lincoln Bank and Trust v. Tax Comm'n*, 827 P.2d 1314, 1323 (Okla. 1992); "Reader's Forum," *The Courier Journal*, Jan. 15, 1998, at 8A (letter from Kentucky State Treasurer John Hamilton justifying his aggressive auditing of Kentucky banks on the basis of poor reporting in comparison with the banking industry of other states).

[43]827 P.2d 1314, 1323.

[44]Maryland, for example, has a contract with several private auditors to conduct reviews of selected unclaimed property records. Maryland's decision whether to use outside auditors is based on "the volume of the records, the scope of the corporation's business (i.e., whether the business is conducted interstate), any information regarding the corporation that [the outside auditor] may already have obtained, the number of corporate employees, shareholders, and subsidiaries, and the corporation's prior reporting history." *Comptroller of the Treasury v. PHH Corp.*, 717 A.2d 950, 952 (Md. App. 1998). On the other hand, the Missouri statute, which is enacted in a form different from the Uniform Unclaimed Property Act, authorizes the State Treasurer to con-

(Footnote 44 continued on next page.)

situation often works in reverse. Private auditing companies, working on commission — a percentage of the amount paid by the audit target to the state[45] — often locate an unsuspecting target, believed likely to be in possession of unclaimed property. The private auditing companies then approach other states, seeking their authority to act as auditing agent for the state. Once a state gives the outside auditor the authority to audit the target, the auditor can and does approach other states, informs them of the states that have already given it authority, and attempts to convince those states to give it the authority to audit.

This entrepreneurial approach on the part of private auditors allows states to audit more businesses than they would have otherwise, particularly those businesses having their principal place of business in another state. Indeed, a business may be the target of an outside auditor that has received authority from other states, yet not from the state in which the business is located. Because it is easy for a state to authorize an auditor that will be conducting an audit on behalf of other states, a state may authorize an audit without determining whether an audit is warranted. Moreover, to gain custody over unclaimed property, states may be tempted to examine entities in any situation that lends itself to convenient and inexpensive examinations. For example, some states will authorize combined audits, requiring auditors who are examining books for other purposes to conduct simultaneous audits for unclaimed property.[46] In short, some sort of reasonable belief standard would be an appropriate check on the arbitrary use of unclaimed property audits.

2. The revision of the Uniform Unclaimed Property Act to remove standards for the selection of audit targets. State unclaimed property laws based on the 1966 version of the Uniform Unclaimed Property Act usually contain a provision requiring that the state have a reasonable belief that the holder has failed to report unclaimed property before an audit is permitted.[47] For example, section 17-322(a) of the Maryland Uniform Disposition of Abandoned Property Act, which is based substantially on the 1954 and 1966 versions of the Uniform Unclaimed Property Act, states: "At reasonable times and on reasonable notice, the administrator may examine the records of any person *if there is reason to believe* that the person has failed to report property that should have been reported under this title." (Emphasis added.) However, the "reason to believe" language was omitted from the 1981 and 1995 acts. The comments to section 30(b) of the 1981 Unclaimed Property Act explain the removal of the "reason to believe" requirement as follows:

> The 1966 Act authorizes examination if the administrator has reason to believe the holder has failed to report property. To require as a prerequisite for an examination that a state has reason to believe information has been withheld *encourages litigation* and imposes an unnecessary burden on the state.

Omission of the "reason to believe" standard effectively permits states and outside auditors to pick companies to audit with no more basis than a mere possibility that substantial amounts of unclaimed property will be uncovered. In the absence of a standard, some form of privacy safeguard is in order under the circumstances, and, at any rate, a question arises about whether a broad, nonstandardized, and unreviewed authority to examine meets constitutional standards.

3. Does the lack of target selection criteria violate the Fourth Amendment? The Fourth Amendment protects personal privacy and shields against unwarranted governmental intrusions.[48] If a person has an actual expectation of privacy that is recognized as "reasonable" by society,[49] the general rule is that a search of private property without consent is unreasonable unless authorized by a valid search warrant.[50] A formal judicial warrant is unnecessary, however, if the enforcement procedures contained in the relevant statutes and regulations provide safeguards roughly equivalent to those contained in formal warrants. Included within those enforcement proce-

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duct unclaimed property audits only by state employees. Mo. Rev. Stat. section 447.572 provides, in pertinent part:

> **Examination of records by authorized persons — when.** The treasurer may at reasonable times and upon reasonable notice examine the records of any person if the treasurer has reason to believe that such person has failed to report property that should have been reported pursuant to sections 447.500 to 447.595. . . . The treasurer may delegate any duty imposed upon the treasurer pursuant to the provisions of sections 447.500 to 447.595 to such other agency employees as the treasurer deems appropriate.

[45]*See* Jim Jordan, "Kentucky Banks Question Fund Seizures by State," *Lexington Herald-Leader*, Nov. 6, 1997, (private auditor receiving 11 percent of the money paid to the state).

[46]*See* Ey, note 10 *supra*, at 5 (describing additional pressures on businesses since state began policy of looking for unclaimed property whenever it conducts a sales tax audit); Quinlan, note 6 *supra* (describing amendment that stripped state Treasurer of power to audit unclaimed accounts after Treasurer's hiring of outside auditors resulted in greater collection in one year than the four previous years combined); O. Ronald Gray, Kimberly Frank, Richard Calvasina, and Fil Juadines, note 41 *supra* (reporting that states are hiring new auditors or directing sales tax auditors and income tax agents to look for unclaimed property as part of their duties).

[47]*See* Uniform Disposition of Unclaimed Property Act section 23 (1966).

[48]The Fourth Amendment to the United States Constitution provides:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

[49]*See Katz v. United States*, 389 U.S. 347, 361 (1967) (Harlan, J., concurring).

[50]*See Camara v. Municipal Ct. of City and County of San Francisco*, 387 U.S. 523, 528-529 (1967).

dures is the resort to courts to enforce the administrative search.[51]

The 1981 and 1995 Unclaimed Property Acts specifically include provisions regarding enforcement. Section 32 of the 1981 Unclaimed Property Act states: "[t]he administrator may bring an action in a court of competent jurisdiction to enforce this Act." Normally, on a target's refusal to permit an inspection under an unclaimed property act, a state must, depending on its specific administrative scheme, issue a subpoena and institute a proceeding in court to enforce the subpoena, or for injunctive relief.[52] Although such a procedure may serve as a proper substitute for a warrant procedure, it does not protect the privacy interests of the target from unreasonable searches by the state. The court must still decide whether the specific search is reasonable within the meaning of the Fourth Amendment; one of the considerations in this review is how the state agency chose to initiate the particular search.[53]

The Supreme Court has long recognized that an executive agency is not required to have probable cause for conducting a search. In *United States v. Morton Salt*, the Court stated of the investigative powers of the Federal Trade Commission:

> It has the power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.[54]

Relying on administrative law cases, such as *Morton Salt*, the Court held that the Internal Revenue Service is not required to meet any standard of probable cause to obtain enforcement of an administrative summons to examine books and records of a taxpayer in the course of the audit of the taxpayer's returns. Under the test the Supreme Court laid out in *United States v. Powell*, all that the IRS must show is that: (1) the search is relevant to a lawful and legitimate purpose; (2) the inquiry is relevant to that purpose; (3) the information sought is not already in the agency's possession; and (4) the administrative steps required by the code have been followed.[55] The "legitimate purposes" of IRS investigations are provided by statute[56] and include "ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax." Thus, so long as a summons is not being used to harass a taxpayer, or for any other inappropriate purpose, the IRS may "search" a taxpayer's books and records merely to assure that taxes are properly being reported and paid.

Following *Powell*, a strong argument can be made that unclaimed property agencies need no specific probable cause standards in seeking information for an unclaimed property audit. But *Powell* must be read in the light of *Marshall v. Barlow's Inc*,.[57] where the Supreme Court found searches conducted by OSHA agents without a "warrant or its equivalent" to be unconstitutional. The Court stated that administrative searches such as the one in that case need not be based on "probable cause in the criminal sense" but may be based on "specific evidence of an existing violation" or a showing that "reasonable legislative or administrative standards for conducting . . . an inspection are satisfied."[58] Subsequently, the Court stressed the need for assuring that the investigation is authorized "pursuant to an administrative plan containing neutral criteria."[59]

Marshall is subject to two possible interpretations. One reading would impose probable cause-type standards only on administrative investigations that require a warrant, and not those for which the relevant statute envisions resort to court review.[60] This would permit a state unclaimed property agency to audit a business without any specific suspicion or belief that the business is not in compliance so long as the search

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[51]The Supreme Court in *Marshall v. Barlow's Inc.*, 436 U.S. 307, 323 (1978), explained the requirement as one that "provide[s] assurances from a neutral officer that the inspection is reasonable under the Constitution." Nevertheless, the Court made clear that the need for a warrant and the reasonableness of a warrantless administrative search "will depend upon the specific enforcement needs and privacy guarantees of each statute." *Id.* at 321. Some statutes, the Court continued, "already envision resort to federal-court enforcement when entry is refused, employing specific language in some cases and general language in others" *Id.*

[52]*See, e.g.*, Md. Code Ann., Comm. Law section 17-323 (1998).

[53]*See United States v. Mississippi Power & Light*, 638 F.2d 899, 907 (5th Cir.), *cert. denied* 454 U.S. 892 (1981).

[54]338 U.S. 632, 642-643 (1950); *see also Oklahoma Press Pub. Co. v. Walling*, 327 U.S. 186 (1946).

[55]379 U.S. 48, 51 (1964). The authority of the IRS to issue a summons is based on IRC section 7602, which permits the use of a summons for five authorized purposes: (1) to ascertain the correctness of a return; (2) to make a return where none has been filed; (3) to determine the liability of any person for any internal revenue tax; (4) to determine the liability at law or in equity of any transferee or fiduciary or any person for any internal revenue tax; and (5) to collect any internal revenue tax liability. Section 7602 empowers the Service to examine books that may be relevant or material and to summon a taxpayer, record custodian, or any other proper person to appear and produce records and give testimony under oath. Saltzman, *IRS Practice and Procedure* para. 13.01[1].

[56]IRC section 7602(a).

[57]436 U.S. 307 (1978).

[58]*Id.* at 320.

[59]*Id.* at 323.

[60]*See Comptroller of Treasury v. PHH Corp.*, 717 A.2d 950, 956 (Md. App. 1998) ("Impliedly, at least, the *Marshall* Court was of the view that in cases where an administrative agency issues subpoenas for records, the government need not show 'probable cause' as it must when a search warrant is requested so long as the statute provides for court review if the subpoena is dishonored. . . . A subpoena, of course, constitutes far less of an invasion of privacy than does a search warrant.").

itself is "reasonable" under the Fourth Amendment.[61] Another reading would require an inquiry during any administrative examination to investigate how the agency chose to initiate the particular search. Reading *Marshall* in this vein, the Fifth Circuit stated that a search will be reasonable if:

> based either on (1) specific evidence of an existing violation, (2) a showing that reasonable legislative or administrative standards for conducting an . . . inspection are satisfied with respect to a particular (establishment) . . . or (3) a showing that the search is pursuant to an administrative plan containing specific neutral criteria. It is important that the decision to enter and inspect . . . not be the product of the unreviewed discretion of the enforcement officer in the field.[62]

It appears that the second reading of *Marshall* — requiring a justification for commencing an audit in all administrative searches — is more reasonable considering *Marshall*'s requirement of a "warrant or its equivalent." The IRS summons procedure would fall within the Court's definition of an "equivalent," and, since *Powell* was decided, it has been accepted that the IRS need not prove it had a reasonable belief that the audited company failed to comply with the tax laws. *Powell* and *Marshall* can be harmonized to stand for the proposition that IRS auditing procedures constitute "reasonable legislative or administrative standards" for conducting an audit.

