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## Coates' Canons Blog: Does Partial Construction Count as “Use” for Property Tax Exemptions?

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Article: <https://canons.sog.unc.edu/partial-construction-count-use-property-tax-exemptions/>

This entry was posted on March 12, 2018 and is filed under Finance & Tax, Property Taxes

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Loyal readers of this blog know that most property tax exemptions and exclusions require that property be used for exempt purposes to avoid being taxed. The fact that a qualified owner (school, religious organization, charitable non-profit, etc.) owns a building does not automatically make that building exempt. That building must be used for the owner's exempt purpose (education, religious worship, charitable endeavors, etc.) to be exempt from property taxes.

For example, if the non-profit Food Bank of Western NC builds a new food warehouse, that building will likely be exempt from property taxes because it is used for the organization's charitable purpose. But if the Food Bank builds a small office building and rents it out to commercial tenants (coffee shop, nail salon, etc.), that building would not qualify for an exemption because it is not being used for a charitable purpose.

Because of the use requirement, vacant land and buildings are generally taxable even if they are owned by a qualified owner because they are not being used for the owner's exempt purpose. But what about property that is being prepared for use but not yet ready for that use as of January 1 (the listing date)? Consider a partially constructed building or a parking lot site being graded but not yet paved. Is that property being “used” for an exempt purpose?

Most exemption/exclusion statutes don't address this issue, meaning it's up for county assessors to make this call. Most North Carolina assessors would say no, construction does not count as an exempt use. If property is under construction as of January 1, 2018, the property will be taxable for 2018 and might be exempt for 2019 if construction is completed and the building is put into use by the end of the year.

This might change after a bombshell of an opinion issued by the Property Tax Commission in January.

The PTC decision, *Appeal of Snow Camp LLC*, involves a 20-acre solar energy electricity farm in Alamance County that was partially constructed as of January 1, 2016. The taxpayer applied in early 2016 for the 80% exclusion available for solar energy electricity equipment under G.S. 105-275(45). The county rejected the application because the equipment was under construction and not in operation as of January 1, 2016. The Alamance County Board of Equalization and Review affirmed the county's decision and the taxpayer appealed to the PTC.

In a 3-2 split decision, the PTC reversed the county and concluded that the solar farm was eligible for a 2016 exclusion because partial construction qualifies as use for property tax exclusion purposes. The two commissioners who voted in favor of the county took the unusual step of filing a lengthy dissenting opinion. Alamance County has appealed, which means the final decision and its potentially sizable ramifications won't be finalized for many months.

Assuming the PTC's reasoning is affirmed on appeal by North Carolina courts, it would reverse the standard approach to partially constructed property. Right now, if an exemption statute is silent about partial construction, the assumption is that partially constructed property is taxable. Under the Snow Camp decision, the opposite would be true. If an exemption statute is silent about partial construction, then the new assumption would be that partially constructed property is exempt.

Let's take a look at the legal reasoning behind the PTC decision and the dissent:

The primary foundation for the majority's decision to exempt the partially constructed solar equipment was a 1960 North Carolina Supreme Court case, *Southeastern Baptist Seminary v. Wake County*, 251 N.C. 775. This case has long been cited in property tax cases for the “buffer zone” concept that can justify an extension of an exemption to cover vacant land used by a religious or educational institution as insulation against urban development.

However, an often-overlooked paragraph of that opinion also exempted a cafeteria that was only 20% completed as of the

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listing date. The PTC reasonably pointed out that if a partially constructed school cafeteria could constitute the “actual use” required for an educational exemption then partially constructed solar equipment might also constitute “actual use” for a solar energy electricity generation exclusion. If so, then the Snow Camp equipment should receive the 80% exclusion under 105-275(45) for 2016 despite the fact it was not actually generating solar energy electricity as of January 1, 2016.

According to the PTC majority opinion, the General Assembly relied on the Supreme Court’s 1960 broad interpretation of “use” when it enacted G.S. 105-275(45) in 2008. In other words, the General Assembly fully intended the solar energy electricity exclusion to cover partial construction and did not need to make it explicit in the wording of the exclusion because it knew that the term “use” has covered partial construction since the Supreme Court’s 1960 *Southeastern Baptist* decision.

