

ABANDONED AND UNCLAIMED PROPERTY LAW IN PUERTO RICO: POTENTIAL IMPACT ON BUSINESSES

COMMENT

FRANCISCO J. RODRÍGUEZ BERNIER^{*}

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I. INTRODUCTION

I RECENTLY RESEARCHED AND PREPARED A MEMORANDUM ON WHETHER OUTSTANDING checks could be considered abandoned property and whether their issuer, a non financial institution, was required to report, and subsequently transfer such property to the Office of the Commissioner of Financial Institutions (the OCFI). This legal question at first seemed odd to me, doesn't OCFI only regulate financial institutions?

In addition, in order to determine whether non financial institutions have this obligation in Puerto Rico, the nature of the asset is also relevant. At first, outstanding checks did not seem to be the type of asset for which their issuers are required to report and transfer to OCFI. I was skeptical because all businesses are expected to have outstanding checks at the end of any accounting period as part of their regular operations.

Based on the research I conducted and a web seminar I attended, named "State Unclaimed Property Laws: Best Practices for Compliance" (the Web Seminar),¹ I became convinced that this is a subject of importance to general businesses in Puerto Rico and that there are necessary steps that should be taken by

^{*} Author is an Associate with McConnell Valdés LLC since October of 2008. He was admitted to the Puerto Rico Bar on February 4, 2009. He is a Certified Public Accountant since 1986 and worked for KPMG in its Audit Department in the San Juan, Puerto Rico office, with Checkpoint Systems of Puerto Rico, and with Oracle Corporation in the Caribbean Region and its Latin America Division.

¹ American Law Institute | American Bar Association, *State Unclaimed Property Laws: Best Practices for Compliance* (Ref. Num.: TSRGCo7, performed on October 20, 2009). Seminar was dictated by Kendall L. Houghton, Esq. from Baker & McKenzie LLP and by Weiyen M. Jonas, Esq. Vice President and Associate General Counsel of FMR LLC Legal Department, Fidelity Investments.

businesses to be properly protected against any non-compliance risk associated to Puerto Rico Law.

II. GENERAL ESCHEAT LAW IN PUERTO RICO

All of the 50 states and territories of the United States, including Puerto Rico, have some type of Escheat Law.² There have been efforts to uniform these laws among states and territories of the United States through the Uniform Unclaimed Property Act (the UUPA).³ The majority of these jurisdictions have used versions of the UUPA as base for their Escheat Laws.⁴

The purpose of Escheat Laws in these jurisdictions, including Puerto Rico, is “to ensure the protection of abandoned property until the rightful owner is located” and it is “intended to prevent a windfall to the holder of unclaimed property.”⁵

Puerto Rico’s Escheat Law is the Abandoned or Unclaimed Money and Other Liquid Assets Act (the Act),⁶ which provides that “money and other liquid assets abandoned or unclaimed by their . . . owners [whose last known address is in Puerto Rico] [be transferred] . . . to the Commonwealth of Puerto Rico.”⁷ Pursuant to the Act every financial institution, or holder (Holder) of money or other liquid assets belonging to another person, shall publish a notice annually of money or other liquid assets presumed abandoned or unclaimed and transfer such property to the Commissioner of Financial Institutions.⁸

As noted, the Act rules over financial institutions or Holders (i.e., non financial institutions); therefore it applies to any business in Puerto Rico. To be a Holder, in the course of its business, an entity must have in custody money or

² Escheat Law is the name commonly given to a general unclaimed and abandoned property law.

³ The National Conference of Commissioners of Uniform State Laws issued the 1954 Uniform Disposition of Unclaimed Property Act, which was amended on 1966. A complete revision was made in 1981 when the Uniform Unclaimed Property Act was published. The 1981 Act was superseded by the 1995 Uniform Unclaimed Property Act. See THE UNIFORMED UNCLAIMED PROPERTY ACT, the Uniform Law Commission, (1995). See also Lori Ferguson-Keney, *Perils of Unclaimed Property*, The CPA Journal, available at <http://www.nysscpa.org/cpajournal/2003/0403/features/fo43403.htm> (last visited, February 26, 2010).

⁴ Ferguson-Keney, *supra* note 3.

⁵ American Law Institute, *supra* note 1.

⁶ Act No. 36 of July 28, 1989, P.R. LAWS ANN. tit. 7, §§ 2101-2109 (2009).