Because section 30(b) of the 1981 Unclaimed Property Act and section 20(b) of the 1995 Unclaimed Property Act fail to require a reasonable belief on the part of the state, under the *Marshall* standard, these provisions potentially violate the Fourth Amendment.

B. Compensation of Private Auditors

For the most part, private auditors work on a commission basis. A Maryland appellate court described the process as follows:

> The administrator has limited resources available with which to conduct the examinations of records of holders of abandoned property. Consequently, the Administrator has a contract with several private vendors, including the National Abandoned Property Processing Corporation (NAPPCO) to conduct the reviews of selected unclaimed property records. The determination to utilize the services of NAPPCO is made based on the volume of the records, the scope of the corporation's business (i.e., whether the business is conducted interstate), any information regarding the corporation that NAPPCO may already have obtained, the number of corporate employees, shareholders and subsidiaries, and the corporation's prior reporting history.
>
> NAPPCO is paid a fee for its services equal to a percentage of the amount of abandoned property actually remitted to the Comptroller as a result of its review. NAPPCO is not paid anything for identifying property as abandoned, unless that property is in fact remitted to the Comptroller.[63]

Contingent fee arrangements create a bounty-hunting mentality. Little incentive exists for the contingent-fee auditor to examine the books impartially or even fairly. Yet, to date, this compensation system has not been successfully challenged. Until the 1995 Unclaimed Property Act added such a provision, state statutes did not provide specific authorization to use outside auditors.[64]

At least one court has concluded that contingent fee contracts violate public policy.[65] In *Sears, Roebuck and Co. v. Parsons*, a Georgia statute authorized contracts with outside auditors. The contracts provided that the auditor would audit personal property returns provided by the county tax assessor, and if the audit resulted in increased valuation, the auditor would receive 35 percent of any amount collected plus 100 percent of all first year penalties collected. The court found such a system to offend public policy:

> Nevertheless, we hold the contract void as against public policy, not because of the services performed, but because of the contingency scheme of compensation for those services.
>
> The power to tax rests exclusively with the government. . . . In the exercise of that power, the government by necessity acts through its agents. However, this necessity does not require nor authorize the creation of a contractual relationship by which the agent contingently shares in a percentage of the tax collected, and we hold that such an agreement offends public policy. The people's entitlement to fair and impartial tax assessments lies at the heart of our system, and, indeed, was a basic principle upon which this country was founded. Fairness and impartiality are threatened where a private organization has

[61]The elements to be examined to determine whether the examination is reasonable include (1) whether the search is authorized by statute and has a legitimate purpose and (2) whether the search is properly limited in scope. *See United States v. Mississippi Power and Light Co.*, 638 F.2d 899, 907 (5th Cir. 1981) (citing *Marshall v. Barlow's Inc.*).

[62]*Mississippi Power*, 638 F.2d at 907-908 (internal quotations and citations omitted).

[63]*Comptroller of Treasury v. PHH Corp.*, 717 A.2d 950, 952 (Md. App. 1998).

[64]1995 Unclaimed Property Act section 20(b): "The administrator may contract with any other person to conduct the examination on behalf of the administrator." Not all state unclaimed property laws permit the state's administrator to contract with private auditors. *See* Mo. Rev. Stat. section 447.572.

[65]*See Sears, Roebuck and Co. v. Parsons*, 401 S.E.2d 4 (Ga. 1991) (invalidating on public policy grounds OCGA Sec. 48-5-298(a)(3)) ("Each county board of tax assessors . . . may enter into employment contracts with persons to . . . [s]earch out and appraise unreturned properties in the county."). *But see Philip Morris U.S.A.*, 436 S.E.2d 828 (N.C. 1993) (contingent fee contract not against public policy); *Suburban Cable TV Co. v. City of Chester*, 685 A.2d 616 (1996) (same).

a financial stake in the amount of tax collected as a result of the assessment it recommends.[66]

Likewise, permitting outside auditors to choose their targets and receive a percentage of the property delivered to the state violates public policy. Differences between tax collection and unclaimed property payments do exist. Unclaimed property does not "belong" to the holder. The two processes are, however, comparable. Because the results of an audit are not necessary to the final determination of liability, it is irrelevant that the payments are of tax or of unclaimed property. Property is not "unclaimed" until a final decision on the merits is issued; until that point it is arguably still the property of the audited entity.[67] Accordingly, nullifying the ability of private auditors to hunt down likely targets for easy gains would give much needed protection to targeted businesses.

C. Conflict of Interest of Private Auditors

Potential amounts reportable each year have prompted states to step up their unclaimed property audit programs. States and the owners, however, are not the only parties benefiting from the increase in audits. Private auditors also benefit from these audits. First, they act as auditors collecting on a contingency basis. Second, many offer consulting services for state unclaimed property administrators, such as auditor training programs, organizational development and program enhancement, consulting, and legislative guidance. Finally, many also offer consulting services for corporations in all aspects of unclaimed property compliance, including reporting, systems development, and planning.

The conflict of interest inherent in such dual role-playing is obvious. On one hand, the auditing firm acts as a consultant to the state to assist the state in creating a more efficient and lucrative unclaimed property program, through which the firm benefits. On the other hand, the firm acts as a consultant to private corporations — the subjects of the unclaimed property laws and audits which the firm assists or conducts. Some form of regulation is necessary to ensure that private auditors do not abuse their public function for personal gain and taint the process.

If private auditors are accountants subject to the AICPA Code of Professional Conduct, the code's conflict of interest standards, which are applicable to all professional services, would apply to the auditors' activities. Among the six principles of the Code of Professional Conduct is Article IV, Objectivity and Independence, which states that "[a] member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services."[68] In addition to the principles, there are more detailed rules, such as Rule 102, which provides: "[i]n the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others."[69] The AICPA also issues interpretations of the rules. The interpretation on conflicts of interest states that a conflict may arise where a member performs services for a client and has a "significant relationship" with another party.[70] An example would be providing investment advice to a client and having a relationship with a financial product sold to the client. The interpretation states that this is not prohibited if the client is informed of the relationship. The disclosure must be made without violating the rule on confidential client information, Rule 301, which states that a member cannot disclose any confidential client information without the client's specific consent.

Unlike the ethical codes and rules regulating attorneys, the AICPA code does not provide much guidance on what constitutes a conflict of interest that should prevent an accountant from performing services for a client. In a litigation setting, the AICPA states that there is a conflict "when a CPA's ability to objectively evaluate and present an issue for a client will be impaired by current, prior, or possible future relationships with parties to the litigation."[71] The limited case law on the subject arises from situations where accountants face disqualification as expert witnesses.[72] The cases do not apply the same standards applied to attorney disqualification because the role of the expert is to give an opinion, not to advocate.[73] Whether accountants are disqualified in these cases turns on whether the expert possesses confidential information about the opposing party. Generally, the confidential information would have to concern the particular matter or prejudice the opposing party to disqualify the accountant.[74] Unclaimed property auditors not subject to the AICPA rules should be governed by a similar set of rules, so that at the very least an auditor could not represent "both sides" where the auditor possesses confidential information related to the particular issues at hand about one of the parties due to a previous relationship.

D. Confidentiality and Privacy Issues

A full examination inherently raises privacy and confidentiality concerns with the examined entity, not only with regard to its own financial records but also with regard to the financial records of the owners. Many holders consider most records relating to unclaimed property as confidential and subject them to

[66] *Sears, Roebuck and Co.*, 401 S.E.2d at 5.

[67] The same argument can be made with regard to an examination of due process requirements. *See infra* II.F.I.

[68] American Institute of Certified Public Accountants Code of Professional Conduct section 55, Article IV — Objectivity and Independence (1996).

[69] AICPA Rule 102 — Integrity and Objectivity.

[70] AICPA Interpretation 102-2 — Conflicts of Interest.

[71] AICPA, Conflicts of Interest in Litig. Servs. Engagements (1993), quoted in *In re Ambassador Group,* 879 F. Supp. 237, 246 (E.D.N.Y. 1994).

[72] *See, e.g., United States v. Healthcare Rehab Syst., Inc.,* 994 F. Supp. 244 (D.N.J. 1997); *In re Ambassador Group, Inc.,* 879 F. Supp. 237 (E.D.N.Y. 1994).

[73] *Healthcare Rehab,* 994 F. Supp. at 249.

[74] *Id.* at 251; *Ambassador,* 879 F. Supp. at 243.

high levels of confidentiality and control within the organization itself.[75] Ordinarily, however, courts will not foreclose an examination on privacy grounds. For example, in *Lincoln Bank and Trust v. Oklahoma Tax Comm'n*,[76] the targeted bank claimed that the Oklahoma Financial Privacy Act prohibited it from disclosing information about customer accounts to the state. The court rejected this argument, finding that the public policy underlying the unclaimed property legislation and the fact that abandoned property bears on the bank's financial condition and operations lead to a conclusion that the administrator acts as a "supervisory agency" who may examine the books under the Privacy Act.[77]

However, the court limited the examination only "to the extent necessary to fulfill its duties under the Unclaimed Property Act and only for the production of documents critical to a meaningful search," thereby affording some theoretical privacy to the records.[78] The court, nevertheless, decided that there was no issue at all with regard to records containing information on abandoned property alone, as "no privacy interest exists in property that is presumed abandoned by law."[79] Considering that the contents of given records may be unknown until examined, the small level of privacy left by the court is probably insignificant.

The *Lincoln* court permitted the examination on the further ground that the statute at issue expressly mandated that reports filed by a holder of abandoned property shall remain confidential in the hands of the state and thus privacy concerns would be met.[80] Obviously, holders are not concerned merely about the privacy of the records in their own hands. Once reported, the concern of public disclosure is even greater. For example, it is common for "heirfinders" — individuals who engage in the business of locating owners of abandoned property and helping the owners in recovering their abandoned property for a fee or percentage of the recovered property — to attempt to obtain abandoned property information filed with the state to seek out owners.[81]

The 1981 Unclaimed Property Act does not provide for confidentiality of information obtained by the state. However, states recognized the need for such a provision and began amending their statutes to provide for confidentiality.[82] Accordingly, the 1995 Unclaimed Property Act added such a provision:

> (d) Documents and working papers obtained or compiled by the administrator, or, the administrator's agents, employees, or designated representatives, in the course of conducting an examination are confidential and are not public records, but the documents and papers may be:
>
> (1) used by the administrator in the course of an action to collect unclaimed property or otherwise enforce this [Act];
>
> (2) used in joint examinations conducted with or pursuant to an agreement with another State, the federal government, or any other governmental subdivision, agency, or instrumentality;
>
> (3) produced pursuant to subpoena or court order; or
>
> (4) disclosed to the abandoned property office of another State for that State's use in circumstances equivalent to those described in this subdivision, if the other State is bound to keep the documents and papers confidential.[83]

Few states have adopted the 1995 Unclaimed Property Act. Thus, unless a state specifically amends its statute to provide for confidentiality, a question arises as to the limits of public disclosure.[84] This issue was addressed in *Merrill v. Oklahoma Tax Comm'n*. The Oklahoma statute, like the Uniform Unclaimed Property Act, requires certain limited information to be made public by unclaimed property administrators to notify

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[75]Anthony L. Andreoli and J. Brooke Spotswood, *Guide to Unclaimed Property and Escheat Laws*, section 13-6 (1996).

