Coates' Canons Blog: Grading North Carolina’s Property Tax System

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Grade inflation may be rampant in higher education (everybody gets an A at Harvard?) but not at the Council on State Taxation. Known as “COST,” this trade organization/lobbying group represents businesses concerned about state tax issues. It recently issued a report card on property tax systems across the US, and its grades are pretty harsh.

North Carolina’s property tax system was awarded a C+, which sounds disappointing until you look at how the rest of the country fared in the eyes of COST. Our state tied for 10th best. No state earned better than a B+ (and only one of those was issued, to Oregon), while seven states earned a D or D+. Ouch.

We need to take the COST report card with more than a few grains of salt, of course. COST represents large businesses and vehemently opposes all property tax breaks that favor residential property over commercial property. But regardless of the ideology involved, the COST report card offers some interesting observations about North Carolina’s property tax system and how it compares to those in other states.

COST evaluated property tax systems in three primary subject areas: transparency, simplicity and consistency, and procedural fairness. “Transparency” focused on whether the state provides a clear explanation of the property tax system on its website and whether taxpayers receive adequate notice of proposed valuations. “Simplicity and consistency” grades hinged on whether there is centralized oversight of local assessors and whether tax forms, filing dates, assessment rates and ratios and appraisal periods are consistent throughout the state. “Procedural fairness” was defined to include length of appeal periods, a “balanced and reasonable” burden of proof for taxpayer appeals, and a comparison of interest rates paid on refunds of overpayments and charged on delinquent underpayments.

North Carolina received a C for transparency, a B for simplicity and consistency, and a C for procedural fairness, which averaged to a C+ overall.

Within those primary subject areas, COST awarded grades for various subcategories. North Carolina’s highest subcategory grades were A’s for having standardized tax forms and making those forms available on a centralized website (way to go, Department of Revenue!) and for providing “de novo” appeals to the Property Tax Commission (meaning the PTC is not required to show deference to the decisions of county boards of equalization and review).

Our state earned B’s for providing tax laws and regulations on a centralized website (although COST thought they were too difficult to find), for the equality of assessment ratios on business and non-business property (but COST took issue with the annual assessment of public service company property), and for the statewide exemption of intangible property (but COST doesn’t like the fact leasehold interests in exempt property are taxable).

On the other side of the spectrum, COST gave our state an F for charging a higher interest rate on delinquent taxes (2% first month, .75% every month thereafter) than the interest rate paid to taxpayers for overpayments after successful appeals (set at the rate paid on late income tax refunds, currently 5%). We got slapped with D’s for our allegedly defective valuation notices (COST concluded that written notice was not required for all valuation changes and that appeal information was not provided to all taxpayers), for our “at least every 8 years” appraisal cycle (COST thinks appraisals are best every 2 to 3 years), and for our failure to allow taxpayers who appeal their assessments to defer payment of the disputed amount.

Are COST’s criticisms of North Carolina’s property tax system legitimate? I think the answer depends on your perspective.

Remember that COST downgrades any tax system that provides exemptions to individuals that are not available to businesses. North Carolina's elderly or disabled homestead exemption, which provides a 50% reduction to disabled taxpayers and low-income seniors, is viewed negatively by COST. If you share this pro–big-business bias, the COST grades likely seem reasonable. Other readers might view COST's analysis as overly critical.

Ideology aside, all parties can at least agree that we need to have our facts straight before reaching any conclusions. COST seems to have done a reasonably good job of learning the facts about North Carolina's tax system. I take issue with a few of COST's factual descriptions of the Machinery Act, but overall I don't see many glaring factual errors.

The most important misstatement in the report is COST's assertion that local governments are not required to give taxpayers written notice of changes in property values outside of discovery bills. That's not entirely accurate. While the Machinery Act could be more clear about this issue, multiple notice requirements are created by G.S. 105-296(i), G.S. 105-317(b)(7), and G.S. 105-317.1(c). Taxpayers can be held liable for taxes even if they never receive an actual bill (G.S. 105-348), but they would certainly retain their appeal rights if they never received notice of a change in their property's tax values.

