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Pennsylvania Treasury Issues Guidance Document Interpreting 2016 Amendments to the Pennsylvania Unclaimed Property Law

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Summary

On March 7, 2017, the Pennsylvania Treasury Department issued a new guidance document and a set of responses to frequently asked questions ("FAQs") interpreting changes to the Pennsylvania Unclaimed Property Law enacted on July 13, 2016.[1] The guidance document and FAQs:

- delay the due date for the reporting of property held by fiduciaries and agents-in-fact and retirement accounts that are presumed abandoned until April 15, 2020, unless the property was required to be reported to the Treasury Department on or before April 15, 2016;
- define the type of first class mail communications not returned as undeliverable by the Postal Service that can prevent property held by fiduciaries and agents-in-fact and retirement accounts from being presumed abandoned as all "account related communications," including tax reports, except for communications consisting of generic marketing and promotion materials;
- provide that the three-year period after which accounts held for the benefit of minors are presumed abandoned will be measured from the date account beneficiaries attain 21 years of age;
- impose a temporary ban on the custodial taking of most individual retirement accounts prior to the death of an account owner until the department determines that the accounts can be transferred to the Treasury Department and rolled-back into owner accounts if reclaimed without adverse tax consequences;
- measure the 60 to 120 day time period during which holders must provide property owners notice of the anticipated transfer of property to the Treasury from either the date reports are due (i.e., April 15th of the year following the year in which property is presumed abandoned) or from the date property is required to be reported if an extension to the April 15th due date is approved by the department; and
- define the term fiduciary in the manner provided by the Uniform Fiduciaries Act to include not only trustees of expressed trusts, but also all holders of property subject to implied, resulting or constructive trusts.

[1] The guidance document and FAQs are available at http://www.patreasury.gov.

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Analysis

1. The 2016 Amendments

The 2016 amendments to Pennsylvania's Unclaimed Property Law[2] modified rules for the presumed abandonment of property held by fiduciaries and agents-in-fact and retirement accounts to provide that these accounts are presumed abandoned three years after the holder "has lost contact with the owner," unless within that three year period the owner has:

- increased or decreased the principal in the account;
- commenced receiving distributions; or
- otherwise indicated an interest in the account or plan or in other property of the owner in the possession, custody, or control of the holder.

The legislation provides that a holder has "lost contact with the owner" if a communication sent to the owner by first-class mail is returned undelivered by the U.S. Postal Service (a process generally referred to as the returned post office or "RPO" rule). Following rules similar to SEC Rule 17Ad-17 for brokerage firms, if a second communication sent within 30 days after a prior communication is returned as undelivered, presumed abandonment is measured from the date that second communication is returned undelivered. If a second communication is not sent within 30 days, however, presumed abandonment is measured from 30 days after the first communication is returned undelivered.

Where holders do not regularly communicate with owners by mail, such as typically occurs when an account owner elects to receive electronic communications, the legislation requires the holder to attempt to confirm the owner's continued interest in the property by communicating electronically with the owner two years after the date of owner's last indication of interest in the property. If an electronic communication is returned undelivered or is not responded to by the owner, the holder is required to send a written notice to the owner by first-class mail. If the mail notice is returned as undelivered, presumed abandonment is measured from the date of the owner's last contact with holder.

2. When Do the 2016 Amendments Take Effect?

The 2016 amendments took effect on September 12, 2016. As a result, the amendments could have required the reporting of property on April 15, 2017, for property held by fiduciaries and agents-in-fact and retirement accounts if property owners had not indicated an interest in the property and holders had lost contact with owners (as determined using the RPO rule) during the prior three year period, i.e., 2014, 2015, and 2016. For tax deferred individual retirement accounts that previously were not reportable until at least three years after account owners attained age 70.5, this would have represented a significant change to prior reporting requirements and may have required the burdensome review of records that were not previously relevant to determining presumed abandonment.

The Treasury Department's guidance document avoids these potential problems by making the new standards for determining presumed abandonment applicable only "on a forward-looking basis." As a consequence, except for property that was due to be reported on or

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[2] Act of July 13, 2016 (P.L. 664, No. 85); 72 P.S. § 1301.8. A more detailed description of the 2016 amendments is available at http://klgates.com/new-amendments-to-pennsylvanias-unclaimed-property-law-2016-07-27-2016/.

before April 15, 2016, property held by fiduciaries and agents-in-fact and retirement accounts is not reportable to Treasury until April 15, 2020. This means that for reports due on April 15, 2017, 2018, or 2019, even if there had been no indication interest in the property and contact had been lost under the RPO standard for three or more years, the property is still not reportable until April 15, 2020.

The Treasury Department's forward-looking interpretation of the new reporting standards for property held by fiduciaries and agents-in-fact and retirement accounts deviates from the department's prior interpretations of unclaimed property law amendments. For example, in 2014 when the time periods for measuring presumed abandonment were reduced from five to three years, reports due on April 15, 2015, were required to determine presumed abandonment based on the lack of indications of interest in property since 2012 rather than 2010.

The Treasury Department's adoption of a forward-looking interpretation of the new standards may in part represent an accommodation to concerns regarding the 2016 amendments expressed by many in the mutual fund, insurance, and financial services industries who would have preferred to defer the reporting of tax deferred or benefitted individual retirement accounts until three years after an account owner attains age 70.5 or dies, whichever occurs sooner. By utilizing a forward-looking interpretation of the new law, the Treasury Department has effectively provided a period of time before the law fully takes effect for the consideration of other reporting alternatives and for additional amendments to the Unclaimed Property Law.