[76]827 P.2d 1314 (Okla. 1992).

[77]827 P.2d at 1321. A "supervisory agency" as distinguished from a "government authority" is defined under the Privacy Act, 6 O.S.1981 sec. 2202(e), as an agency "which has statutory authority to examine the financial condition or business operations" of a financial institution. *Id.* at 1319 n.28. The court, however, left open the question of whether the state could inspect the records of a national bank for unclaimed property. *Id.* at 1320 n. 30. However, other cases have held that confidentiality of national bank records is not required by law and must yield to public necessities such as unclaimed property laws. *See, e.g., Lord v. First Nat'l Bank of St. Paul*, 313 N.W.2d 390, 395 (Minn. 1981).

[78]827 P.2d at 1322.

[79]*Id.* at 1321-1322.

[80]*Id.* at 1321.

[81]*See Keegan v. Bailey*, 443 S.E.2d 826, 827 (W.Va. 1994) (defendant in the business of researching governmental records in an attempt to locate money owed to individuals and corporations for 10 percent fee of moneys recovered).

[82]For example, Oklahoma amended its Uniform Disposition of Unclaimed Property Act in 1988 to provide for confidentiality. Okla. Stat. tit. 60, section 661(H) (Supp. 1988).

[83]1995 Unclaimed Property Act section 20(d).

[84]This question arises particularly in light of states' Freedom of Information Acts. For example, the West Virginia Freedom of Information Act provides that "[e]very person has a right to inspect or copy any public record of a public body in this state, except as otherwise expressly provided." W.Va. Code section 29B-1-3(1) (1992). Some states may provide an exception for abandoned property records. West Virginia's Uniform Disposition of Unclaimed Property Act states that "records of abandoned property kept by the state treasurer are available for inspection and copying only by an owner of such property as to the particular property he owns. . . . These records are exempt from the provisions of [the Freedom of Information Act]." In *Keegan v. Bailey*, an heirfinder brought suit to inspect records of stale vendor checks issued by the state in payment for goods and services. The court found that the West Virginia exception to the Freedom of Information Act was not applicable because the seven-year dormancy period had not run and hence the vendor checks were not yet presumed abandoned property. 443 S.E.2d at 828-829.

owners of their property.[85] In *Merrill*, a private individual sought all records and information maintained by the state unclaimed property division of the state Tax Commission, including those not specifically made available under unclaimed property statutes. At the time of the request, the state did not have a confidentiality provision that would prohibit compliance with such a request. The individual contended that the Oklahoma Open Records Act permitted access to all unclaimed property records because they were not specifically required by law to be confidential.[86] The court rejected the claim, holding that if the release of information in a public body's custody would invade an individual's privacy or damage a party's commercial interests, the exemption to the Open Records Act would apply.[87] The court found that the type of information found on unclaimed property reports is of the type which would ordinarily be subject to a protective order because it has the potential to harm unclaimed property reporter's financial interests, and thus should remain confidential.[88]

Because the unclaimed property statutes of many states include confidentiality provisions and due to holdings such as *Merrill*, it would seem that holders should have little concern regarding the confidentiality of their records in state hands. Even if states keep information, there is a concern about confidentiality with private auditors. The 1995 Unclaimed Property Act specifically extends the confidentiality of "documents and working papers obtained or compiled by the administrator, *or the administrator's agents, employees, or designated representatives* in the course of conducting an examination." (Emphasis added.) Again, few states have enacted the 1995 Unclaimed Property Act. Nevertheless, most private auditors will sign a confidentiality agreement specifically protecting the target from disclosure by the auditor.[89] Although the validity and extent of these confidentiality agreements have never been tested, any entity subject to an authorized audit should require the auditor to sign such an agreement.

An example of the problems that still exist with regard to unclaimed property audits relates to the examination of the federal or state tax returns of the entity or person being examined. While sections 6103 and 7213 of the Internal Revenue Code prohibit a state tax authority from disclosing federal returns or the state returns that it has received or reviewed during tax audits, there are few states that have statutory limits of the same sort that relate to unclaimed property auditors. Some of the states that do treat unclaimed property audits as confidential and subject to criminal or civil penalties, or specifically bar unclaimed property auditors from disclosing tax information obtained from either taxing authorities or taxpayers, are Alabama (Ala. Code section 35-12-46); Alaska (Alaska Stat. section 34.45.290); Arizona (Ariz. Rev. Stat. sections 42-2001 & -2003); Oregon (Or. Rev. Stat. section 98.356); and Virginia (Va. Code Ann. section 55-210.24:2).

E. Lack of Procedures on Scope and Manner of Audits

The Unclaimed Property Acts provide few procedures regarding the actual audit process. If a state does not adopt specific procedures, audited entities will face inconsistent audit results, particularly when subjected to audits conducted by outside auditors who may follow differing auditing guidelines, and, as discussed above, take too liberal an approach to unclaimed property laws. For example, auditors may reach differ-

[85]Okla. Stat. tit. 60, section 662 (1983) ("The State Treasurer shall cause notice to be published not later than March 1, or in the case of property reported by life insurance companies, September 1, of the year following the report required by Section 661 of this title. . . . The published notice must . . . contain: 1. The names in alphabetical order and last-known address, if any, of persons listed in the report and entitled to notice. . . . "). *See* 1981 Unclaimed Property Act section 18.

[86]The Open Records Act provides "All records of public bodies and public officials shall be open to any person for inspection, copying, and/or mechanical reproduction during regular business hours; provided: . . . the Oklahoma Open Records Act does not apply to records specifically required by law to be kept confidential." Okla. Stat. tit. 51 section 24A.5 (1988).

[87]831 P.2d at 640.

[88]*Id.* at 641. *Contra Connell v. Sacramento Super. Ct.*, 50 *Cal. Rptr.* 2d 357, 365-66 (Cal. Ct. App. 1996) (court permitted heirfinder to inspect state's outstanding vendor warrants under California Public Records Act as general public interest in disclosure outweighs any specific interest in nondisclosure).

[89]A form confidentiality agreement of one private auditor states as follows:

(Footnote 89 continued in next column.)

[Name] as agent for the states set forth on Annex A (the "States"; such term also including any additional states that may during the course of [Name] examination also authorize [Name] to act as its agent), has requested certain information from [Name of Company] (the "Company") in connection with its abandoned property examination of the Company's books and records.

[Name] shall treat as confidential and protect from disclosure to third parties, other than its own employees, agents and representatives, and the States, all information that the Company may furnish in writing to [Name] or its agents, representatives or employees in connection with its abandoned property examination; provided however, that this letter agreement shall not prohibit [Name] from disclosing such information to (a) any person specifically approved by the Company or (b) pursuant to or as required by law. [Name] further agrees that it will not use any such information for any purpose other than the performance of such examination.

The information referred to in the preceding paragraph shall not include any information (i) previously known to [Name] prior to the receipt of such information, (ii) subsequently acquired by [Name] from a third party having an independent right to disclose such information or (iii) which is now or later becomes publicly known through no fault of [Name].

Any failure or delay by the Company in enforcing any provision of this letter agreement will not operate as a waiver of that provision, and the Company will be entitled to injunctive relief, as well as all other remedies available at law or equity, if [Name] breaches this letter agreement.

ing conclusions based on varying accounting approaches taken by a specific company or industry.[90]

1. Notice and scope of audit. Section 30(b) of the 1981 Unclaimed Property Act and section 20(b) of the 1995 Unclaimed Property Act provide that the administrator may examine "at reasonable times" and only "upon reasonable notice."[91] Advance notice of an audit is not often an issue; all audits are commenced by virtue of an audit notification letter from the state. More often, as with all types of audits, issues arise regarding the extent of the examination and questions regarding the records and books to be examined.

Neither the 1981 nor the 1995 Unclaimed Property Act provides guidance as to the permissible scope of an unclaimed property audit. Section 31 of the 1981 Unclaimed Property Act and section 21 of the 1995 Unclaimed Property Act provide a general rule for retention of records. The 1981 Unclaimed Property Act provides that "every holder required to file a report . . . as to any property for which it obtained the last known address of the owner, shall maintain a record of the name and last known address of the owner for 10 years after the property becomes reportable." The 1995 Unclaimed Property Act amended this section to require the holder to maintain records "containing the information required to be included in the report." These sections, however, are not geared to establish the scope of the records that will be available for an audit.[92] The general examination provisions of the Unclaimed Property Acts state broadly that the administrator may examine "the records of any person to determine whether the person has complied with the act." Because no limitation is placed on the scope of the search, a strong argument can be made that such broad authority is unconstitutional, violating the Fourth Amendment.

As discussed above, a warrant provides assurances that an inspection is reasonable under the Constitution, in part, because it "advise[s] the owner of the scope and objects of the search, beyond which limits the inspector is not allowed to proceed."[93] The Supreme Court has noted that "[d]eliniating the scope of a search with some care is particularly important where documents are involved."[94] Resort to a neutral decision-making body, which *Marshall* treated as a warrant "equivalent," would effectuate that purpose equally well. In other words, no contested inspection would be permitted under any unclaimed property act without resort to the court's review of the reasonableness of the search. A court order or subpoena could supply the appropriate limits of an inspection. Accordingly, the broad language provided in the Unclaimed Property Act would not be unreasonable under the Constitution.

The issue of the scope and objects of a search has been examined in the context of the inspection process provided by the Internal Revenue Code. Code section 6001 separately obligates taxpayers to keep records.[95] In *United States v. Mobil*, the IRS sought to inspect certain records kept by Mobil. When Mobil refused, the IRS did not serve a summons on Mobil, as it is empowered to do under IRC section 7602. Instead, it sought a permanent injunction to compel inspection of the records kept pursuant to section 6001. The court held that section 6001 did not give the IRS authority to inspect a taxpayer's records; rather, Congress intended to authorize such inspections only by resort to specific statutorily-created procedural schemes such as the summons procedure.[96] The court found that permitting unilateral inspection under section 6001 would be inconsistent with the Fourth Amendment.[97]

The *Mobil* court said that, under *Marshall*, the focus of the constitutional scrutiny of an administrative inspection is on whether there are "reasonable legislative or administrative standards" for conducting the inspection and the reasonableness of a warrantless search depends on the specific enforcement guarantees of each statute.[98] In *Marshall*, the Court was concerned that the scope of permissible inspection was not defined by the OSHA statutes and regulations; a warrant would provide that definition. Following that reasoning, the *Mobil* court determined that permitting the IRS to inspect under section 6001 would permit the IRS an inspection of a less-than-well-defined group of records without the proper judicial supervision required by the Fourth Amendment.[99]

The Unclaimed Property Acts do not define the scope of an audit other than permitting a search of

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[90]Recently, a number of states have considered bills to amend the state unclaimed property law because auditors were finding that certain credit balances were presumed unclaimed property even though the amounts were arguably not within the scope of the statute, but appeared to be through the accounting methods used by the corporation. *See* note 10 *supra*; Tim Gray, "To Short Escheat the State Isn't Funny to Harlan Boyles; North Carolina Treasurer," *Business North Carolina,* June 1998, at 16.

