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## Coates' Canons Blog: Discovering Erroneous Exemptions

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Article: <https://canons.sog.unc.edu/discovering-erroneous-exemptions/>

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When property tax geeks like me hear the term “discovery,” our minds don’t usually leap to Marie Curie and the theory of radioactivity or Indiana Jones and the Ark of the Covenant. No, we property tax geeks dream about more mundane discoveries: the boat that was never listed for taxes by the New Jersey transplant after retiring to Wilmington or the new garage and bonus room that was added to the house down the street by the folks who moved in last year.

As I describe in this post, property tax discoveries usually involve property like that boat or new addition that was never listed by the taxpayer. But that’s not the only type of situation where discovery comes into play. Tax officials must also use the discovery process when confronted with property that received an exclusion or an exemption for which it was not eligible.

Consider this common scenario. Grandma Gertie passes away after receiving the 50% elderly and disabled exclusion for many years. Grandson Greg inherits the house. Greg isn’t eligible for the elderly and disabled exclusion. But the tax office doesn’t learn of Gertie’s death for several years and continues to apply that exclusion to Greg’s house.

How can we solve this problem? Discovery.

Discovery permits the assessor to recapture taxes from the current tax year and up to five previous tax years. G.S. 105-312. If the county learns in 2018 that Grandma Gertie passed away in late 2015, then the house that Grandson Greg inherited should have lost the elderly and disabled exclusion starting at least with the 2016 tax year. (Transfer via a will or intestacy proceeding is deemed to have occurred on the date of death regardless of how long it might take to determine the identity of the new owner.)

Why “at least” 2016? Because if Grandma Gertie died in early 2015, then the house should have lost the exclusion beginning in 2015.

G.S. 105-285(d) states that ownership for property tax purposes is determined as of January 1 unless property that was exempt on January 1 is transferred to a non-exempt owner prior to July 1 of that year. In that case, the taxes for the year of the transfer are calculated as if the new owner owned it on January 1. According to a 1989 N.C. Attorney General’s opinion, this rule is not limited to property that was completely exempt as of January 1. It also applies to property (such as Grandma Gertie’s house) that was partially excluded on January 1.

In simpler terms: property that is taxable on January 1 is always taxable for the coming tax year even if it is subsequently transferred to an exempt owner. But property that is exempt, excluded or partially excluded as of January 1 is taxable for the coming the year if it is transferred to a taxable owner prior to July 1.

Back to our example. If Grandma Gertie passed away prior to July 1, 2015, then the property should have been fully taxable for 2015 in the hands of Greg. The discovery bill calculated in 2018 would include the years 2015 thru 2018. But if Grandma Gertie passed away on July 1 or later in 2015, then the discovery bill would start with 2016.

### ***Don’t forget the 5-year limitation***

Discovery is a powerful tool but it doesn’t guarantee that the county will recover all taxes lost due to inappropriately applied exclusions. If the mistake occurred more than five years ago, the county will lose some of those taxes.

Pretend Grandma Gertie died in late 2010. If the county doesn’t learn of her death until 2018, the earliest year that the county could include on a discovery bill to recapture the elderly and disabled exclusion would be 2013 (2018 would be the

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current year and the five previous years would be 2013 to 2017). Tax years 2011 and 2012 are too old to be included in the discovery bill, meaning the county will not be able to recapture the inappropriately applied elderly and disabled exclusion for those years.

Some assessors have asked if they may use the “immaterial irregularity” provision in G.S. 105-394 to retroactively bill for inappropriately granted exemptions or exclusions that are more than five years old. While I applaud their creativity, I think that approach violates the Machinery Act. The discovery process is the only method permitted to recapture taxes on property that was inappropriately exempted or excluded. It cannot be combined with retroactive bills under the immaterial irregularity provision to recapture more years of missed taxes.

#### ***What if deferred taxes are involved?***

Discovery still applies, but the assessor should first calculate the applicable roll-back taxes based on the year in which the disqualifying event occurred.

For example, assume Grandma Gertie was receiving the circuit breaker exclusion rather than the elderly and disabled exclusion. Under the circuit breaker, three years of deferred taxes become due and payable when the property is transferred.

If Grandma died in 2015 and the assessor learns of her death in 2018, then the assessor would calculate the three-year roll back from 2015 (covering the years 2012, 2013, and 2014) and then apply the discovery process for tax years 2015 to 2018.

If Grandma Gertie died in 2010 and the assessor learns of her death in 2018, then the assessor would apply the roll-back for years 2007, 2008, and 2009, and use the discovery process for years 2013 to 2018. The county would not be able to collect any missed taxes for 2010 through 2012 due to the five-year limitation on discovery bills.

#### ***Discovery penalties for inappropriately applied exemptions and exclusions?***

Yes. G.S. 105-312(h) states that 10% discovery penalties must be computed for “each year in which a failure to list occurred.” Is the incorrect granting of an exclusion or an exemption the equivalent of a failure to list? Yes, according to G.S. 105-273, which defines “failure to list property” to include the “failure to notify the assessor that property granted an exemption or exclusion under an application for exemption or exclusion does not qualify for the exemption or exclusion.” [Hat tip to Lee Harris of Durham County for his wise feedback on this issue.]

As a result, discovery bills for erroneous exemptions must include discovery penalties on the recaptured taxes for personal property and improvements (under G.S. 105-303, discovery penalties do not apply to land).

In Grandma Gertie’s case, the discovery bill would include penalties on the missed taxes for her house but not for the land on which the house sits.

If the governing board disagrees with that approach, it can waive the penalties under G.S. 105-312(k).

## **Links**

- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-312](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-312)
- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-285](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-285)
- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-394](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-394)
- [www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-303](http://www.ncleg.net/gascripts/statutes/statutelookup.pl?statute=105-303)