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## Coates' Canons Blog: More Questions About the New Builders' Inventory Exclusion

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The General Assembly finally closed up shop for 2015 but conversations about the new laws produced this session continue to percolate.

A prime topic of these discussions is the new exclusion for improvements to residential and commercial real property (S.L. 2015-223). I've already blogged and published a bulletin about the law, now nicknamed the "builders' inventory exclusion." After hearing many interesting questions about the exclusion at Department of Revenue seminars over the past few weeks, I thought a follow-up blog would be helpful.

The builders' inventory exclusion applies to real property held for sale and excludes the taxes on increased appraisals due to subdivision, non-structural improvements (grading, streets, utilities, etc.) and construction of single-family homes or duplexes. Read this bulletin for the full details. Here are my thoughts on a few additional questions about the new law.

*Does the exclusion cover increases in property tax appraisals due to rezoning?*

No.

Rezoning will often be necessary for a development project to proceed. And rezoning often increases the tax value of real property, as it is one of the few justifications for changing real property tax values in between county-wide reappraisals. G.S. 105-287(a)(2c).

But the fact that rezoning may be the lynchpin for new development and may impact a property's tax value does not justify an exclusion under S.L. 2015-223. The new law covers only taxes on increases in value due to improvements made by the property's owner. It does not cover taxes on the increases in value due to actions taken by governments or other third-parties.

A rezoning occurs due to action by a city or county. It might be initiated upon request by a property owner but it is accomplished by the government. As a result, the builders' inventory exclusion cannot apply to value increases resulting from rezoning.

In many cases involving commercial development, rezoning will be the primary cause of increased property tax values on the land prior to the start of construction. Assessors will need to carefully distinguish between appraisal increases attributable to rezoning (which are not covered by the new exclusion) and appraisal increases attributable to non-structural improvements made by the builder (which are covered).

*Is the exclusion terminated if the owner resides in a new house or allows someone else to live in the house for free?*

No if the owner/builder occupies the new house, yes if a third-party occupies the house. At least that's my view, seeing as the new law's language does not offer clear answers to these questions.

S.L. 2015-223 states that the exclusion is terminated if a residential structure is "occupied by a tenant." A traditional landlord-tenant arrangement with a lease and an obligation to pay rent for a new house would of course terminate that house's eligibility for the exclusion.

I don't think the exclusion should be terminated if the house is occupied by the owner/builder. All of the definitions of the term "tenant" that I can find indicate that a tenant must be a party other than the property's owner. If an owner cannot be a tenant in her own property, then house occupied by its builder/owner is not occupied by a tenant and is therefore still

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eligible for the exclusion assuming that the house remains for sale.

More difficult to resolve would be a situation where the builder allows a third party to occupy the house for free. Normally we think of a tenant as someone who signs a lease and agrees to pay rent for the use of property. But as I read the many definitions of “tenant” available on-line, most of them suggest that any party with the right to occupy property owned by another party qualifies as a tenant even if no lease or rent obligation exists. If so, then I think any new home occupied by any third-party with permission of the owner should be disqualified from the exclusion.

*Does the sale of property from one builder to another eliminate the property's eligibility for the new exclusion?*

No.

The new owner/builder may qualify for an exclusion based on improvements made to the property by that new owner/builder. But the sale from one builder to another does terminate any exclusions attributable to improvements made by the first owner/builder. See the example beginning on the bottom of page 6 in this bulletin.

*When are applications for the builders' inventory exclusion due? Are late applications permitted?*

The annual application required for this new exclusion is due at the close of the listing period, which is January 31 unless the county extends that period. G.S. 105-307. However, G.S. 105-282.1 permits late applications through the end of the calendar year if the governing board finds “good cause” for taxpayer’s failure to satisfy the application deadline. See this blog post for more on the “good cause” standard.

*Who may qualify as a “builder” under the new exclusion?*

Any property owner who is in the business of buying property, improving that property, and then selling it may qualify as a “builder” under S.L. 2015-223.

Most often it will be obvious that a property owner is a builder based on that owner’s prior development projects. But first-time builders may also qualify for the exclusion; they simply need to prove to the assessor’s satisfaction that they are in fact holding and improving the property in question for sale.

Proof of intent to sell the property could be a contract with a real estate broker or advertisements placed in local publications. Also important might be proof that the property owner is listing business personal property for taxation; if the owner is actually in the business of buying, improving and selling property (rather than just building a house for her own use) then that owner should be listing some business personal property for taxation.

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