[91]*See, e.g.*, D.C. Code Ann. section 42-230 (1992) ("The Mayor may at reasonable times and upon reasonable notice examine the records of any person to determine if such person has complied with the provisions of the [Disposition of Unclaimed Property Act]").

[92]The retention period commences after the property is reported; thus, no audit motives are involved. Rather, record retention is for the benefit of states to make a claim to the property and prove that the last-known address was in their state. *See* Comments to Section 31 of the 1981 Unclaimed Property Act ("The experience of several states has confirmed that substantial amounts of unclaimed property, for which at one time the holder had records of address, are now subject to claim only by the domiciliary state of the holder since the recorded address has not been retained.").

[93]*Marshall v. Barlow's*, 436 U.S. at 323.

[94]*Id.* at 324 n. 22.

[95]"Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe." IRC section 6001.

[96]*United States v. Mobil Corp.*, 543 F. Supp. 507, 515 (N.D. Tex. 1981).

[97]*Id.* at 519.

[98]*Id.* at 518.

[99]*Id.* at 518.

"records" to "determine whether the person has complied with the provisions of [the] Act."[100] Accordingly, without requirements similar to those the IRS must follow when issuing a summons, or a similar administrative procedure that would provide a judicially supervised defined inspection, the Unclaimed Property Act is not consistent with the Fourth Amendment. As will be discussed in Part III below, providing a summons-type enforcement procedure would both help remedy constitutional concerns regarding the scope of a search and help control unnecessary and overbroad examinations by private auditors.

2. Manner of examination. The Unclaimed Property Acts provide little detailing the manner in which examinations are to be conducted. The 1981 Unclaimed Property Act provides instruction only where the holder fails to maintain required records:

> If a holder fails after the effective date of this Act to maintain the records required by Section 31 and the records of the holder available for the periods subject to this Act are insufficient to permit the preparation of a report, the administrator may require the holder to report and pay such amounts as may reasonably be estimated from any available records.[101]

Section 20(f) of the 1995 Unclaimed Property Act amends this section by requiring the target to pay the amount the administrator "reasonably estimates, on the basis of any available records of the holder or by any other reasonable method of estimation, should have been but was not reported."[102]

The following discussion is an example of the manner in which at least one private auditor conducts unclaimed property audits. The private company uses what it refers to as "General Ledger Examination Procedures," which have a number of phases. The first phase, basic information gathering, is not fully explained, but appears to be a relatively minor part of the audit as the "examiner should be able to accomplish this via letters and phone calls. A one day visit to the company might be necessary." Presumably the auditor receives basic information about the target during this phase. The second phase is a uniform information request for information such as organization charts, information on centralization of accounting functions, information on escheat accounting systems and policies (including summaries of abandoned property filings), charts of accounts, policies regarding stale dated checks and account balances, record retention policies, listing of bank accounts, number of payroll and accounts payable checks per month, and annual reports. After this uniform information request, a company-specific request is made, which includes general ledger analysis of escheatable property accounts, abandoned property filings with supporting documentation, and other information unique to the target company and its industry.

Following the document requests, the auditor interviews management personnel and tests escheat policies by reviewing data to determine whether to conduct a complete field examination. Thereafter, a field examination may be conducted. The examination will often be a sampling. The auditor will draw up a chart of current accounts, including, for example, suspense accounts, income accounts, and operating accounts. The auditor examines the accounts and isolates those accounts believed to contain unclaimed property. Samples of unreconciled items are then taken from these accounts. From the sample, the auditor extrapolates back in time for the number of years under examination to project the likely amounts of unreported unclaimed property. After the examination, the auditor holds a closing examination where the results of the audit are disclosed to the target and prepares a draft report, which is provided to the holder for review and comment.

Problems with these procedures are readily apparent. For example, a private auditor may not permit a review of the results of the examination, whereas a state may have a review procedure. Additionally, unlike the Unclaimed Property Acts, which provide for estimation only where the target fails to keep records, auditors will sample existing records as a matter of practice even where records do exist.[103] This, however, is more than anything else an issue of reliability of expert evidence.[104] In any event, it is clear that private auditors should be required to follow the same set of examination procedures that the states must follow. For example, on the conclusion of the audit, the findings would be subject to review by the state as would occur in a state review. This would ensure that the target is not being subjected to overreaching examinations and that audits are being conducted with some modicum of subjective fairness.

More troubling, however, is the effect that the audit will have on the state. Once the private audit is completed and a final report is delivered to the state, the state is not bound by that audit. In other words, at the conclusion of the audit the state may accept the report as filed and accept the results therein. On the other hand, the state may conclude that the audit was insuf-

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[100] *See, e.g.*, 1981 Unclaimed Property Act section 30(b), 8A U.L.A. 617, 668 (1983).

[101] 1981 Unclaimed Property Act section 30(e).

[102] *See, e.g.*, Idaho Code section 14-530 (1997) ("If a holder fails to maintain records required by section 14-531, Idaho Code, and the records of the holder available for the periods subject to this chapter and [sic] insufficient to permit the preparation of a report, the administrator may require the holder to report and pay such amounts as may be reasonably estimated from any available records.").

[103] In the tax setting, sampling is not supposed to be used unless an examination of all the records would be prohibitive in time and resources. Saltzman, *IRS Practice and Procedure*, para. 8.06[3][a] n. 32.2 (1998 Supp.); IRM 42(18)(0), Statistical Sampling Examination Program (Nov. 4, 1994).

[104] In *New Jersey v. Chubb*, 570 A.2d 1313 (N.J. Super. 1989), the court held that the state can prove the extent of the target's liability through statistical estimation and extrapolation from existing data in cases where the issuer's lack of records precludes direct proof, provided that the method used meets the requirements for expert evidence. *Id.* at 1317.

ficient and elect to re-examine the target. States generally refuse to accept an auditor as an exclusive agent. A state will accept the auditor's report but will not agree that it cannot reaudit the company. Thus, a target can never be assured that it will not be subject to more than one complete audit.

Of course, a state may, on its own, elect to audit a holder twice, or even simultaneously by two different entities. The Unclaimed Property Act does not, in any of its versions, prohibit unnecessary or second inspections. This, however, only underscores the need for a provision similar to that found in IRC section 7605(b), which provides that taxpayers shall not be subject to unnecessary inspections or second inspections if certain prerequisites are not met.[105] Without such a provision a state's ability to fully re-examine would run afoul of any standards of fairness, and possibly due process.

F. Appeal of Findings

Some states — particularly those that have delegated unclaimed property laws into the hands of the state tax commissioner and thus apply the administrative procedures used in tax audits — provide for administrative appeals.[106] However, most states do not. In these states, a party that disagrees with a final report of findings must resort to litigation in court, by either bringing a declaratory suit itself[107] or by virtue of being brought to court by the state on refusal to pay or deliver the amounts the audit determined to be reportable.

It is disturbingly uncertain whether a state is required to provide an administrative appeal in unclaimed property examinations. The Due Process Clause provides that "No person shall . . . be deprived of life, liberty, or property, without due process of law." Before determining what process is due, one must first ask whether the government function is actually depriving the individual of life, liberty, or property without due process. Here, then, the questions that must be answered are whether a holder will be deprived of "property" on payment of unclaimed property and whether the Unclaimed Property Act supplies adequate due process safeguards. The answers would appear to be both "no" and "yes."

On the surface, it appears that unclaimed property is not "property" of the holder, but rather of the owner, so that the holder does not face a loss of "property" for which due process is required. Moreover, a state cannot force collection of property without judicial proceedings. As described above, on a failure to achieve agreement on the final report, a state can only institute a judicial proceeding, at which point the holder would have an opportunity to be heard. Accordingly, it can be argued that no administrative appeal is necessary. For example, administrative appeals in federal tax audits are not statutorily mandated, but a creation of procedural regulation. Thus, not every taxpayer is granted an appeal. Due process is not held to be violated because a taxpayer is permitted to file a petition in the Tax Court before assessment is made,[108] and is able to secure prepayment judicial review.

Further analysis suggests, however, that some form of administrative due process is constitutionally required and that the review procedures under the Unclaimed Property Act are not adequate.[109]

1. Does the Fourteenth Amendment require administrative review of unclaimed property audits? It has been said that unclaimed property audits do not deprive the putative holder of property because the

[105]Section 7605(b) states: "No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year (1) unless the taxpayer requests otherwise or (2) unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary." The use of similar language in unclaimed property statutes would thus permit the state to conduct second inspections if necessary. Nevertheless, a question could be raised concerning a state's ability to reexamine after the private audit. Assuming that the private audit acts as the state's "first" audit — as it receives the state's authority — the state arguably could not reexamine as it never actually investigated in the first place. In such a case, the state's audit could always be seen as extraneous to a point.

[106]*See, e.g.*, Idaho Code section 14-532 (1997) (applying collection and enforcement procedures provided by the Idaho income tax act to actions to enforce the unclaimed property law).

[107]*See, e.g., Revenue Cabinet v. Blue Cross and Blue Shield of Kentucky, Inc.*, 702 S.W.2d 433 (Ky. 1986) (insurer bringing declaratory action to prevent state from claiming escheat of uncashed subscriber benefit and premium refund checks); *Bank of America v. Cory*, 164 Cal.App.3d 66, 210 *Cal. Rptr.* 351 (Cal. Ct. App. 1985) (bank's declaratory action against state challenging controller's attempt to escheat an account for withheld interest and service charges imposed on dormant accounts); *Blue Cross of Northern California v. Cory*, 120 Cal.App.3d 723, 174 *Cal. Rptr.* 901 (Cal. Ct. App. 1981) (hospital service corporation's declaratory action against state controller for ruling on whether certain unnegotiated and unreturned checks issued by corporation had escheated to the state).

[108]If there is a deficiency (the excess of the correct tax over the amount shown as due on the tax return), a notice of deficiency, which is a letter stating the amount of the deficiency and summarizing how it was computed, is sent by certified or registered mail. The notice of deficiency informs the taxpayer of impending assessment action by the Service and gives the taxpayer an opportunity to contest the determination in a petition to the Tax Court, rather than paying the tax and subsequently suing for a refund. If the taxpayer does not petition the Tax Court within 90 days (150 for taxpayers outside the United States), the Service may assess the deficiency without further notice. During this waiting period, the Service cannot attempt to collect the deficiency. Once the period expires or the Tax Court rules on a petition that a deficiency exists, the Service may assess the tax, which is the formal recording of the tax liability. After assessment, the taxpayer cannot seek review from the Tax Court and must make payment of the assessed tax before filing suit for a refund. Saltzman, *IRS Practice and Procedure* paras. 10.01, 10.03[2][a].

