UNCLAIMED PROPERTY
PROFESSIONALS ORGANIZATION

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Sept. 22, 2016

Treasurer Timothy A. Reese
Lt. Governor Mike Stack
Speaker Mike Turzai
Senator Patrick M. Browne

Re: PA H.B. 1605's Unclaimed Property Provisions

Dear Treasurer Timothy A. Reese:

The Unclaimed Property Professionals Organization (UPPO) is the national trade association of unclaimed property holders and service providers. We represent over 375 unclaimed property holders and service providers and 1,300 unclaimed property professionals of diverse industries and employer size. UPPO advocates for fairness in unclaimed property laws and regulations, and respectfully submits our concerns and a request for clarity regarding the unclaimed property provisions added to PA H.B. 1605.

Due Diligence – Section 1301.10A
One of the new statutory provisions imposed by H.B. 1605, Section 1301.10A, requires holders to perform due diligence for property valued at $50 or more when the holder's records do not disclose the owner's address to be inaccurate. Further, under Section 1301.10A (2)(B), it states in part, "written notice shall be sent via first class mail, ***unless the owner has previously agreed to a method of electronic notice that remains valid to contact the owner…."*** It is with respect to this new statutory language designating the method of required owner notice/outreach that we respectfully request clarification, via administrative rule or regulation, in order to avoid misunderstanding over its practical application.

First, there is some question regarding whether the language makes electronic communication optional. Specifically, if an owner has previously agreed to a method of electronic notice that is valid, does the holder have the option of sending a written notice via first class mail OR sending the notice via electronic communication? Conversely, does the new provision require that if an owner has previously agreed to a method of electronic notice that is valid, this is the only method that should be used for the notice?

The second question pertaining to the Section 1301.10A (2)(B) provision is what constitutes owner agreement to a method of electronic notice. Does the owner have to specifically agree to receive due diligence notices required by this statute via an electronic method in order for the holder to be required to send the electronic notice? Further, in some industries the owner's consent or direction to receive electronic information or notices from a holder may be limited to certain types of mailings like tax forms (i.e., Forms 1099). Below is an example of a situation where the owner agreement to a method of electronic notice may not be clear:

Example: Owners often consent to receive account statements electronically but still want their tax documents via U.S. Mail (or visa versa). Does the consent to receive specific documents electronically constitute the owner ***previously agreeing "to a method of electronic notice that remains valid to contact the owner"?***

Similar to the first question relating to Section 1301.10A(2)(B), we request that holders be provided guidance in administrative rules and regulations that clarify when an owner has agreed to a method of electronic notice and hence triggers the holder's requirement to send the due diligence notice via the electronic method.

Concerns Relating to the Possible Assessment of Early Distribution Taxes (Federal and State)

Generally speaking, owners of IRAs may elect to withdraw funds from their account(s) at any time, but are only required to begin taking distributions from the account(s) as of the year they reach the age of 70 ½ (to be received no later than April 1 of the following year). IRA owners who elect to begin taking distributions after they reach the age of 59 1/2, must pay tax on the distributions as ordinary income but need not pay additional early distribution taxes (highlighted in IRS Publication 590-B "Distributions From Individual Retirement Arrangements (IRAs)").

However, if an account owner takes a distribution prior to reaching age 59 ½ (an "early distribution"), the owner must pay a 10 percent additional tax on the distribution of any assets (money or other property) from a traditional IRA. The 10 percent additional tax applies to the part of the distribution that would be included in the account owner's gross income, would be in addition to any regular income tax on that amount, and would be reported on the owner's federal income tax return as an additional tax owed on a retirement plan. It is worth noting that early distribution taxes on other forms of retirement accounts such as a Savings Incentive Match Plan for Employees (SIMPLE IRA) may be as high as 25 percent.

