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States Are Abusing Abandoned-Property Funds to Plug Budget Shortfalls

By Tamara Salmon

Imagine finding out that your investment account has been turned over to your state because it was considered “abandoned.” Imagine, too, that after the account was turned over to the state, the account received a capital gains distribution. As a result, you are liable for paying the taxes on that distribution—and can be assessed monetary penalties for not paying the taxes in a timely fashion.

Don’t think this can happen to you? It’s exactly what happened to one North Carolina resident. The financial institution holding his account failed to document every time he walked into the local bank where he maintained the account. Consequently, the institution had to deem the account “abandoned” under state law and turn it over to North Carolina. Although the account owner has the right to reclaim the value of the account as of the day it was turned over to the state, according to North Carolina law the state—not the account’s owner—owns any gains that accrue to a financial account once it is turned over to the state. This meant that a $30,000 capital gains distribution received while the account was in state custody was lost to the rightful owner forever.

The Growing Impact of State Abandoned-Property Laws

Stories like this are popping up in states across the country. Abandoned-property laws originally were enacted to help reunite lost owners with property they have forgotten about. In theory, states can use their superior resources (such as property and tax records) to locate owners of lost accounts and reunite them with their property. In practice, however, states do not look for owners. Instead, since the financial crisis, states have increasingly viewed abandoned property as a lucrative source of revenue to shore up budget shortfalls. Currently, states hold more than $40 billion from accounts deemed abandoned.

Though each state’s abandoned property law is unique, prematurely deeming accounts abandoned is a common recent trend. Since 2008, states have been shortening “dormancy periods”—the period from the date the account is deemed abandoned and the date it must be turned over to the state. This period used to be seven years, but today it is most commonly three years. This change leaves investors with less time to connect with their financial institutions to prevent their account from being turned over to the state.

Increasingly Aggressive Action

More damaging, however, has been the trend to declare property abandoned due to a lack of contact with the account’s owner. Under this “no-contact standard,” if an account owner fails to affirmatively contact the institution holding the account within a specified period (typically every three years), the account may be deemed abandoned even if the owner is receiving statements from the institution or making automated transactions with the account. A man in Texas who was making regular payroll deposits into his mutual fund account, for example, was shocked to find that the state had deemed his account abandoned because, under Texas law, automated account activity is not considered “contact.”

Rather than recognizing the harm to account owners from these state laws and taking steps to redress it, some states are getting more aggressive, liquidating abandoned accounts to get their hands on the money sooner to shore up their coffers. Last March, South Dakota Governor Dennis Daugaard signed a law ordering the immediate sale of roughly $6 million in stocks and bonds held by the state as abandoned property, precluding the state from looking for the owners of this property before its liquidation.

What You Can Do to Protect Yourself

So, what should American investors do to protect themselves from these aggressive state laws? We recommend three simple steps:

1. Contact your financial institution every year by calling and talking to a live person, logging onto your password-protected account, or making a transaction—other than an automated transaction—in each one of your financial accounts. (As noted above, do not make the mistake of thinking that automated purchases or redemptions are recognized as contact.) If you are not in the habit of doing so, pick an easy-to-remember date each year to contact your financial institutions (such as April 15).
2. If you move, contact each of your financial institutions to update your contact information. Even if you have not moved, when you contact your financial institution, it never hurts to double-check that the contact information they have on file for you is correct.
3. Open and review all mail from your financial institution. If your account is in danger of being deemed abandoned, your financial institution will ask you to contact them to protect the account. If you're concerned that such a letter may be a scam, in lieu of using the contact information in the letter, use the contact information on the last statement you received from the financial institution.

For more information on how to protect your accounts, including FAQs about lost property and a tool to help you determine whether you have lost property, visit ProtectYourFinances.org.

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