[109]Indeed, this argument may be applicable in the federal tax example. Arguably, judicial review by the Tax Court is not a substitute for administrative review, an expeditious and informal review that avoids the expense of litigation.

unclaimed property is not the holder's property, and so the holder lacks standing to raise any constitutional challenge on Fourteenth Amendment grounds.[110] This approach is founded on two erroneous assumptions. First, it is assumed that the holder has no rights with regard to the property; and, second, that the property determined to be payable to the state will, in fact, be unclaimed property of another owner.

The holder of unclaimed property does have some rights in the property. The holder can be characterized as a trustee, defined as someone who holds title to property for the benefit of another.[111] The basic elements of a trust are: (1) a trustee, holding the trust property for the benefit of another; (2) one or more beneficiaries, to whom the trustee owes duties with respect to the trust property; and (3) trust property, held by the trustee for the beneficiaries.[112] Even if the holder's interest is considered too limited to be that of a trustee, or the holder's duties do not rise to the level of the fiduciary duties of a trustee, the holder is arguably at least a bailee.[113] A bailee has a limited interest, but it is still a property interest.[114]

Under the Fourteenth Amendment, procedural due process is required where there is a deprivation of protected liberty and property interests.[115] Before a deprivation of a protected interest, a person must be afforded some type of hearing, except in extraordinary situations where a governmental interest justifies postponing the hearing until after the event.[116] The terms "liberty" and "property" are broad, and procedural due process protects property interests "well beyond actual ownership of real estate, chattels or money."[117] The definition of "property interests" is provided not by the Constitution but by independent sources, such as state law.[118] The source of the property rights of the bailee has a long history in common law.[119] While it appears that no holder has yet to challenge current escheat statutes based on the Due Process Clause, there is some basis for arguing that a holder has well-established property interests that should be protected by due process.

The second assumption — that the property determined to be payable to the state will, in fact, be unclaimed property of another owner — fails to recognize that the holder's failure to agree to the findings of the final report is due to its belief that the property is not that of another owner. For example, as illustrated above, amounts that appear to be unclaimed property may very well be mere bookkeeping entries, not reflecting "real" property. Payment of those sums would be a deprivation of the business's property. Thus, property is determined to be that of another only on an evidentiary showing that such property indeed belongs to another. Until such time, it would be a mistake to assume that the property is not the holder's.

Moreover, an argument can be made that after the statute of limitations has run against the owner, the status of the holder of the property changes. In practicality, the debt no longer exists and consequently the sums representing such debt belong to the holder. Accordingly, a deprivation of the holder's property would arguably have occurred.[120]

2. What appeal process is due holders of unclaimed property? A holder of unclaimed property is constitutionally entitled to some type of administrative appeal if the circumstances meet the three-part test enunciated in *Mathews v. Eldridge*.[121] Under the *Mathews* standard, three factors are considered: (1) the private interest affected by the official action; (2) the risk of an erroneous deprivation of the interest through the current procedure and the probable value of additional or sub-

[110]In *Anderson Nat'l Bank v. Luckett*, 321 U.S. 233 (1944), for example, the Supreme Court stated in *dicta* that in the case of abandoned bank accounts, the bank cannot bring a due process challenge to the escheat laws because the bank is a debtor to the depositors. *Id.* at 242.

[111]Charles E. Rounds, Jr., Loring *A Trustee's Handbook* 1 (1998).

[112]*Restatement (Third) of Trusts* section 2 cmt. f (1996).

[113]George Gleason Bogert, *The Law of Trusts and Trustees* section 11 (1996). A bailment is the delivery of personal property by a person (bailor) to another (bailee) for the execution of a special object on or in relation to such goods. *Black's Law Dictionary* at 141 (6th ed. 1990). A constructive bailment occurs where one person holds chattel under circumstances where the law imposes upon him the obligation to deliver it to another. *Id. But see Standard Oil Co. v. State of New Jersey*, 341 U.S. 428 (1951), in which Standard Oil challenged New Jersey's Escheat Act claiming that a judgment of escheat did not protect Standard Oil from liability to stockholders whose claims to stocks and dividends are escheated. In that case, the Court stated that a holder and owner "have no contractual arrangement between themselves for its disposition in case of the owner's failure to make claim. As the disposition of abandoned property is a function of the state, no implied contract arises between obligor and obligee to determine the disposition of such property." *Id.* at 436. In the decision, however, the Court was addressing the power of the state to regulate abandoned property, not the ability of the holder to challenge the statute.

[114]*Id.*

[115]*Board of Regents of State Colleges v. Roth*, 408 U.S. 567, 569 (1972).

[116]*Id.* at 570 n. 7.

[117]*Id.* at 571-72.

[118]*Id.* at 577.

[119]*Trusts and Trustees*, note 113 *supra*, 11.

[120]Most states have extinguished a holder's ability to use a statute of limitations provision, as between a holder and the owner, as a defense against the state. In other words, a holder must deliver unclaimed property to the state even if the statute of limitations has run on the owner's claim. *See, e.g.*, Idaho Code section 14-529 (1997); Alaska Stat. section 34.45.430 (Michie 1986). *See* 1981 Unclaimed Property Act section 29(a) (providing that "[t]he expiration, before or after the effective date of this Act, of any period of time specified by contract, statute, or court order, during which a claim for money or property can be made or during which an action or proceeding may be commenced or enforced to obtain payment of a claim for money or to recover property, does not prevent the money or property from being presumed abandoned or affect any duty to file a report or to pay or deliver abandoned property to the administrator as required by this Act.").

[121]*Mathews v. Eldridge*, 424 U.S. 319 (1976).

stitute procedures; and (3) the government's interest, such as the function involved and the fiscal and administrative burdens of the additional or substitute procedure.[122]

Under the *Mathews* standard, it is unclear whether an administrative procedure is required. First, as discussed above, whether the holder's interest is a cognizable property interest under the Due Process Clause has not been established. Assuming that the holder does have a property interest, that interest would not be among the "stronger" private interests.[123] The second factor is the risk of error without the proposed additional procedure of an administrative appeal and whether the additional appeal will reduce errors. Finally, the governmental cost of the additional appeal is considered. To satisfy the second and third factors, a holder would need to gather evidence of erroneous deprivations under the current system, with its lack of uniform procedure and dependence on private auditors. Considering the "unofficial" means in which most of the audits are conducted, it would be difficult to marshal such evidence. Of course, the additional administrative procedure would entail greater governmental cost, but the benefit to society of an increased assurance of just government action must also be considered.[124]

Finally, another interest that could be considered is whether the government has an interest in obtaining the property more quickly without an administrative procedure. In *United States v. James Daniel Good Real Property*,[125] the government argued that it should be able to seize real property subject to civil forfeiture without prior notice and hearing.[126] The Supreme Court found that the argument that urgency is necessary in seizures of personal property because it can "disappear" did not apply to real property.[127] Thus, the Court held that due process requires notice and hearing before seizure of real property.[128] The obvious absence of any realistic likelihood of flight should weigh in favor of an additional administrative procedure. Although unclaimed property is personal, rather than real property, businesses that are the holders do not have an incentive to "hide" property akin to that of a criminal defendant facing civil forfeiture as a result of a criminal conviction. In short, while the nature of the evidence necessary would permit a holder of unclaimed property to make a due process claim, whether such a claim could prevail is uncertain.

III. Suggested Procedures

As state audit programs have expanded, the number of unclaimed property examinations performed by private and state auditors have increased. Once the Supreme Court clarified rules of priority when more than one state claimed abandoned property,[129] multi-state audits became standard, rather than the exception. States now cooperate in these multi-state audits, under the terms of multi-state audit agreements. With these increased audits, uniform procedures to protect audit targets from intrusive and unnecessary audits seem to be both necessary and appropriate as a matter of policy and of law. This section suggests that a basis for establishing uniform procedures for unclaimed property audits can be readily created from existing sources: (1) the rules and procedures of the IRS; (2) the Unclaimed Property Examination Standards and Procedures Manual; and (3) the Model State Administrative Procedure Act, which has long been an integral part of IRS procedures. Together, these sources provide the requirement of a summons, guidelines limiting the scope of the audit, and some form of administrative appeal. Such procedures provide much needed protection of the rights of holders.

A. Pre-Audit Procedures

1. Require a reasonable belief standard for selection of audit targets. Before a state commences an unclaimed property examination, the state should have some basis in fact for believing that the audit target has unclaimed property. States that have adopted section 23 of either the 1954 Unclaimed Property Act or the 1966 Unclaimed Property Act have adopted a standard requiring the state to have a "reasonable belief" that the holder has failed to report unclaimed property before an examination may be made. Courts disagree, however, on what this standard requires. The first state court decision to tackle the issue applied a standard for testing the underlying basis of the commissioner's reason to believe "no stricter" than that applied by the Supreme Court in *Marshall* — that is, specific evidence of a violation or reasonable standards for conducting an inspection.[130] The Oklahoma court found that the Oklahoma Tax Commission had specific evidence of a violation. Although it did not say what "general administrative plan" the Oklahoma Commission applied, the Oklahoma court did find that there was a neutral, nondiscriminatory pattern of enforcement. There was evidence that the defendant bank failed to report items that other reporting banks did report, and that of the 58 percent that filed a report about 20 percent of the banks indicated an absence of unclaimed property, but

[122]*Id.* at 335.

[123]An example of a strong private interest is a person's right to control over his home, which "is a private interest of historic and continuing importance." *United States v. James Daniel Good Real Property*, 510 U.S. 43, 53-54 (1993). Also, the *Mathews* Court found that a person's private interest in continuing receipt of social security disability benefits pending a final administrative decision did not support the requirement of an evidentiary hearing before termination of disability benefits. *Mathews*, 424 U.S. at 341-42.

[124]*Id.* at 348.

[125]510 U.S. 43 (1993).

[126]*Id.* at 62.

[127]*Id.* at 57.

[128]*Id.* at 62.

[129]*Delaware v. New York*, 507 U.S. 490 (1993).

[130]*Lincoln Bank and Trust Co. v. Oklahoma Tax Comm'r*, 827 P.2d 1314, 1322 (Okla. 1992).

that every bank that had been examined did in fact possess unreported unclaimed property.

A Maryland Court of Appeals adopted the view that, to meet the "reason to believe" standard, the administrator must be able to point to specific, articulable facts that would justify a reasonable person, knowledgeable in the field of unclaimed property, to believe that a person or business entity was not reporting abandoned property as required by the Unclaimed Property Act.[131] This was the view of a Minnesota appellate court some 16 years before.[132]

The *Lincoln Bank* and *PHH Corp.* standards are substantially the same. Articulable facts that would lead a reasonable person to believe justifiably that a person or business is not reporting unclaimed property would undoubtedly also form the basis of a neutral administrative audit plan. Both standards rely on the same facts — comparison with similar reporting entities or similar industries. Under both standards, a state would have to point to factual evidence that would support a reasonable belief. An articulable facts standard would protect persons and businesses from "combined audits" and the practice of blindly "signing on" to audits conducted by private auditing companies.