Various exceptions may apply to this additional 10 percent tax on early distributions and are summarized below:

- Made to a beneficiary or estate on account of the IRA owner's death
- Made on account of disability

- Made as part of a series of substantially equal periodic payments for your life (or life expectancy) or the joint lives (or joint life expectancies) of you and your designated beneficiary
- Qualified first-time homebuyer distributions
- Not in excess of account-owner's qualified higher education expenses
- Not in excess of certain medical insurance premiums paid while unemployed
- Not in excess of account-owner's unreimbursed medical expenses that are more than a certain percentage of account-owner's adjusted gross income
- Due to an IRS levy, or
- A qualified reservist distribution

UPPO is generally in support of the RPO requirement for the presumption of abandonment, but expresses concern that the change to Section 1301.8(2), which suggests that IRAs could be reportable to Pennsylvania regardless of the age attained by the owner, could result in IRA assets being removed from a retirement plan prior to the account owner reaching age 59 ½, and possibly trigger the additional 10 percent early distribution tax on the value of the assets that would be reported as unclaimed property. There is no expressed exception to the early distribution penalty if account assets are transferred into a state's custody under a state's unclaimed property statute, so it is unclear what the IRS' expectations would be, should IRA assets be removed from an account prior to the 59 ½ year threshold.

The Commonwealth should consider the following potential issues and impacts to Pennsylvania residents:

- Does the transfer of the entire IRA account balance to the state result in the elimination of the "qualified" status of the assets, and impose negative tax consequences on Pennsylvania residents?
- Does Pennsylvania's mandatory liquidation requirement, 72 P.S. § 1301.17(e) constitute an early distribution, even where such a distribution was never wanted or asked for by the account owner? Does the General Assembly have the authority to subject its residents to such consequences?

Without IRS guidance specific to whether the 10 percent early distribution tax would apply to the unclaimed property reporting of an IRA for an owner who has not reached the age of 59 ½, we are very concerned that unintended risks are being potentially imposed on account owners as well as IRA custodians, ranging from:

- the incorrect application of taxable income reporting;
- tax withholding and overall tax liability computation;
- long term loss of compounded interest earned on account balances;
- long term loss of the accrued value of reinvested dividends no longer accruing on accounts in the event of the liquidation of the (now) unclaimed property assets; and,

- general interference with the long term retirement investing goals of individuals who often use IRAs as passive, long term investments where there is absolutely no expectation of the need to access the funds prior to retirement.

Example: If a young IRA owner set up her/his account at an early age with the intent not to touch these funds due to the nature of the investment, the account could potentially be escheated prior to the person reaching the age to take distributions without penalty and then the assets may not be there for the account-owner once s/he is of retirement age. The state liquidates mutual funds so the owner would only be entitled to the value of the account at the time the state liquidated the shares. The potential result is that the owner has lost market growth for potentially 20 to 30 years.

Federal Preemption of Pennsylvania's Dormancy Standard for IRAs

We are concerned that the Commonwealth's new dormancy standard is inconsistent with, and preempted by, the federal laws and regulations that create, control and govern the tax treatment of IRAs. There are three categories of federal preemption: (1) express preemption, (2) field preemption, and (3) conflict preemption.[1] Express preemption occurs when the federal law says it overrides state laws.[2] Field preemption occurs when, in the absence of express preemption, the federal government has regulated a field so comprehensively that federal law displaces state law.[3] Conflict preemption occurs when, in the absence of express preemption, adhering to state law requirements renders federal law compliance "a physical impossibility"[4] or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[5] In *Crosby v. National Foreign Trade Council*, the United States Supreme Court addressed when state law is an "obstacle" to federal intent, explaining, "a sufficient obstacle is a matter of judgment, to be informed by examining the federal statute as a whole and identifying its purpose and intended effects." [6]

The test of whether federal law preempts state law is whether Congress intended it to have such an effect.[7] Congress' intent must be "clear and manifest" when the state law

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[1] Federal law may preempt state law by operation of the U.S. Constitution's Supremacy Clause, which reads, "Laws of the United States […] shall be the supreme Law of the Land […] Laws of any State to the Contrary notwithstanding." U.S. Const. Art. 6, Cl. 2.

[2] *See English v. General Elec. Co.*, 492 U.S. 72 (1990). An example of express federal preemption of, say, state taxation of airline tickets reads: "a State, a political subdivision of a State, and any person that has purchased or leased an airport under section 47134 of this title may not levy or collect a tax, fee, head charge, or other charge on—(1) an individual traveling in air commerce." 49 U.S.C. § 40116(b). We were unable to find express preemption of state law in the federal tax code and Treasury regulations against states' application of unclaimed property statutes to FSAs.