⁷ *Id.* Statement of Motives. The Act was amended on September 2, 2000 (clarifying the “custody” nature of the Commonwealth of Puerto Rico possession of these assets). Section 3 of Act 346 of September 2, 2000, P.R. LAWS ANN. tit. 7, § 2103 (2009), (Spanish Version) (the Act rules over these assets if the last known address of the respective owners is in Puerto Rico). See Sec. 4(e).

⁸ Sec. 6 of the Abandoned or Unclaimed Money and Other Liquid Assets Act, P.R. LAWS ANN. tit. 7, § 2105 (2008). Money or other liquid asset is presumed abandoned after 5 years in possession. *Infra* note 17.

other liquid assets belonging to another person.⁹ The complete definition for Holder is:

[A]ny person that in the course of his business has in his custody money or *other liquid assets* belonging to another person, with the obligation of returning or paying them to said other person, his beneficiaries, heirs or successors in law, on a specific date or one to be determined, or when a certain or contingent event occurs, whether foreseeable or not. (emphasis added)¹⁰

The matter as to when an entity becomes a Holder is critical since the Act specifies that Holders have reporting obligations, even when there is still no presumed abandoned property.¹¹

The Act considers “other liquid assets” to be:

[A]ssets that can be changed into money easily or within a term less than one (1) year with no loss or with a loss that does not exceed fifty percent (50%) of its value, and includes checks, certified checks, certified money orders, bank, postal, or other money orders, travelers checks, pass books, certificates of deposit, stocks, shares, promissory notes, bonds, dividends, escrow funds, sureties, credits and other similar assets.¹²

This “other liquid assets” definition includes “credits” and “other similar assets,” which are open ended terms that lack specificity. The danger of this definition is that the Act could be applied to any asset that is “similar” to the ones described, as it could also be applied to outstanding checks.

For an indication as to what OCFI considers “other similar assets” in “custody,” I reviewed the property reports that the agency requires. According to their Addendum to the Final Report on Abandoned or Unclaimed Money and Other Liquid Goods as of June 30,¹³ among the “miscellaneous” assets to be reported by Holders in Puerto Rico to OCFI are:

1. Payment for goods and services (identifying number = MSo4)
2. Unrefunded overcharges (identifying number = MSo7)
3. Accounts Payable (identifying number = MSo8)
4. Other outstanding checks (identifying number = MS16)¹⁴

According to this form, and the Act, any business in Puerto Rico that, as the result of its regular operations has accounts payable, credits due to customers, or outstanding checks, among other items (i.e., in possession of assets belonging to

⁹ Sec. 2 (f) of the Act, P.R. LAWS ANN. tit. 7, § 2101 (f) (2009).

¹⁰ *Id.*

¹¹ *Infra* note 18.

¹² Sec. 2(d) of the Act, P.R. LAWS ANN. tit. 7, § 2101(d) (2009).

¹³ Office of the Commissioner of Financial Institutions, *Form INPR-IFA (E)*, available at <http://www.ocif.gobierno.pr/unclaimedeng/infholders.aspx> (last visited February 26, 2010).

¹⁴ *Id.*

a third party), could become a Holder. In other words, according to the Act, all businesses that operate in Puerto Rico may be considered Holders.

To be a Holder the entity must have the custody of an asset “in the course of its business,”¹⁵ a phrase not defined by the Act. Nonetheless, the reasonable inference is that its possession should be the natural and expected result of its regular course of business.

In order to be a Holder, assets need to be “in custody,” another term not defined by the Act. Being in possession of an asset belonging to another party should not automatically (i.e., *per se*) convert its possessor into a Holder; however, the Act is silent as to this matter. It is more reasonable to conclude, that if the purpose of the Act is “to ensure the protection of abandoned property until the rightful owner is located,”¹⁶ a possessor will become a Holder (i.e., in “custody”) if it holds an asset belonging to a third party for a period of time longer than what is considered reasonable for its type of business.

Will a check issued and not immediately paid by a bank be an outstanding check, and therefore, make of its issuer a Holder? Will any accounts payable recorded in the accounting books of a business immediately convert that business into a Holder?

We must look asset by asset to determine under which circumstances an entity in possession of assets belonging to another party becomes a Holder. As to outstanding checks, the most reasonable threshold for an issuer to become a Holder will be when the check has been outstanding for more than six (6) months after its issuance date. This period of time is contained in the Commercial Transaction Act (i.e., a special statute), and its purpose is to terminate the obligation of a bank as to paying a check after certain time has elapsed since its date of issuance.¹⁷ As to accounts payable, for a debtor to become a Holder, any amount that remains unpaid (i.e., check not issued) beyond the agreed upon payment term (e.g., Net 30) could be determinative.

