
Coates' Canons Blog: What To Do When Property That Should Be Taxed Isn't

By Chris McLaughlin

Article: <https://canons.sog.unc.edu/what-to-do-when-property-that-should-be-taxed-isnt/>

This entry was posted on March 07, 2016 and is filed under Finance & Tax, Property Taxes

Local government property tax offices are very good at what they do, with collection rates averaging around 98%. But nobody's perfect. Mistakes happen.

One common mistake is when property that should be taxed isn't. Perhaps the tax office never knew the property existed. Or the tax office had the property on its tax rolls but for some reason failed to levy taxes on that property.

Tax offices have two options to recapture taxes that should have been levied but weren't. One is the discovery process in GS 105-312. The other is retroactive billing authorized by the "immaterial irregularity" provision in GS 105-394. The choice between these two remedies depends on what caused the taxes to be missed.

A few years ago I co-authored a property tax bulletin on this topic with Stan Duncan, the recently retired veteran tax official from Henderson County. That bulletin discusses in detail how these remedies work and how to choose between them. Today's blog briefly summarizes that analysis and illustrates how those remedies should be used for one particularly common example of missed taxes: property that lies within a municipality but for some reason is not taxed by that municipality.

Discovery: the definition of "discovered property" requires that the discovery process in GS 105-312 be used only when a listing error caused the missed taxes.

If property was never listed for taxation or listed at a substantial understatement (e.g., a house that was recently remodeled and expanded was listed at 2,000 square feet instead of its actual square footage of 4,500), then discovery applies.

Discovery also applies when property was listed under an exemption or exclusion for which it was not eligible (e.g., a residence continues to receive the elderly and disabled exclusion after the elderly owner dies and leaves the property to her 40-year old daughter).

If discovery applies, the tax office must bill missed taxes on the property for a maximum of six years: the current tax year plus the previous five. If the property is personal property or improvements to real property, the discovery bill must include penalties of 10% per missed listing period for each tax year included in the discovery. Interest does not accrue on a discovery bill until the next January 6.

See this post for more on discovery billing.

Immaterial Irregularity: GS 105-394 excuses defects in all aspects of the property tax process. By explicitly stating that minor errors do not invalidate property taxes, the provision permits local governments to retroactively bill taxes that originally were missed or billed incorrectly.

In 2008, the North Carolina Supreme Court approved of a local government's use of GS 105-394 to bill ten years of back taxes retroactively on property that was listed by the taxpayer but for some reason never taxed. In this case, called *In re: Morgan*, the Supreme Court adopted the dissenting opinion from an earlier Court of Appeals ruling on the same matter. That opinion makes clear that the retroactive bills should include interest accruing from the original dates of delinquency for the missed taxes.

In re: Morgan does not offer an opinion as to how many years of retroactive tax bills are permitted. Theoretically, the tax office should bill every year of taxes that was missed. But practically it makes sense to bill only those years that fall within the 10-year statute of limitations on enforced collections created by GS 105-378.

How should these remedies be applied to the problem of property that lies within a municipality but has not been taxed by that municipality?

First, determine if the problem is a listing error that must be fixed using the discovery process.

If the property has never been listed for taxation by the assessor, meaning neither the county nor the city has ever taxed the property, then discovery must apply. But most often in these situations the county has been levying taxes on this property all along. If so, that means the property was listed by the assessor. The problem was a failure to levy municipal taxes on that property, not a failure to list the property. Discovery does not apply if the problem is a levying error rather than a listing error. Instead, the problem must be fixed with retroactive municipal tax bills issued under the authority of GS 105-394.

Assuming the problem must be solved using GS 105-394, the second step is to determine how many years of municipal taxes were missed and prepare retroactive tax bills using the appropriate tax value and municipal tax rate for each year. Interest should be applied to each bill as if it had been originally taxed appropriately.

The taxpayer is of course going to be less than thrilled to receive a multi-year tax bill including interest. Which leads to the third and final step . . .

Ask the municipal governing board (town council) if it will agree to waive the interest on these retroactive tax bills under the "clerical error" justification of GS 105-381, the refund and release provision. (For more on GS 105-381, see this blog post.)

If the property owner was paying the county taxes in timely fashion each year, it's reasonable to assume that but for the clerical error by the tax office (the failure to levy municipal taxes on the property) the property owner would have also paid the municipal taxes in a timely fashion. Those taxes would never have accrued interest. I think the governing board would be authorized to release that interest under GS 105-381.

But there is no justification to release the principal taxes on those retroactive bills. GS 105-381 doesn't authorize a local government to release taxes just because they forgot to bill those taxes originally.

Let's apply this analysis to a hypothetical. Assume Billy Blue Devil's property lies in Carolina County and has been taxed by the county every year. In 2005, Tar Heel Town annexed an area that included Billy's property. For some reason, Tar Heel Town taxes were never levied on Billy's property. (Note it doesn't matter which government collects the town's taxes or which government made the mistake that caused the missed taxes.)

In 2016, the town realizes it has not been receiving taxes on Billy's property. How can it remedy this situation?

Discovery rules don't apply because Billy's property has been listed for taxation by the county all along. That means the problem must be remedied using retroactive tax bills under GS 105-394.

The town (or the county, if the county collects the town's taxes) should create bills for Billy's property for tax years 2006 thru 2016. (Technically the town could also bill for 2005 but because that year falls outside of the 10-year statute of limitations the best approach is to start with 2006 taxes.)

Each bill should reflect the tax value of the property for that year and the town tax rate for that year. Interest should be added to each of those retroactive bills from its original delinquency date. The bill for 2006 taxes should include interest from January 6, 2007, the bill for 2007 taxes should include interest from January 6, 2008, etc.

If Billy has been paying his county taxes on time each year, the town council might consider releasing that interest as mentioned above. But there could be factors that argue against a release. Let's assume that there is clear evidence Billy knew darn well his property was within the city's boundaries. Perhaps he began receiving town trash collection and water



and sewer services immediately after the 2005 annexation. Perhaps his kids have been participating in city recreation programs. If so, then the town council might refuse a release because it concludes that Billy was on notice that he was in the city and that he was intentionally benefiting from city services while knowingly avoiding city taxes.

The facts will of course vary from case to case, meaning there is no bright line rule when interest should be waived. The important points to remember are (i) the principal taxes should not be waived and (ii) the decision to waive interest is for the governing board to make, not the tax office.

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
- sogpubs.unc.edu/electronicversions/pdfs/ptb147.pdf
- canons.sog.unc.edu/?p=8453
- www.courtlistener.com/opinion/1387262/in-re-morgan/
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-378
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-381
- canons.sog.unc.edu/?p=1861