Based on this case law, a number of procedures would be appropriate for the selection of returns or companies for unclaimed property audits. First, the determination should be made by state officials, not private auditing firms to insure the integrity of the process and avoid abuse. Second, the state agency charged with the responsibility for unclaimed property audits should be required to have and to make an administrative record of the factual basis for the selection of the reports.[133] Last, the state agency should select audit targets based on articulable neutral factual bases, such as industrywide data gathered from prior audits or from other states, information contained in a report filed by a potential target, failure to make an abandoned property report, or random selection criteria.

2. Provide audit targets with a notice setting out the scope of the audit. Pursuant to the Uniform Unclaimed Property Acts, a state need only give the holder advance notice of an audit. The notice does not inform the holder of the scope of the examination. It would better serve the purposes of the state and the notified company if the notice set out (a) the statutory and regulatory procedures applicable to unclaimed property audits, and (b) the procedures available if there are disagreements about the course of an audit, including administrative review procedures. The notice also should set out the reason why the targeted company is being audited. In addition, the targeted company should receive a copy of an audit plan for the audit and an invitation to meet to discuss the plan and any changes in the form of audit plan dictated by the company's particular circumstances. The audit plan should call for the production of only those records that are reasonably related to the conduct of the audit. To insure the integrity of the process, the extent to which sampling methods and projections may be used should be described.

One issue that also should be dealt with is that of multiple audits. Private auditors currently seek authority from a number of states so that the same auditor conducts audits of a single holder on behalf of a number of states. Requiring each state to issue its own summons could subject the holder to more than one audit, while currently the holder might be subject to only one audit. In state tax audits, however, it is also possible for one taxpayer to be subject to separate audits by different states. The solution to the problem may lie in uniform audit procedures. If the states followed the same procedures and standards in auditing for unreported unclaimed property, it would be possible to establish a system in which the findings from the audit of the first state to issue a summons could apply to the subsequent claims of other states.

B. Audit Process

1. Records to be reviewed during examination. Should the auditor fail to specify the records and interviewees to be examined, however, the Unclaimed Property Act provides no alternative course for compelling compliance other than resort to court process. The problems of such a system have been described above. One solution to better protect the target from intrusive examinations is to require a summons (a warrant equivalent) for the appearance and production of specified documents that the auditor has some reasonable belief that the person or business is not reporting unclaimed property and that the documents are relevant to the examination.

The Internal Revenue Code has well-developed summons procedures. Section 7602 permits the use of a summons to ascertain the correctness of a return, to make a return if none is filed, or to determine liability. A summons must be served in a specific manner and when requiring the production of books and papers, the summons must describe them "with reasonable certainty."[134] The time and place of examination are sub-

[131] *Comptroller of the Treasury v. PHH Corp.*, 717 A.2d 950, 957 (Md. App. 1998).

[132] *First Nat'l Bank of Saint Paul v. Lord*, Mem. Op. No. 447350 (D. Minn. Apr. 20, 1982).

[133] The National Association of Unclaimed Property Administrators currently recommends that

> it makes good sense to review the holder's past reporting history and articulate specific reasons (if only for a memorandum in the file) that a holder has been selected for examination. Such review may have the additional benefits of maximum use of audit staff and may avoid the embarrassment of notifying a holder who is already in compliance.

J. Brooke Spotswood, "Reason to Believe Revisited," *NAUPA Newsletter*, vol. 15 no. 1, (printed Aug. 25, 2000) at http://www.unclaimed.org/news/headlines.asp.

[134] IRC section 7603. The time and place of the examination is such time and place as may be fixed by the IRS and as are "reasonable under the circumstances." IRC section 7605(a).

(Footnote 134 continued on next page.)

ject to restrictions as set forth in section 7605, which also prohibits unnecessary examinations and more than one inspection of a taxpayer's records for each taxable year.[135]

The procedures for challenging an IRC summons have been clarified by case law.[136] First, a summons may be challenged before the IRS official presiding at the return date. If the official rejects the challenge, the IRS must proceed under section 7402(b), which grants district courts jurisdiction to compel compliance with the summons by appropriate process. The summons enforcement action is an adversary hearing in which the court adjudicates the challenge to the summons.[137] The Secretary of the Treasury or his delegate files a complaint seeking enforcement of the summons.[138] An order to show cause can be served setting a deadline for filing a responsive pleading.[139] At the hearing, the IRS must prove that the summons complies with the requirements of *Powell* and be able to rebut asserted defenses.[140] The challenger must produce evidence to rebut the IRS case and must carry the burden of proof that the summons is an abuse of the court's process.[141] At the conclusion of the hearing, the court makes findings of fact and conclusions of law.[142] A refusal to comply with the court's order subjects the witness to contempt.[143] The orders of the court, either enforcing the summons or finding contempt, can be appealed, and a stay pending appeal can be sought.[144] If the court determines that it cannot decide the case on the available record, the court may direct further proceedings, such as discovery.[145]

An individual or entity served with a summons can raise numerous objections, including: (1) objections pertaining to the procedural validity of the summons, for example, that the IRS has failed to comply with formal statutory requirements regarding service, time and place of examination, and description of the records to be produced; (2) objections pertaining to the scope of the summons, i.e., that the summons seeks records or testimony not relevant to the correctness of a return; (3) constitutional objections; (4) evidentiary privilege objections; and (5) objections regarding the existence of a valid purpose for the summons.

Instituting a similar summons-type procedure in state unclaimed property examinations would supply targets with at least one layer of protection from overreaching examinations. First, it would provide a mandatory framework for the scope of the examination by requiring a specification of the records to be examined in the summons itself. More importantly, it would provide a target with assurance of state involvement in the audit. A summons procedure would place the burden of setting the scope of the examination on the state, which would be required to issue the summons, not the private auditor who may otherwise possess the unbridled authority to set the scope of the examination. Considering that the private auditor works for a percentage of the amount paid to the state, it would normally seek to expand an examination, perhaps unnecessarily. A summons procedure would hinder such expansive examinations.

Moreover, a formal summons procedure would discourage private auditors from treasure hunting, picking and choosing without justification those entities that seem "ripe" for examination because of their revenues or size rather than those that may legitimately carry unreported unclaimed property.

Under the Internal Revenue Code, the Service can compel production of books and records that "may be relevant or material" to its examination or investigation.[146] The taxpayer must produce records required to be kept by law, which are "books of accounts or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits or other matters required to be shown by such person in any return of such tax or information."[147] In addition, a second examination with regard to a particular tax year requires an investigation and conclusion that the additional examination is necessary.[148]

The Service has also established guidelines for requests of tax audit workpapers, which taxpayers are more reluctant to produce since they may reflect the opinions and estimates of the taxpayer and tax adviser.[149] Audit or tax accrual workpapers, defined as workpapers of independent accountants of "the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to his/her examination" are to be requested only in "un-

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Generally, it is unreasonable to hold the examination at an IRS office other than the one closest to the taxpayer's home or business or to hold it at the taxpayer's place of business if it would prevent business from being conducted. Michael I. Saltzman, *IRS Practice and Procedure* para. 13.02[2] (1991). Also, the date of appearance must be not less than 10 days from the date of the summons. *Id.*

[135]Unnecessary examinations are absolutely prohibited. A second inspection is permitted if the secretary, after investigation, notifies the taxpayer that an additional inspection is necessary. The second inspection rule is designed to prevent agents from harassing taxpayers by requiring a superior's approval for a repetitive examination. IRC section 7605(b); Saltzman, *IRS Practice and Procedure* para. 13.02[3].

[136]*See Reisman v. Caplin*, 375 U.S. 440 (1964).

[137]Saltzman, *IRS Practice and Procedure* para. 13.04[1] (citing *Reisman v. Caplin*, 375 U.S. 440 (1964)).

[138]*United States v. McCarthy*, 514 F.2d 368, 372-373 (3d Cir. 1975); Saltzman, *IRS Practice and Procedure* para. 13.04[2].

[139]*McCarthy*, 514 F.2d at 372.

[140]*McCarthy*, 514 F.2d at 373.

[141]*Id.*

[142]*Id.*

[143]*Id.*

[144]*Id.*

[145]*Id.*

[146]IRC section 7602. The Service need not meet the definition of "relevance" in a legal, evidentiary sense. *See United States v. Powell*, 379 U.S. 48, 57 (1964).

[147]IRC section 6001.

[148]IRC section 7605(b).

[149]IRM 4024-4026, MT 4000-235 (May 14, 1981); Saltzman, *IRS Practice and Procedure*, para. 8.06[3][b]. For a discussion of the work product privilege for workpapers, see *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984).

usual circumstances."[150] Examples are where the papers are needed to address specific, identified issues, the agent has sought all facts known to the taxpayer relating to the issues and the agent has sought from the accountant supplementary analysis with regard to the issues.[151] The agent is required to have taken "all reasonable means" to obtain the information from the taxpayer before seeking the information from the accountant.

Uniform rules for unclaimed property audits should also provide guidelines about the scope of the examination of records. It does not appear that, as a policy matter, access to unclaimed property records should be governed by a "may be relevant standard." Moreover, unlike tax audits, there is no statutorily defined set of records that businesses are required to maintain for unclaimed property audits. The 1981 and 1995 Unclaimed Property Acts provide that holders required to file reports retain records containing the information required to be included in the reports, and that organizations providing checks and money orders must maintain records of outstanding instruments for three years after the filing of the report.[152] If possible, the categories of records that are likely to provide information regarding retention of unclaimed property should be identified, so that there are "standard" records that are examined in an audit.[153] In that case, an auditor seeking records other than the types specified could be required to meet a higher threshold to obtain the records in the same way that revenue agents must show that available records do not adequately address a specific, identified issue to obtain tax accrual workpapers.

2. Time and place of examination. Procedures regulating the time and place of examinations are all well established in the tax law. Although IRC section 7605(a) provides only for exams "reasonable under the circumstances," the regulations do give guidance. Exams can be scheduled during normal business hours of the Service, and will usually be held at the district office closest to the taxpayer's home or business.[154] A full examination occurs where most of the books, records, and pertinent documents are maintained, generally the taxpayer's home or business.[155] The examination on the premises permits the agent to make observations and interview the taxpayer's employees.[156] The examination can be held elsewhere if, for example, the place of business is so small that the examination would interfere with business operations.[157]

Uniform procedures for unclaimed property audits should similarly provide for basic reasonableness in the time and place of audits. Most of the audits take place at the premises of the holder. Uniform procedures should provide, for example, that the audits can be held only during the regular hours of operation of the business being audited. In addition, some provision should be made so that the audit is not so disruptive as to prevent the audited entity from conducting business.

3. The examination. Suggested uniform unclaimed property examination standards and procedures are set forth in the Unclaimed Property Examination Standards and Procedures Manual (the Manual).[158] Of course, the states are not obligated to accept the standards contained in the Manual. More importantly, private auditors currently may conduct their examinations as they see fit, without state supervision or guidance. The Manual proposes a four-part examination consisting of: (a) the pre-examination conference; (b) the actual field work; (c) the exit conference; and (d) the closing conference.