In other words, credits, or any similar assets belonging to another person, that are in possession of a business beyond a standard and customary period of time, according to its type of business, or beyond any period of time established as “reasonable” by any special statute, should make of its possessor a Holder. On the other hand, any person that in the course of its business possesses assets belonging to another person within a standard or a reasonable period of time, according to its type of business, or within a period of time established as “reasonable” by any special statute, should not be considered a Holder. However,

¹⁵ Sec. 2(f) of the Act, P.R. LAWS ANN. tit. 7, § 2101(f) (2009).

¹⁶ P.R. LAWS ANN. tit. 7, §§ 2101-2109 (2009). *See also* Statement of Motives of the Act.

¹⁷ Sec. 3-404 of the Puerto Rico Commercial Transaction Act, P.R. LAWS ANN. tit. 19, § 954 (2009).

there is no case law that ascertains this, and the Regulation (Regulation)¹⁸ issued on this matter by OCFI does not clarify this point.

The potential application to all businesses in Puerto Rico is real, and the Act needs serious consideration because of the penalties that can be imposed for not complying with the obligations it imposes, which are:

1. To submit annual reports of assets in custody and presumed abandoned (i.e., unclaimed for more than 5 years);¹⁹
2. If no presumed abandoned property, to file an annual report indicating so;²⁰
3. To publish an annual notice in a newspaper of general circulation of the presumed abandoned property and its last known owner;²¹ and
4. By the 10th of December of each year, to transfer the presumed abandoned property to OCFI.²²

It is worth noting that one of the obligations requires Holders to submit annual reports, even if there is no presumed abandoned property. Not rendering this report is a breach of the Act.

There is no limitations period in the Act. The Regulation, on the other hand, gives the owner of the property as much as ten (10) years after property is transferred to OCFI to claim it,²³ after which it will become the property of the Commonwealth of Puerto Rico. This means that OCFI could go after abandoned property in Holders' possession with no limitations period.²⁴

Businesses not complying with these obligations are subject to a \$5,000 administrative fine per each noncompliance of any of its obligations, according to the Act,²⁵ in addition of being required to transfer presumed abandoned property to OCFI, which could represent a significant amount of money.

III. ESCHEAT LAW AS APPLIED IN THE STATES

The Act does not create a tax; instead, it creates an obligation to report, to give notice of, and to transfer abandoned assets. As any other obligation, prop-

¹⁸ Office of the Commissioner of Financial Institutions, Regulation to Implement Act No. 36 of July, 28 1989, Regulation 4706 (June 3, 1992), available at <http://www.cif.gov.pr/documents/4706.pdf>.

¹⁹ Sec 5 of the Act P.R. LAWS ANN. tit. 7, § 2104 (2008). See also, Sec. 4 of the Act, P.R. LAWS ANN tit. 7, § 2103 (2008).

²⁰ *Id.*

²¹ Sec 6 of the Act, P.R. LAWS ANN tit. 7, § 2105 (2008).

²² Sec. 6 (c) of the Act, P.R. LAWS ANN. tit. 7, § 2105(c) (2008).

²³ Art. 9 of the Regulation, *supra* note 18.

²⁴ Even though this is an obligation to the Commonwealth of Puerto Rico, it can be claimed that the Statute of Limitations of the Act is 15 years, because there is no stated limitations period. See Art. 1864 of the Civil Code of Puerto Rico, P.R. LAWS ANN. tit. 31, § 5294 (2009).

²⁵ Sec. 9 of the Act, P.R. LAWS ANN. tit. 7, § 2108 (2008).

erty in custody should be accrued as a valid liability and should be reported in the financial statements.²⁶

As in Puerto Rico, Escheat Laws in the States includes under their scope some sort of “other liquid assets.” One of the speakers in the Web Seminar shared an experience she had with one of her clients who happened to manage inventory. This entity was imputed with abandoned properties in its possession whose origin were credits due to suppliers. These credits were generated from differences from quantity received over quantity billed by suppliers. In other words, excess of quantity received over quantity billed was considered a credit to suppliers, and therefore, credits became assets in custody of the entity, making it subject to the Escheat Law. This illustrates the extent to which Escheat Laws are being applied in U.S. jurisdictions.