3. What Constitutes "Communications" Under the RPO Rule?

The Treasury Department's guidance document provides that for purposes of the RPO rule, "communications" consist only of those "which concern a particular owner's account," including the mailing or delivery of tax notices to account owners, but do not include communications consisting of "generic marketing and promotional communications."

The recognition of tax notices, such as Form 1099-Rs, K-1s, and similar documents, deviates from the practice in many other states, and the recommendations of the National Association of Unclaimed Property Administrators, that generally do not recognize tax notices as communications for purposes of application of RPO rules.

4. When Are Accounts Held for the Benefit of Minors Presumed Abandoned?

Prior to adoption of the 2016 amendments to the Pennsylvania Unclaimed Property Law, the presumed abandonment of fiduciary accounts was measured (in the absence of any indications of interest in accounts) from the date the accounts became "payable or distributable." For these purposes, the Treasury Department regarded individual retirement accounts, including IRAs, 401(k)s, and SIMPLE accounts, as not "payable or distributable" until the date at which tax penalties arose for the failure to take minimum required distributions. Because the Treasury Department regarded individual retirement accounts as not "payable or distributable" until subject to tax penalties for the failure to take minimum required distributions, to avoid the premature custodial taking of individual retirement accounts "not subject to mandatory distribution requirements," *i.e.*, Roth accounts, a separate provision was added to the Pennsylvania law in 2014 making such accounts subject to presumed abandonment until after the account owner attained age 70.5.

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The 2016 amendments deleted from the Unclaimed Property Law the distinction between property that is "payable or distributable" and property "not subject to mandatory distribution requirements" because it was legally incorrect and confusing to suggest that individual retirement accounts were not payable or distributable until the dates individual retirement accounts became subject to tax penalties for the failure to take minimum required distributions. Instead, the 2016 amendments sought to impose uniform rules for commencement of dormancy periods for all types of retirement accounts. An unintended consequence of this change, however, was that it eliminated a bright-line test to determine when beneficiaries of fiduciary accounts have property interests in such accounts. Instead, the change made it necessary to look to the law of trusts to determine when beneficiaries have sufficient legally enforceable interests in fiduciary accounts to make accounts subject to presumed abandonment.

To partially address the loss of a clear bright-line rule to determine the date from which to measure the presumed abandonment of fiduciary accounts, the guidance document provides that for accounts payable to minors presumed abandonment is measured from the date a minor account beneficiary attains the age of majority, described by the guidance document as age 21. This rule follows the requirement of the Uniform Gifts to Minors Act ("UGMA") and the Uniform Transfers to Minors Act ("UTMA") that generally terminates a custodianship and requires the distribution of account assets to a beneficiary at the age of majority.

While these provisions of the guidance document are generally useful because they provide an explicit bright line rule, they pose problems for gifts to minors made under the terms of agreements that extend a custodianship under the UGMA or UTMA beyond age 21 and may create problems for the administration or other types of trusts that benefit minors not created under the UGMA or the UTMA but which contain provisions that delay distributions until a later age or upon the satisfaction of designated contingencies, as may occur in spendthrift trusts.

In the future it may be desirable for further guidance to be developed to determine when sufficient property interests in trusts arise to make them subject to presumed abandonment. In the meantime, however, holders will need to address these issues with the advice of counsel based on the laws of trusts.

5. Will the 2016 Amendments Have Adverse Tax Impacts on Owners of Individual Retirement Accounts?

An issue of concern regarding the 2016 amendments expressed by many in the mutual fund, insurance, and financial services industries was that by repealing prior Pennsylvania law that did not make individual retirement accounts subject to presumed abandonment until account owners attain age 70.5, the 2016 amendments could expose account holders to adverse tax consequences, such as the 10% penalty generally associated with withdrawals before age 59.5, and the taxation of distributed income at the higher tax rates applicable to most account owners during their active working years.

To address these concerns, the Guidance Document announced that the Treasury Department is currently undertaking an "extensive review" of the tax implications of the custodial taking of individual retirement accounts to assure that account owners will not be "negatively impacted from a tax perspective" by the taking of unclaimed accounts by the department or the refund of unclaimed accounts to their owners. The Treasury Department

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also announced that until it issues a new policy guidance regarding such accounts, the department "will neither demand nor accept any retirement account that is presumed abandoned." This temporary ban on the custodial taking of individual retirement accounts, however, will not apply to:

- any account for which "the beneficiary cannot be located for a period of three years following the death of the owner and that is not subject to a mandatory distribution requirement"; or
- any account for which "the owner has attained 70.5 years of age and is not subject to a mandatory distribution requirement," i.e., Roth accounts.

These rules may need further fine tuning because generally personal representatives of decedents have five years following the death of account owners to transfer accounts tax free to qualified beneficiaries. In addition, the exclusion of Roth accounts should be reconsidered because the absence of tax penalties for not taking distributions after age 70.5 does not mean that the escheat prior to age 70.5 will not have adverse tax consequences on an account owner, either in the form of the 10% penalty imposed for most distributions prior to age 59.5, and the adverse tax consequences often associated with distributions taken prior to age 70.5 when many account owners may still be actively working and are accordingly in higher tax brackets.

It may also be advisable for the Treasury Department to expand its evaluation of adverse tax impacts of custodial takings to include other types of fiduciary property, including health and tuition savings accounts.

6. What Constitutes Property Held By a Fiduciary?

The guidance document provides that the term "fiduciary" under the 2016 amendments "retains the same meaning as used in the prior version of [the law]," and cites to definition of the term "fiduciary" as contained in the Uniform Fiduciaries Act. The Uniform Fiduciaries Act broadly defines the term to include "a trustee, under any trust expressed, implied, resulting, or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer, or any other person acting in a fiduciary capacity for any person, trust, or estate."

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