A few other quibbles: the interest on refunds owed after county board of equalization and review decisions is now the same as that charged on delinquent taxes (G.S. 105-360(e)); real property owners normally have far more than 30 days to appeal their real property tax assessments (G.S. 105-322); and taxpayers may avoid interest charges on the undisputed portion of tax bill during an appeal simply by paying that amount prior to the delinquency date (G.S. 105-360(a)).

My primary criticism of the COST report is its subjectivity. Just because COST identifies a particular property tax practice as ideal does not make it so.

Prime example: North Carolina requires counties to reappraise their real property at least every eight years. G.S. 105-286. Roughly half of the state's counties currently reappraise on cycles of four, five, or six years. COST gives the state a D in this subcategory because it believes appraisal periods should be two or three years in length. While I agree that eight years is a long time to wait in between reappraisals, there is no magic time period that perfectly balances the costs of more frequent reappraisals with the accuracy of more frequent reappraisals.

Another example: North Carolina permits local governments to ignore *de minimus* tax bills of up to $5. G.S. 105-321(f). COST gives the state a C on this issue because it believes that the *de minimus* threshold should be set at the cost of collection. How do you calculate the cost of collection for a single tax bill? Is it the cost of printing and mailing a tax bill? That's certainly less than $5.

Enough of my complaints and criticisms. If you look beyond the grades, the COST report offers invaluable information about property tax practices in other states. Too often we get stuck in the Machinery Act weeds; this report helps us put the North Carolina system into national (and even international) context.

Assessment/tax caps: The Machinery Act does not cap annual increases in property valuations, property tax rates, or property tax revenues. (An 8% annual cap on tax revenue increases was proposed this past legislative session in connection with authorization for fracking but the General Assembly eventually shelved it for further study.)

That's not the case nationwide. More than a dozen states enforce some type of property tax cap. Some of these states limit the increase in tax appraisals to a certain percentage (for example, annual assessment increases are capped at 5% or inflation until property is sold in Michigan), some apply different caps to different types of property, while others limit overall tax revenues (for example, 2% limit on tax levy increases in New York and 4% in Rhode Island).

Appraisal Periods: North Carolina's maximum appraisal period of 8 years is definitely among the longer periods permitted across the country. Granted, some states (Hawaii, New Jersey, New York, and Pennsylvania) don't have any mandatory maximum appraisal period (one county in Pennsylvania has not reappraised its property in over 30 years!). But roughly half of the states require reappraisal at least every four years, and a dozen require **annual** reappraisal of all property.

Equal Assessments: With one exception, North Carolina does not discriminate between commercial and non-commercial property. All personal property is assessed annually, all real property is appraised in accordance with a county's reappraisal schedule. The only exception is public service company property, real and personal, which is assessed by the Department of Revenue annually.

Other states treat commercial and non-commercial property very differently. According to COST, in more than a dozen states the effective tax rate on commercial property was more than double that on residential/non-commercial property. In at least five big cities across the county, the effective tax rate on commercial property (as calculated by COST, mind you) was 3.5 times more than the effective rate applied to other property. New York City allegedly taxes commercial property nearly 5 times higher than it taxes residential property.

I can’t say for certain which of these property tax systems are best. But I can say with certainty that it’s important for North Carolina tax professionals and policy makers to educate themselves about what’s happening in other states. The more we learn about other property tax systems, the better we can improve ours.

Links

- www.thecrimson.com/article/2013/12/3/grade-inflation-mode-a/
- cost.org/WorkArea/DownloadAsset.aspx?id=88125
- www.dor.state.nc.us/downloads/property.html
- www.ncleg.net/gascripts/Statutes/StatutesTOC.pl?Chapter=0105
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- www.ncga.state.nc.us/EnactedLegislation/SessionLaws/HTML/2013-2014/SL2014-4.html