Coates' Canons Blog: How to Calculate Discovery Bills

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When property that should be taxed isn't, a local government has two options. If the property was not taxed due to a listing error, then the local government must use the discovery process in GS 105-312. All other taxing errors must be resolved using retroactive bills issued under GS 105-394, the "immaterial irregularity" provision.

I described the retroactive billing process in my last post. Today I describe the discovery billing process. For the full details about both approaches, see this bulletin.

What is a discovery?

GS 105-273(6a) defines discovery to mean recapturing missed taxes on property that was:

1. Not listed for taxation;
2. Listed at a substantial understatement; or,
3. Listed under an exemption or exclusion for which it did not qualify.

Any of these three listing errors *must* be resolved using the discovery process. If the property escaped taxation for any other type of error, then discovery does not apply and the problem must be solved using retroactive billing as described here.

What years may be included in a discovery bill?

A discovery bill may include up to six years of missed taxes, the current tax year plus the previous five. The "current tax year" is the tax year that opens in the calendar year the discovery was made. GS 105-312(g) & (i). For example, if a discovery is made in March 2016 then the current tax year is 2016-17 and the discovery bill could go back to 2011-12 (if the listing error in question extended that far back). Missed taxes from older years cannot be included in the discovery bill and will never be billed or collected.

GS 105-312(d) states that a discovery is "made" on the date "the abstract is made or corrected." That language doesn't really match current tax office technology and procedures, so it's not entirely clear what the trigger date should be for "making" a discovery. In my view, a discovery should be considered made when the tax office sends notice to the taxpayer of the discovery bill because that is when the missed taxes are first added to the tax records.

When does a discovery bill become delinquent?

The date of a discovery is important not only for determining what years may be included in the discovery but also for determining when the discovery bill will become delinquent and accrue interest. GS 105-312(i) states that a discovery bill is considered part of the tax levy for the tax year that opens in the calendar year in which the discovery is made. To continue with the example from above, a discovery bill made in March 2016 would be part of the 2016-17 tax levy. Taxes for the 2016-17 year become delinquent and begin to accrue interest on January 6, 2017. A March 2016 discovery bill would become delinquent and begin to accrue interest on that same date.

What values and tax rates should be used to compute a discovery bill?

Each tax year included in a discovery bill must be calculated using the tax value and tax rate for that particular year. For example, assume the assessor discovers that Billy Blue Devil failed to list his boat for 2015 and 2016 taxes. The missed 2015 taxes must be calculated using the boat's 2015 assessed value and the county's 2015 tax rate. The missed 2016 taxes must be calculated using the boat's 2016 assessed value and the county's 2016 tax rate.

When do penalties apply and how are they calculated?

Penalties apply to discovery bills for personal property and improvements to real property (buildings) that were not listed or listed at a substantial understatement. Penalties also apply to discovery bills for real or personal property that received an exemption or exclusion for which it did not qualify. But penalties do not apply to the failure to list land (dirt), because under "permanent listing systems" it is assessors and not taxpayers that are charged with the responsibility to list land correctly. GS 105-312(h) and -303(b)(3).

Discovery penalties are 10% for each listing period missed and are calculated separately for each tax year included in the discovery bill.

Consider Billy Blue Devil's discovery bill for the failure to list his boat for 2015 and 2016 taxes. The penalty for the 2015 portion of the bill would be 20% of the 2015 taxes boat because he missed two listing periods for that tax (2015 and 2016). The penalty for the 2016 portion of the bill would be 10% because he missed only a single listing period for that tax (2016).

The largest possible discovery penalty for any one tax year is 60%. The 60 percent penalty would apply to the fifth year prior to the current year of a discovery bill because the taxpayer will have missed six listing periods for that tax. For example, the earliest tax year that could be included in a 2016 discovery bill is 2011. The missed taxes for 2011 would be hit with a 60% penalty because the taxpayer missed six listing periods for those taxes (2011, 2012, 2013, 2014, 2015, and 2016).

See this example from my property tax collection courses for an illustration of how to calculate a discovery bill that includes six years of omitted taxes and penalties.

May discovery bills be waived?

Yes. Unlike "regular" property tax bills, discovery bills may be waived in whole or in part by the governing board (or the board of equalization and review) for any reason whatsoever. GS 105-312(k). Note this decision must be made by the board, not by the assessor or tax collector. A board's decision not to waive some or all of a discovery bill is reviewable by the Property Tax Commission only if the taxpayer can demonstrate illegal discrimination or bias on behalf of the board.

How does discovery interact with the retroactive roll-back of deferred taxes?

Assume Tom TarHeel's property was receiving the present-use value (PUV) agricultural exclusion for decades. In 2016 the assessor learns that in 2010 Tom sold his property to an owner who did not qualify for the PUV exclusion.

Taxes for the year in which the disqualifying event occurred should be calculated as if the taxpayer was never eligible for the exclusion, meaning there is no roll-back for 2010. GS 105-277.1F(b). The assessor should retroactively calculate the three-year roll-back of deferred taxes under the PUV program for the years 2009, 2008, and 2007.

Discovery applies to the years 2010 and forward because the property received an exclusion for which it was not qualified. However, the discovery was made in 2016 which means the five years prior that may be included in the bill begin with 2011. The missed deferred taxes for 2010 will never be collected because they fall outside the reach of the discovery provision.

Penalties will apply to each of the six tax years included in the discovery bill, starting with a 60% penalty for the missed 2011 deferred taxes and decreasing to a 10% penalty for the missed 2016 deferred taxes.

To whom should discovery bills be sent?

GS 105-312(d) instructs the assessor to prepare the discovery bill in the name of the taxpayer who had the obligation to list the property for the tax year(s) included in the bill. But sending notice to the current owner of discovered real property (land and/or improvements) is also recommended it that property has changed hands recently. Under GS 105-365.1, the current owner and not the previous listing owner will be the responsible taxpayer if a discovery bill becomes delinquent.

Assume Roy builds a garage on his property in 2012 and fails to list the new improvement with the assessor. In 2016 Roy sells the property to Mike. Two months later the assessor discovers the garage and sends Roy (the owner who originally had the obligation to list the garage) a discovery bill for the years 2013 to 2016.

If that bill remains unpaid on Jan. 6, 2017 (the delinquency date for discovery bills made in 2016), which taxpayer will be personally responsible? Mike, because it is a tax on real property and GS 105-365.1(b)(1) states that it is the owner on the date of delinquency and not the listing owner who is personally responsible for taxes on real property. The collector could attach Mike's wages and bank accounts or levy on his car or foreclose on the property to collect that discovery bill.

Because Mike is ultimately responsible for the discovery, the assessor should send a copy of that bill to both Roy *and* Mike. Mike will of course be furious with the tax office and claim that he can't be held responsible for Roy's failure to list the garage. C'est la vie. Mike might be able to sue Roy to be compensated for the discovery bill. But that doesn't change the fact that county's only collection option is to go after Mike, not Roy.

Links

- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-312
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-394
- canons.sog.unc.edu/?p=8432
- sogpubs.unc.edu/electronicversions/pdfs/ptb147.pdf
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-273
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-303
- canons.sog.unc.edu/wp-content/uploads/2016/03/2016_discovery_problem_answers.docx