(a) Pre-examination conference. During the pre-examination conference, the holder is advised of its reporting requirements under the Unclaimed Property Act. The holder is also given a summary of its prior compliance by comparing the prior reports (or lack thereof) with holders in the same industry. There is also a discussion of the general conduct of the examination and procedures. The examiner schedules a time for the field work and requests those records necessary to initiate the examination.[159]

(b) Field examination. The field work consists of the application of various examination procedures set forth in the Manual and development of specific procedures for the particular holder or industry. The examination covers various categories such as, *inter alia*, outstanding checks and drafts, stocks and bonds, unidentified deposits and remittances, credit balances, safe deposits, collateral, escrow funds, trust property, credit memoranda, gift certificates, suspense accounts, and tangible property. The examiner-in-charge is responsible for the progress of the examination and apprising the holder of the findings as necessary. The examiner-in-charge also supervises the work of the staff examiners.[160]

(c) Exit conference. At the exit conference, the holder is advised of the factual and legal findings of the examination. The examiner-in-charge presents a preliminary "Statement of Examination Findings," along with working papers to enable the holder to reconcile the

[150]IRM 4024.4, MT 4000-235 (May 14, 1981) (Guidelines for Requesting Audit of Tax Accrual Workpapers).

[151]*Id.*

[152]1981 Unclaimed Property Act section 31; 1995 Unclaimed Property Act section 21.

[153]One possibility would be the categories of documents described in the Unclaimed Property Examination Standards and Procedures Manual. *See infra* III.B.3.

[154]Reg. section 301.7605-1(b) (time of examination), (d)(2) (place of examination); *see also* Saltzman, *IRS Practice and Procedure* para. 8.06[1][d].

[155]Reg. section 301.7605-1(d)(3).

[156]Saltzman, *IRS Practice and Procedure* para. 8.06[1][d]; *see also* reg. section 301.7605-1(d)(3)(iii) (permitting site visitations).

[157]Reg. section 301.7605-1(d)(3)(ii) (exception for certain small businesses).

[158]Anthony L. Andreoli and J. Brooke Spotswood, *Guide to Unclaimed Property and Escheat Laws*, section 13-19 (1996).

[159]*Id.* (Manual 1.04).

[160]*Id.* (Manual 1.05).

findings with the holder's books and records. If the examination reveals unreported property, the holder has 30 days to review the findings and propose adjustments.[161] The examination is not to remain open for longer than 30 days from the presentation of the preliminary "Statement of Examination Findings." If the holder does not provide adjustments after the exit conference or if the holder waives the closing conference, the case is closed based on the numbers in the preliminary findings.[162]

(d) Closing conference. At the closing conference, all of the closing conference adjustments are disclosed. After the closing conference and the resolution of all factual issues and adjustments, examinations fall into two categories. The first is "Examination Closed Agreed," which means that all demandable and reportable amounts have been reported/remitted by the holder and the holder has agreed to report properly in the future. The second is "Examination Closed Unagreed," which occurs when the holder refuses to report or remit any portion of the amount that is demandable or reportable. After the closing conference, the final draft of the Report of Examination is prepared and a formal demand for payment made. Litigation would ensue at that point.[163]

The Manual's description of the stages in the examination process are substantially the same as the phases of IRS tax examinations, especially those of large corporate taxpayers. Unlike IRS examinations of large corporate taxpayers, however, audited holders of unclaimed property have no access to alternate dispute resolution mechanisms at the audit stage. As a result they can be locked into dealing with private auditors without an opportunity to resolve disagreements administratively. Accordingly, a number of procedures the IRS has developed in large case audits are addressed below.

4. Settlement at the audit stage. The auditor conducting an unclaimed property audit should be required to prepare a written report. Quality review procedures should be established, so that there is a regular review of the audits by the states for errors and to assure that the auditor's conclusions are well grounded in the facts and supporting papers. Even if the states cannot establish unclaimed property departments to conduct the audits, they should be required to invest in some form of review of the audits, considering the magnitude of revenue that unclaimed property may represent. A system providing for a type of "quality" review of the audits should contribute to their fairness and accuracy.

Administrative due process appears to require three steps: the auditor's report, the holder's protest, and the opportunity for administrative review. At the conclusion of an examination, IRS procedures provide for the examiner to explain proposed adjustments to the taxpayer.[164] This is the "closing conference" stage suggested in the Manual. During an IRS examination, even when the taxpayer agrees to the adjustments, the examining officer's report is subject to some review, and the taxpayer is provided with a copy of a summary report.[165] The examining agent requests the taxpayer to execute an agreement form and make an advance payment of the deficiency and interest.[166] The taxpayer is also notified of its administrative appeal rights. The taxpayer is informed that if the taxpayer does not agree with the proposed adjustments, the issuance of the report triggers a 30-day period in which the taxpayer may make a written protest, and commence the administrative appeals process (which is discussed in detail below). Similar procedures and notices should be used in unclaimed property audits.

IRS procedures provide a number of alternate dispute resolution options for large corporate taxpayers that would apply equally well to the audits of unclaimed property holders, particularly those that find themselves the target of frequent audits. Certain large corporate taxpayers may settle disputes at the examination stage under three procedures: (1) early referral; (2) Delegation Order 236; and (3) accelerated issue resolution.[167]

Under IRS early referral procedures, a "developed" unagreed issue may be transferred to Appeals, while other issues in a case continue to be examined by the examination team. It is expected that the early resolution of the transferred issue in Appeals will accelerate the examination process.[168] This procedure could be used constructively in unclaimed property audits, but obviously the procedure presupposes the existence of an administrative appeal office in the state. Assuming such an office exists, a holder who has undergone an audit on one period and does not agree with the auditor's determination, for example, could appeal the result to the appeal function, and if successful, apply the agreement to the other years in the examination.

Delegation Order 236 permits the examination case manager to settle disputes on certain issues, provided that those issues relate to the same transaction and were previously resolved during the administrative appeals process for the same taxpayer in a different tax period.[169] For the abandoned property holder that is audited more than once, this procedure would be a useful means of addressing an issue on the audit level, without the need to resort to administrative appeals,

[161] *Id.* (Manual 1.06).

[162] *Id.* (Manual 1.08).

[163] *Id.* (Manual 1.07).

[164] Saltzman, *IRS Practice and Procedure* para. 8.07.

[165] *Id.*

[166] *Id.*; *see also* IRM 4485.2, MT 4400-269 (Mar. 9, 1990) (Advance Payments Received by Examination Function).

[167] For a detailed discussion of the audit procedures for large corporate taxpayers and the settlement options available to those taxpayers, see Saltzman, *IRS Practice and Procedure* para. 8.06[6][d] (Supp. 2000).

[168] Ann. 94-41, 1994-12 IRB 9, *Doc 94-2611*, *94 TNT 44-12* (Mar. 21, 1994).

[169] *See* IRM 42(11)(8), Case Manager's Handbook (14)20 (Case Manager Settlement Authority), MT 42(11)-41 (Feb. 28, 1995).

where the same issue has already been addressed for another reporting period.

Accelerated issue resolution allows the examination case manager to settle issues that extend to the current tax year. This permits the taxpayer to settle recurring issues for periods that are not yet under audit and therefore, accelerate resolution.[170] A similar procedure would likewise permit holders of abandoned property to resolve issues for the current period. This procedure would reduce the number of adjustments in subsequent audits, because recurring issues would already have been agreed on.

In addition to implementing procedures that permit settlement at the examination stage, a new system of unclaimed property audits must address the settlement authority of private auditors. To permit private auditors to settle unclaimed property claims gives too much authority to individuals who are personally interested in the outcome — the higher the amount the audit secures, the greater the auditor's compensation. Private auditors should not have the final word on how much property a holder must surrender. Private auditors who negotiate a "settlement," acting as "auditors," are not simply examining records and making recommendations. In negotiations, the role of the private auditor is akin to an adversary of the holder. If the unclaimed property system is to have credibility, therefore, private auditors should be limited to reporting recommendations, and authority to settle cases should rest solely with the state administrators. Such limitations on the authority of private auditors would provide more confidence in the integrity and independence of the unclaimed property audit system.

C. Administrative Review Following an Audit

As described above, an administrative appeal procedure is necessary to protect audit targets who disagree with the findings of the audit. Assuming that a state is constitutionally required to provide an administrative appeal in unclaimed property examinations at least two potential models exist: the Model State Administrative Procedure Act (MSAPA) and IRS procedure, which is based in part on the MSAPA.

1. MSAPA administrative appeal model. The rules for administrative procedures in unclaimed property audits could follow certain provisions of the Model State Administrative Procedure Act of 1981, which are the source of administrative procedure in three states.[171]

Under the 1981 MSAPA, an agency is required to conduct an adjudicative proceeding before issuing an order except where the order is merely a decision whether to issue a complaint or summons or whether to initiate an investigation or prosecution.[172] Under the MSAPA, if a person applies to the agency for an adjudicative proceeding, the agency must conduct one unless a statute vests the agency with discretion to not conduct the proceeding or the matter does not concern the applicant's legal rights and interests.[173] On application by any person for an order on an issue, the agency must respond within 30 days and notify the applicant of any errors in the application or additional needed information.[174] Within 90 days, the agency must approve or deny the application or commence a formal adjudicative hearing or conference.[175]

The applicant may participate in the hearing and be represented by counsel or other representative.[176] The presiding officer has the power to issue subpoenas, discovery, and protective orders in accordance with the rules of civil procedure.[177] At the hearing, the parties may present evidence and argument, conduct cross-examination, and present oral or written statements.[178] A final decision must include findings of fact and conclusions of law, and a statement of the underlying facts in support.[179] The findings of fact must be based exclusively on the evidence of record in the proceeding.[180] The final order must be rendered within 90 days after conclusion of the hearing.[181] The MSAPA also provides for motions for reconsideration within 10 days after the order.[182]

The MSAPA provides for "conference adjudicative hearings" in simpler cases, such as those where there is no disputed issue of material fact, or the monetary amount in dispute is below a certain threshold.[183] The conferences are less formal than adjudicative procedures, and the usual rules regarding subpoenas and evidence do not apply.[184] The MSAPA contemplates another category of proceeding, called "summary adjudicative proceeding," for cases where the disputed amount is below a yet lower threshold.[185] The MSAPA provides for judicial review of final agency decisions, and even non-final decisions where the postponement

[170]Rev. Proc. 94-67, 1994-44 IRB 13, *Doc 94-9383*, *94 TNT 202-10* (Oct. 31, 1994); IRM 42(11)8, Case Manager's Handbook (14)30 (Accelerated Issue Resolution), MT 42(11)8-41 (Feb. 28, 1995).

[171]New Hampshire, Washington, and Arizona have adopted major provisions of both the 1981 and 1961 acts. 15 U.L.A. 1 (Supp. 1999). The 1961 MSAPA, which is less detailed than the 1981 MSAPA, has been adopted in 27 states: Alabama, Arizona, Arkansas, Connecticut, Georgia, Hawaii, Illinois, Iowa, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New York, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Vermont, West Virginia, Wisconsin, and Wyoming. 15 U.L.A. 35 (Supp. 1999).

(Footnote 171 continued in next column.)

[172]Model State Administrative Procedure Act section 4-101(a), 15 U.L.A. at 67.

[173]*Id.* at section 4-102(b), 15 U.L.A. at 68.

[174]*Id.* at section 4-104(a)(1), 15 U.L.A. at 72.

[175]*Id.* at section 4-104(a)(2), 15 U.L.A. at 72.

[176]*Id.* at section 4-203, 15 U.L.A. at 77.

