

## Spotlight on Unclaimed Property: Loyalty Reward Programs

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Unclaimed or abandoned property is a multi-billion dollar revenue source for states. States are constantly seeking out new types of unclaimed property, especially given difficult fiscal situations. As unredeemed balances on gift cards and stored value cards (i.e., breakage) have become a common type of unclaimed property in most states, will states also turn their attention to unused loyalty reward program values? If so, how should issuers of loyalty reward cards respond?

### Loyalty Reward Cards are not Gift or Stored Value Cards

Loyalty reward cards are structured marketing programs that reward and encourage loyal behavior on the part of customers. These programs are variously described as discount cards, club cards or rewards cards. The owner of the card is typically entitled to either a discount on current or future purchases or an allotment of points that can be used toward making future purchases. Loyalty reward cards, however, are distinguishable from gift and stored value cards.

During an audit examination of an issuer of loyalty reward cards, a state may attempt to treat uncashed loyalty rewards as unclaimed property by applying their gift and/or stored value card statutory provisions to loyalty reward cards. In addition to the important corporate domicile state of Delaware, a number of states treat unredeemed gift card and stored value card balances as unclaimed property, including the District of Columbia, Georgia, Nevada, New Jersey, New York and Texas. While some states may generally exempt unredeemed gift or stored value card balances from being unclaimed property, including Florida, Ohio and Virginia, others provide exemptions only if the cards carry no expiration dates, no dormancy or service charges, and are gift cards issued for merchandise. These states include California, Illinois and Tennessee.

States may come to understand the distinction between loyalty reward cards and gift or stored value cards. Even New Jersey explicitly provides that its broad (and controversial) unclaimed property statute concerning gift and stored value cards does not apply to loyalty reward cards. Nonetheless, an issuer holding unredeemed loyalty rewards should be prepared to show that its loyalty reward cards are not gift or stored value cards.

### Are Unused Loyalty Rewards Unclaimed Property?

Just as states should not be able to rely on statutory provisions that treat unredeemed balances on gift or stored value cards as unclaimed property, a holder should similarly not be able to rely on gift or stored value card exemptions provided by other states. Therefore, if the customer does not redeem loyalty rewards within a state's dormancy period (typically three or five years after the card was issued), are the rewards reportable as unclaimed property?

As with yesteryear's gift certificates, a state would likely consider uncashed loyalty rewards as intangible, not tangible, property since the value is represented by the reward points and not the physical card. Section 1(13) of the 1995 Uniform Unclaimed Property Act defines "property" to include "...a fixed and certain interest in intangible property that is held, issued, or owed in the course of a holder's business...." Section 2 of the Act provides various dormancy periods for specific types of property to determine when they are presumed abandoned and subject to reporting as unclaimed property. A catch-all provision in Section 2(a)(15) provides

that "all other property [is presumed abandoned], five years after the owner's right to demand the property or after the obligation to pay or distribute the property arises, whichever first occurs." While not every state has enacted the Act (or has enacted one of its 1981, 1966, or 1954 predecessors), many states provide the same or similar statutory treatment of the issue.

An owner of a loyalty reward card has a right to demand products or services in exchange for his reward points, but not a cash equivalent value of the points on his card. Likewise, the holder has no obligation to pay a cash equivalent value to the owner; rather, the holder's obligation is to exchange a product or service, but only when the owner uses or redeems her or his points. Further, the owner has not offered cash or services in exchange for the card or rewards. The card is not prefunded. Therefore, the owner or customer has not given any monetary consideration in exchange for the loyalty reward. The underlying business transaction that caused the points to be generated should not count as monetary consideration because presumably the transaction was a fair exchange for goods or services at their market value.

However, Section 2(e) of the Act provides that "[p]roperty is payable or distributable...notwithstanding the owner's failure to make demand or present an instrument or document otherwise required to obtain payment." Could a state rely on this provision and the broad definition of "property" to argue that unused loyalty rewards are unclaimed property, regardless of the owner's inability to demand cash redemption or the absence of monetary consideration for the owner's loyalty reward?

A holder may need to rely on the derivative rights doctrine. That is, a state succeeds only to the rights an owner of unclaimed property has to or in the property that is presumed abandoned. Just as the owner has no right to cash equivalent of the loyalty reward, neither does the state have the authority to demand the cash equivalent. Still, the holder could be confronted by the no private escheat public policy that has prevailed in the other cases, including those involving gift certificates.

If loyalty rewards are reportable unclaimed property, what is the value to be reported? Like loyalty rewards cards, gift cards usually do not allow the owner to demand a cash equivalent of the face value or balance of a gift card. For this reason, state unclaimed property statutes provide that the amount of a gift card that is presumed abandoned is the face value, percentage of face value or the unredeemed balance. Since loyalty reward cards are not gift or stored value cards, a state may not be able to rely on this provision. As a result, loyalty reward cards should have no reportable value.

## **Conclusion**

The popularity of loyalty reward card programs for issuers and consumers make them a valuable marketing tool. This value, however, will likely not escape the attention of state unclaimed property administrators and auditors in this era of state budget shortfalls. Loyalty reward cards raise a number of questions for holders and states with respect to unclaimed property, including classification and valuation, among others. For these reasons, issuers of loyalty reward cards should be prepared to vigorously defend their rights in an unclaimed property audit examination while proactively addressing the treatment of their loyalty reward programs under state unclaimed property laws.

Should you wish to further discuss these unclaimed property issues, please contact one of the attorneys in the Firm's Tax Department.