Not everybody accepts that the partial construction question was clearly settled 58 years ago by *Southeastern Baptist*. The PTC dissenting opinion suggests that case turned not on the partial construction issue but on the fact that the education exemption in question contains a provision that exempts land adjacent to existing exempt structures. Because the Southeastern Baptist property contained on it completed structures being used for religious educational purposes, the additional land that contained the partially constructed buildings was also exempt by the express terms of the statute. The *Southeastern Baptist* court also exempted unused buildings that were “unfit for occupancy,” a fact that the PTC dissent relies on to argue that it was the “additional land” provision in the exemption statute and not the partial construction that justified an exemption for all of the seminary’s land and structures.

This dispute over the import of the *Southeastern Baptist* decision was underscored by a 2015 North Carolina Court of Appeals case. In *Appeal of Vienna Baptist Church*, the Court of Appeals denied a religious exemption under G.S. 105-278.3 for a partially completed church on the grounds that construction did not constitute the required religious use. 241 N.C. App. 268 (2015) For reasons unknown, the court of appeals never mentioned the *Southeastern Baptist* case while reaching its decision to tax partial construction. Perhaps the court just plain missed it during its research. Perhaps the court was aware of it but decided that it didn’t apply exemptions other than the specific one at issue in *Southeastern Baptist*. Perhaps it agreed with the PTC dissenters on how best to interpret *Southeastern Baptist*. Regardless, the court concluded that the partially completed Vienna Baptist Church building was taxable.

The General Assembly apparently was not pleased with this result because several months later it amended G.S. 105-278.3 to explicitly cover partial construction. The PTC majority interprets this response as proof of the General Assembly’s intention to include partial construction within *all* exclusion and exemption statutes. The PTC dissenting minority disagrees, concluding that the General Assembly’s decision to amend only G.S. 105-278.3 and not the many other exemption and exclusion statutes in the Machinery Act confirms that the issue of partial construction differs from statute to statute.

Which side has the better argument here? It’s a close call, but I’d go with the dissent for two key reasons.

First, the North Carolina Supreme Court has long held that exemption statutes must be strictly construed in favor of taxation; unless property clearly falls under the scope of the language used in an exemption statute, that property must be taxable. *State v. Whitehurst*, 212 N.C. 300 (1937). If reasonable people can disagree whether construction should count as an exempt use, then the rule of strict construction in favor of taxation leads to the conclusion that partially constructed property must be taxable.

Second, nearly all of the many dozens of exemptions and exclusions in the Machinery Act are silent on the issue of partial construction. Yet a handful of them do specifically cover partial construction (G.S. 105-275(8)(a) thru (c)(pollution control and waste management equipment), G.S. 105-275(39a)(correctional facilities), G.S. 105-277.02 (homebuilders inventory), and most recently G.S. 105-278.3 in response to the *Vienna Baptist Church* decision). In my view, this suggests that when the General Assembly intended to exempt partial construction, it took steps to make sure that the statute in question explicitly accomplished that goal. When it didn’t want partial construction to be exempt, it remained silent on the issue.

One final argument in favor of deciding that construction does not equal use: North Carolina courts have already made that determination in another area of local government law. Under G.S. 160A-58.54 a municipality pursuing an involuntary annexation (still possible just very rare since these 2011 legislative changes) must demonstrate that a certain percentage of the area to be annexed is “used” for residential, commercial, industrial, institutional, or governmental purposes. In 2004, the North Carolina Supreme Court affirmed a Court of Appeals decision concluding that property under construction

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for future commercial use cannot be considered to be in use for commercial purposes. *Ridgefield Properties, LLC v. City of Asheville*, 358 N.C. 216 (2004), affirming 159 N.C. App. 376 (2003).

I think the same logic should apply to property tax exemptions. If so, then partial construction should be taxable because it is not a current exempt use.

But I don't get to make that final decision; our state courts will. In the meantime, the PTC opinion is not binding on assessors but is a warning that partial construction might become exempt. A county that is faced with an exemption application for big-dollar partial construction may still deny the exemption and tax the property. But it might not be a bad idea to set that payment aside for a potential refund in case a subsequent court opinion extends all exemption statutes to cover partial construction. Stay tuned . . .

## Links

- [files.nc.gov/ncdor/documents/files/snow\\_camp\\_llc\\_16-765.pdf](https://files.nc.gov/ncdor/documents/files/snow_camp_llc_16-765.pdf)
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