[177]*Id.* at section 4-210, 15 U.L.A. at 84.

[178]*Id.* at section 4-211(2)-(3), 15 U.L.A. at 85.

[179]*Id.* at section 4-215(c), 15 U.L.A. at 90-91.

[180]*Id.* at section 4-215(d), 15 U.L.A. at 91.

[181]*Id.* at section 4-215(g), 15 U.L.A. at 91.

[182]*Id.* at section 4-218(1), 15 U.L.A. at 95.

[183]*Id.* at section 4-401, 15 U.L.A. at 100-101.

[184]*Id.*

[185]*Id.* at section 4-502, 15 U.L.A. at 104-105.

of judicial review would result in an inadequate remedy or irreparable harm disproportionate to the public benefit from the postponement.[186] Judicial review of disputed fact issues is confined to the agency record.[187] The court may grant relief if it determines that the appellant has been substantially prejudiced by one of specific reasons, such as an agency's error of law, use of unlawful procedure, or based on a fact determination not supported by substantial evidence.[188]

The provisions of the 1981 MSAPA would be useful in the unclaimed property context. The act provides for simplified proceedings in cases below certain monetary thresholds. For smaller cases concerning unclaimed property, simple, quick proceedings would permit holders to challenge disputes, though they might not if the only recourse was a formalized hearing under evidentiary and civil procedure rules. The procedure could provide two or three different levels of proceedings delineated by the dollar amount in dispute so that smaller disputes are resolved in informal conferences. The holder also would be permitted to "appeal" the outcome of the conferences to a full "adjudicative proceeding."

The 1981 MSAPA creates a presumption in favor of an agency hearing. Other than decisions to issue a summons or complaint or to begin an investigation, the agency is required to conduct a hearing prior to issuing a decision. If a person applies to the agency for a decision, the agency must approve or deny the application or conduct a hearing within a certain time period, unless a statute gives the agency the discretion to not hold a hearing, or if the matter does not concern the person's legal rights and interests. Thus, the presumption is that the agency will be required to conduct a hearing, unless certain exceptions apply. Thus, a holder disputing a claim can generally demand an agency hearing and present evidence and argument. The agency must then issue a decision within an allotted time period. The fact that the holder has a right to a hearing on the state's actions in unclaimed property cases should deter unjustified audits.

2. IRS administrative appeal procedure. The IRS offers an administrative appeal procedure based in part on the MSAPA. Where the taxpayer does not agree with the proposed adjustments, the Service sends a "30-day letter" stating the proposed determinations, along with a copy of the examination report.[189] During this 30-day period, the taxpayer can appeal and request a hearing before the Appeals Office.[190] If the taxpayer wishes to forego an administrative appeal, the taxpayer can wait until the end of the 30-day period, at which point a notice of deficiency will be issued, commencing the 90-day period to file a petition in the Tax Court.[191]

The appeals process, in which the taxpayer makes a written protest and requests a conference on disputed issues, is an alternative dispute resolution procedure.[192] The IRS Appeals process is critical to the functioning of the federal tax system, as the rate of settlement (as high as 90 percent) suggests.[193] Some states have similar appeals provisions in their tax audit procedure.[194] The administrative appeals within the IRS are made to the Appeals Office.[195] The taxpayer requests a "conference" to discuss disputed issues.[196] Depending on the nature of the dispute, the taxpayer may be required to file a written protest giving the specific reasons for contesting the findings of the Service.[197] The conference is informal, without a stenographer or testimony under oath.[198] During the conference, the appeals officer may decide that further factual submissions or additional conferences are required or discuss settlement.[199] If the case is settled, the appeals officer prepares a report supporting the settlement and the taxpayer is issued a bill for the settlement amount.[200] If there is no settlement, the appeals officer prepares a report discussing the settlement offer and settlement range, and a statutory notice of deficiency is issued.[201]

Administrative appeal should also be provided in unclaimed property cases. If a settlement can be reached following the audit, a settlement agreement would be signed and the target billed for the settled amount. Failure to pay would give the state regular creditor remedies, such as attachment. If settlement is not reached, the target should be given the right to an administrative appeal to a state office dedicated to unclaimed property claims. As in the tax system, the administrative appeal need not closely resemble a court proceeding, but simply provide a relatively quick means of resolving the disputed issues. As has already been discussed, the unclaimed property auditor should be required to issue a report setting forth the proposed adjustments and the bases therefore. The holder of the property would then be provided with an opportunity, within a defined period of time, to make a written

[186] *Id.* at sections 5-102, 5-103, 15 U.L.A. at 111-112.
[187] *Id.* at section 5-113, 15 U.L.A. at 123.
[188] *Id.* at section 5-116, 15 U.L.A. at 127.
[189] Saltzman, *IRS Practice and Procedure* para. 8.08.
[190] *Id.*
[191] *Id.*

[192] IRM 8131(2), MT 8-188 (Jan. 9, 1989) (Appeals Mission).
[193] IRS Annual Report for 1988, at 36.
[194] For instance, a Michigan taxpayer can request an informal conference with a referee of the Bureau of Revenue. *See* Federation of Tax Administrators, *State Tax Appeal Systems*, August 1994 at 33, 35 (New York provides for a "conciliation conference"); N.Y. Tax Law section 170(3-a) (McKinney's 1998).
[195] *Id.* A number of state systems also provide for similar appeals. *See State Tax Appeal Systems*, August 1994 at 29 (Minnesota), 55 (Massachusetts), 66 (North Carolina), 69 (Pennsylvania), 71 (Washington).
[196] Saltzman, *IRS Practice and Procedure* para. 8.08.
[197] 26 CFR section 601.106(a)(1)(ii).
[198] Saltzman, *IRS Practice and Procedure* para. 9.05[3].
[199] *Id.*
[200] *Id.*
[201] *Id.*

protest of the findings in the auditors' report, and request an administrative appeals conference.[202]

The example of the tax system shows that a flexible administrative appeal can be invaluable in resolving a large percentage of the cases. Without administrative review, the only means a holder could challenge the unclaimed property audit would be to commence a declaratory action, or to wait to defend a suit filed by the state. The high costs and other burdens of litigation would result in holders capitulating to the results of the audit, while a simpler procedure would encourage holders to make at least one challenge to incorrect or unfair audits.

D. Judicial Review of Administrative Appeals

As with any administrative review, the holder should have the right to appeal a final abandoned property administrative decision to the courts. Because most of the abandoned property statutes do not provide for administrative appeal, they also do not provide for judicial review of such administrative decisions. The procedures and standards applied in the judicial review of the administrative decisions of the IRS provide a good model for review of abandoned property administrative decisions.

While a taxpayer need not participate in the appeals process and thereby exhaust every administrative remedy available prior to seeking judicial review, it is recognized that the taxpayer must protest the tax imposed before seeking a refund.[203] Likewise, a protest requirement would probably be imposed in the abandoned property context, since both actions are based on a theory of a claim for assumpsit.[204]

Although a taxpayer seeking review of an IRS determination may choose between three courts (district court, Court of Federal Claims, and Tax Court),[205] it is assumed that the only court with jurisdiction to review a decision of a state abandoned property administrator is the lowest state court of general jurisdiction. The state abandoned property laws are not so complex that a specialized court is needed, nor would there be a sufficient number of petitions for review to justify a specialized court.

The purpose of judicial review in the abandoned property context is the same as in the tax realm — to determine whether the decision that additional funds are due is correct. In tax procedure, the taxpayer has the burden of proving to a preponderance of the evidence either the correct tax or that the IRS's deficiency determination is invalid, depending on whether the tax has already been paid or not.[206] Likewise, the burden should be on the holder of property to prove to a preponderance that the administrator's determination that additional property is escheatable is incorrect. Because the administrative record is not relevant, as in tax cases, the court should apply a *de novo* standard of review to decisions of the state abandoned property administrator.

E. Interest

1. Underpayments. Under the Internal Revenue Code, taxpayers who fail to pay the full amount of tax are required to pay interest on the unpaid amount from the "last date prescribed for payment of the tax" until the tax is paid.[207] The date the tax is "prescribed" is generally the date a taxpayer is required to file the return reporting the tax due.[208] Many unclaimed property statutes already contain a similar provision, with the holder being required to pay interest from the date the property should have been transferred to the state until the property is actually transferred.[209]

2. Overpayments. When a taxpayer has overpaid, the government must pay interest.[210] Interest on overpayment runs from the date of overpayment.[211] The current unclaimed property statutes make no provision for situations where a holder is determined to have overpaid. In fairness to the holder, when it is determined that the holder has surrendered more than what should have been transferred to the state, the state should be required to pay interest on the excess.

IV. Conclusion

As states become increasingly aggressive in searching for and seizing unclaimed property, audits for unclaimed property will become a greater burden on a greater numbers of private businesses. Although different estimates exist, the stakes are sizable, and doubtlessly are in the billions of dollars. Under the current state of affairs, with little state involvement, lack of established rules and procedures, and the predominant role of private auditors working on contingency, there is little to protect holders from overly aggressive and unjust audits. Without any form of administrative appeal, holders are left with no recourse except to bring declaratory actions in the courts or to defend lawsuits brought by the states, as demonstrated in the examples at the beginning of this article. Considering the magnitude of the revenues involved, states should formalize unclaimed property audits in a manner that provides some level of protection of the rights of holders.

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[202]The protest requirement has long been a prerequisite for pursuing review of a taxing authority's decision. *See* Charlotte Crane, "Protests, Refunds, and the Power of the Federal Courts," *Tax Notes*, July 19, 1999, p. 427.

[203]*Id.*; *see also Flora v. United States*, 362 U.S. 145 (1960) (describing historical basis for tax refund suit).

[204]*Flora*, 362 U.S. 145.

[205]IRC sections 6213 (permitting suit in Tax Court), and 7422 (authorizing suit in district court or Court of Federal Claims).

[206]Saltzman, *IRS Practice and Procedure* para. 1.05[1].

[207]Saltzman, *IRS Practice and Procedure* para. 6.02; IRC section 6601(a).

[208]*Id.* at para. 6.02[2]; IRC section 6601(b).

[209]*See* Cal. Civ. Proc. Code section 1577 (West 1982); Fla. Stat. ch. 717.134 (1999); N.J. Stat. Ann. section 46:30B-103 (1989).

[210]Saltzman, *IRS Practice and Procedure* para. 6.03; IRC section 6622.

[211]*Id.*

The rules and procedures related to tax audits is one template that could be followed to establish unclaimed property audit procedures. The summons, audit, and appeals procedures of the Internal Revenue Code can serve as a guideline for creating audit systems that provide some measure of protection to holders. In addition, the Model State Administrative Procedure Act provides a framework for affording holders the right to different levels of administrative review in most cases. In the case of the Kentucky hospital described at the outset, a summons procedure would have set the parameters of the records to be reviewed, while providing a mechanism to challenge the final audit results. Likewise, a target selection standard would have assured the large mail order company that the state of Indiana had a "reasonable belief" that unclaimed property had not been reported, before requiring the target to open its books for inspection. Even if the states cannot establish rules and procedures as detailed as those in the tax setting, they should not be permitted to reap the rewards of unclaimed property audits without making any investment in the protection of holders' rights.