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## Coates' Canons Blog: Allocating Tax Payments

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Article: <https://canons.sog.unc.edu/allocating-tax-payments/>

This entry was posted on April 23, 2015 and is filed under Finance & Tax, Property Taxes

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Suppose Billy Blue Devil owes \$2,000 in delinquent taxes for 2012, 2013 and 2014. Billy mails the tax office a check for \$500 with no note or instructions about what taxes he is paying. What should the tax office do with that check?

Cash it, of course. But after that, how should the tax office allocate the \$500 among the various taxes Billy owes? This is a very popular question, one that the Machinery Act doesn't answer.

### Allocation of Partial Payments: G.S. 105-358

The Machinery Act offers only one bit of guidance about the allocation of tax payments. G.S. 105-358(b) requires that a partial payment for the tax owed in a particular year first must be allocated to any interest, costs and penalties that have accrued on the taxes for that year. Any remaining funds are then allocated to the principal amount of taxes owed for that year.

That provision is helpful but it doesn't answer the larger question of determining which year's tax should be paid first. In Billy's case he owes taxes from three different years, 2012, 2013, and 2014. G.S. 105-358(b) tells us what to do once we pick the year to which Billy's partial payment will apply. The statute doesn't tell us which year to pick.

### The AG's Opinion

The only legal authority I can find on the topic of payment allocation comes from a nearly 65-year-old opinion letter from the North Carolina Attorney General's Office. The letter is so old that it's not available on the AG's website, which includes opinions back to 1977. My esteemed School of Government property tax predecessor, Bill Campbell, found the letter in a 1951 edition of the School's now-defunct magazine, *Popular Government*.

Addressed to one Wade H. Lefler, the Attorney General's letter opined that a tax office must comply with taxpayer instructions as to which year a payment should apply. But if the taxpayer does not provide any such instructions, the tax office is free to apply the payment to the tax year of its choice.

An Attorney General's opinion is not binding law. But the advice in that 1951 letter still seems sound to me. The taxpayer should have the right to choose the year to which a payment will be applied. If the taxpayer fails to do so, then the tax office can make the decision itself. In the case of Billy Blue Devil, because he failed to give any instructions the tax office is free to choose the tax year—likely 2012, the oldest tax year involved.

### Oldest First?

Most tax offices prefer to apply a payment to the oldest tax year first, because that is the tax year in most danger of becoming uncollectible thanks to the ten-year statute of limitations on property tax collection. G.S. 105-378(a). An "oldest-first" policy makes sense, but it should apply only when the taxpayer does not provide instructions about the year to which a payment should be applied. Those taxpayer instructions can be explicit or implicit.

What do I mean by "implicit"? If it is reasonably clear which year's tax the taxpayer is trying to pay, the tax office should apply the payment to that tax year even if the taxpayer doesn't explicitly tell the tax office to do so.

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Consider this hypothetical: as of August 1, 2015, Tina TarHeel owes \$475.64 in 2015 (current) taxes and \$600 in delinquent taxes and interest from 2014 and 2013. Here are four different payment scenarios for Tina. Despite their differences I think each payment should be applied to the 2015 taxes.

1. Tina mails a check for \$200 and writes "current taxes" in the memo line.
2. Tina mails a check for \$200 along with the payment slip from her 2015 tax bill.
3. Tina hand delivers a check for \$200 and instructs the clerk to apply it to 2015 taxes.
4. Tina mails a check for \$475.64 with no note, payment slip, or instructions in the memo line.

I think it is reasonably clear in each of these scenarios that Tina intended her payment to apply to 2015 taxes. The tax office should comply with her intention.

### **Don't Forget G.S. 105-358**

Remember that the taxpayer's instructions can control only the selection of the particular tax year to which a payment is applied, not the order of payment within in that particular year. G.S. 105-358(b) controls the latter process.

For example, assume Wanda Wolfpack owes \$600 in delinquent taxes and interest for 2013 and \$500 in delinquent taxes and interest for 2014. She sends a check for \$300 with a note that says the payment is for "2014 principal taxes." Although the tax office would prefer to apply the payment to the oldest taxes first, Wanda's instructions should control and the payment should be applied to 2014 taxes.

But Wanda does not get to choose to pay principal taxes before interest. G.S. 105-358(b) requires that this partial payment first be applied to 2014 interest, with any remainder applied to 2014 principal taxes.

### **Which Property?**

Sometimes a tax office gets a payment and doesn't even know to which property, much less which tax year, it should be applied. Tax offices should treat these situations similar to those above. If the taxpayer identifies a specific property explicitly or implicitly, then the payment should be applied to that property. If the taxpayer doesn't identify any specific property, the tax office can choose to apply the payment to any property owned by the taxpayer—likely the property with the oldest delinquent taxes.

What if the party that provides payment does not own any property? Then the tax office is really on its own. Ideally the tax office should contact the paying party and get some guidance. If that fails, sending the check back to the paying party might be the only option.

### **Mistakes & Taxpayer Complaints**

Here's a common scenario: Billy Blue Devil owns multiple properties in Carolina County. He mails a tax payment with no instructions. The tax office applies the payment to the property owned by Billy that has the oldest delinquent taxes. Three weeks later Billy decides he really wanted the payment applied to another of his properties. Should the tax office move the payment?

No. Moving a tax payment from one property to another is the equivalent of a tax refund on the original property. Tax refunds are permitted under G.S. 105-381 only in cases of illegal taxes or clerical error by the tax office. Billy's taxes clearly weren't illegal. And the decision by the tax office to apply the payment to one of Billy's properties was not a clerical error. It may have been an error on Billy's part when he forgot to send instructions as to how he wanted his tax payment applied, but an error by the taxpayer doesn't justify a refund under G.S. 105-381.

A refund and shifting of the tax payment would be justified if Billy instructed the tax office to apply the payment to Parcel A and the tax office mistakenly applied it to Parcel B. But if the only mistake involved was a mistake by the taxpayer, the tax office should not shift a tax payment from one parcel to another.



## Links

- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-358](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-358)
- [www.ncdoj.com/About-DOJ/Legal-Services/Legal-Opinions.aspx](http://www.ncdoj.com/About-DOJ/Legal-Services/Legal-Opinions.aspx)
- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-378](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-378)
- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-381](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-381)