[3] *See California v. ARC America Corp.*, 490 U.S. 93 (1989); *Freedman v. Redstone*, 753 F.3d 416 (3rd Cir. 2014), holding that the Internal Revenue Code does not field preempt state corporate governance laws because corporate governance is "only tangentially related to tax questions."

[4] *See Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963).

[5] *Hines v. Davidowitz*, 312 U.S. 52 (1941).

[6] 530 U.S. 363 (2000).

[7] *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987).

being preempted regulates a traditional area of state regulation.[8] Escheat is a traditional area of state regulation.[9]

In accordance with this standard, were state unclaimed property law to require the transfer of IRA property to the state prior to the date of mandatory distribution, it should be found to be a "sufficient obstacle" to the purpose and effects of federal tax law. By requiring the distribution of IRAs, even before such distribution is elected by the taxpayer or required by federal law, Pennsylvania's law would trigger tax implications for owners that were not intended by Congress. This would directly contradict Congress's clear and manifest purpose of providing a clearly defined and heavily regulated tax benefit to retirees. Thus, state unclaimed property law would violate the Supremacy Clause as a result of conflict preemption.

The Change Is Inconsistent with the Tenets of Pennsylvania Unclaimed Property Law

Even aside from the frustration of federal law, the new statutory scheme is wholly inconsistent with Pennsylvania's own unclaimed property law tenets. The Pennsylvania Disposition of Abandoned and Unclaimed Property is founded on the premise that the Commonwealth may take custody of property that is "payable or distributable" to an owner, but which the owner has abandoned or neglected to claim.[10] The change implemented by H.B. 1605 permits the Commonwealth to take custody of assets that are not "payable or distributable"[11], and ignores whether the owner has truly abandoned the property or not. Thus, the legislation crosses over the threshold of taking custody, and acts instead to confiscate the assets of Pennsylvania residents.[12]

On Sept. 5, 2016, the Wall Street Journal published an article on this development wherein Scott Sloat, the designated spokesperson for the Treasury, stated that the new dormancy standard represents Treasury's "attempt to protect the interest of beneficiaries of retirement accounts." He also stated: "*These changes permit beneficiaries to access an account when an account owner has deceased prior to the mandatory distribution age*," which appears to indicate that a very narrow concern (treatment of an IRA whose owner dies before reaching the age of minimum required distribution) has been addressed through an imprecise and overly broad change in the controlling dormancy standard. The fact that these provisions were hurriedly added to H.B. 1605 before its passage and approval may explain the mis-match between the

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[8] *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1971).
[9] *See, e.g., Connecticut Mutual Life Ins. Co.*, 333 U.S. 541 (1948).
[10] *See Smolow v. Hefner*, 959 A.2d 298 (Pa. 2008) (the Pennsylvania unclaimed property laws "are triggered by the neglect of the owner.")
[11] Assets are not "payable or distributable" and thus subject to unclaimed property law unless the holder has an affirmative obligation to pay or distribute assets to the owner. *See* Uniform Unclaimed Property Act of 1995, Comment to Section 1(6), explaining that a holder is a person "who could be sued successfully by the owner for refusing to make payment". Thus, where holders are requested by an owner to hold long-term assets on its behalf until such time as those assets must be distributed, there is no property that is unclaimed.
[12] *See e.g.*, Erin E. Arvedlund, "Can Pennsylvania confiscate your IRA? Under a new law, maybe", *The Philadelphia Inquirer* (September 12, 2016).

ostensible concern of the Treasury and its proposed “solution”; nevertheless, for the many reasons cited above, these provisions are of concern to UPPO.

We encourage the Treasury Department to consider the implications that the IRA trigger provision will have on holders and consumers, and to provide practical guidance as to how holders should interpret and execute the due diligence provisions to ensure compliance with this new provision.

Please contact me with any questions or concerns about the content of this letter.

Thank you for your consideration,

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