As to its enforcement, because of the current economic slowdown, it is expected that the states and territories will be more aggressive in applying their Escheat Law since, after a specified period of time, the title over assets presumed abandoned will be conveyed to them.

Some U.S. jurisdictions have already significantly increased their unclaimed property “collections.” As an example, Delaware’s collections on this matter increased from \$125.7 million in 1999 to \$392.1 million in 2009.²⁷ In this state these types of collections are handled by the Bureau of Unclaimed Property, under the Division of Revenue of the Department of Finance of the State of Delaware. For Fiscal Year 2010, this bureau was assigned a \$1,500,500 budget, and 14 full time public servants.²⁸

An effort that is being applied by jurisdictions to increase the “collections” of “escheat property” is the performance of audits. In some states these audits are performed by state auditors, in others, there are third party auditors, paid on a contingent fee based on the assessment issued to Holders of unclaimed property as a result of the audit.²⁹ In some cases, for years when no records were kept, these audits extrapolate unreported escheat property found in the years audited to those years without records.³⁰

This third party audit is the preferred strategy for jurisdictions that are not willing to dedicate more (or any) public servants and budget to this matter. In

²⁶ See generally RESEARCH AND DEV. ARRANGEMENTS, Statements of Fin. Accounting Standards No. 68 § 32 (Fin. Accounting Standards Bd. 1982) (explaining the Generally Accepted Accounting Principles).

²⁷ State of Delaware, Financial Department, *Delaware Fiscal Notebook 2009 Edition, State General Fund, Revenue by Category, available at* http://finance.delaware.gov/publications/fiscal_notebook_09/Section02/sec2page23.pdf (last visited March 2, 2010).

²⁸ See Fiscal Year Appropriations Act, House Bill No. 290 (June, 29 2009), available at <http://budget.delaware.gov/fy2010/hb290.pdf>.

²⁹ American Law Institute, *supra* note 1.

³⁰ *Id.*

some jurisdictions interests are assessed on the value of the property that is not transferred on time to the appropriate governmental authority.³¹

There is no indication that Puerto Rico will become more aggressive with its Escheat Law enforcement, however, the Act is enforceable, and could be implemented accordingly.

In addition to potential administrative fines and the obligation to transfer presumed abandoned assets to OCFI, there is also a risk for over-escheatment, which can cause lawsuits by owners whose property was allegedly wrongfully escheated. There is also the risk for the Holder to lose its indemnification because of reports submitted that are considered not in good faith.³²

IV. BEST PRACTICES

Compliance with the Escheat Law can be complex because of the different types of liquid assets that can be in custody under the Act. This is why all businesses in Puerto Rico need to establish unclaimed property procedures and formats to ensure compliance. This should include definition of roles for employees handling these issues and a well thought segregation of duties. There needs to be accountability and people responsible to ascertain there is compliance with the Act. In most states, the corporate departments that are generally responsible for Escheat Law compliance are Tax, Risk/Compliance, Accounts Payable, Treasury, and General Accounting.³³

These internal controls should be properly documented, including their compliance. Records shall be retained and be available in case there is an audit on unclaimed property.

The role of counsel and consultants will be to assist in the drafting and implementing of policies and procedures, to understand and communicate industry-specific best practices, and to represent Holders in audits and filings.

V. CONCLUSION

Puerto Rico has its Unclaimed and Abandoned Property Act, which rules over financial institutions as well as any non financial institution that is consider a "holder." Any entity doing business in Puerto Rico that, as part of its regular operations generates, among other items, outstanding checks or records accounts payable that remain outstanding for a period of time that exceeds what is reasonable for its type of business, or exceed a period of time stated as "reasonable" pursuant to any special statute, is a Holder pursuant to the Act.

³¹ *Id.*

³² *Id.* In Puerto Rico the Holder will not be liable for property properly transferred to OCFI under the ACT. P.R. LAWS ANN. tit. 7, § 2105(d) (2009).

³³ American Law Institute, *supra* note 1.

Businesses in Puerto Rico need to be aware of this and should establish an appropriate system of internal controls to protect themselves from any potential audits by OCFI or other state-empowered entity. Risk of noncompliance with the Act includes the imposition of administrative fines by OCFI and transfer to them of the escheat property. Furthermore, an understatement in corporate books of liabilities generated from unclaimed property in possession of a Holder, if considered material, could place business executives of such Holder at risk of non-complying with their diligent duty to disclose accurate financial statements.