Coates' Canons Blog: When Does An Appraisal Error Justify a Refund?

By Chris McLaughlin

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Which of these appraisal errors justifies a property tax refund?

1. Taxpayer is taxed for property that did not have a taxable situs in the jurisdiction.

2. Taxpayer is taxed for a house that burned the prior December.

3. Taxpayer has vacant land but is taxed for the land plus a house.

4. Taxpayer has an unfinished attic but was taxed for a finished attic. Finish was never verified by appraiser.

5. Taxpayer has a 1,500 square-foot house but the assessor appraised it at 1,750 square feet based on the size of similar houses in the same neighborhood.

Most property tax professionals would agree that a refund is justified in situations 1, 2 and 3. So do I. But situations 4 and 5 are tougher nuts to crack.

Property tax refunds and releases are governed by G.S. 105-381, which limits them to circumstances in which the tax either was levied due to clerical error or was illegal. While those terms are not defined by the statute, they've been analyzed several times our state courts.

The most detailed of these opinions came from the N.C. Court of Appeals when it analyzed the meaning of the term "clerical error" in the 1997 case Ammons v. Wake County. As I discussed in this 2010 post, the court concluded that to qualify as a clerical error the mistake must be that one produces an unintended result and is apparent from the face of the documents, such as a transcription mistake (for example, recording 5,200 square feet instead of 2,500 square feet.) The term "clerical error" does not include errors in judgment or law on such issues as market value, quality of construction, or eligibility for a property tax exclusion. These types of non-clerical errors must be resolved through the annual appeal process and may not be corrected retroactively under G.S. 105-381.

Applying the *Ammons* analysis to the five situations above, I don't think any qualifies for a refund due to clerical error. In each situation, the appraisal was that intended by the assessor. None of the situations involved an unintended appraisal—in each instance the assessor produced an appraisal that he/she thought was appropriate at the time.

But clerical error is only one of two justifications for a property tax refund. Might any of the five situations above qualify as "illegal taxes"?

Here's our court defines that term: "[G.S. 105-381] and our case law recognize a distinction between an erroneous tax and an illegal tax or invalid tax. An illegal or invalid tax results when the taxing body seeks to impose a tax without authority, as in cases where it is asserted that the rate is unconstitutional or that the subject is exempt from taxation." *Redevelopment Comm. V. Guilford County*, 274 N.C. 585 (1968).

I think it's clear that situations 1 and 2 would constitute illegal taxes because the taxing unit had no authority to tax property not in its jurisdiction (situation 1) or that did not exist as of January 1 (situation 2). Similarly, situation 3 seems to be an illegal tax because a taxing unit has no authority to tax property that never existed.

In contrast, situations 4 and 5 involve property that did exist in the taxing unit's jurisdiction as of the listing date but that received inflated appraisals. Is a tax on non-existent market value illegal and subject to a refund under G.S. 105-381?

Not normally. In *Kinro, Inc. v. Randolph County*, 108 N.C. App. 334 (1992), the court of appeals concluded without analysis that "over assessed values of personal property" do not constitute an illegal tax. If the taxpayers in situations 4 and 5 were complaining only of market value errors—let's say they thought that the assessor ignored relevant sales of comparable properties—clearly they would not be entitled to refunds. Market value judgments may be challenged only during the appeal process for the current tax year.

But that's not really the case in situations 4 and 5. The taxpayers don't claim that the assessor simply made a poor estimate of what the properties would have sold for on January 1. Instead, the taxpayers claim that the assessor appraised and taxed physical property features (a finished attic, additional square feet) that did not exist in the taxing unit's jurisdiction as of the listing date (and in fact never existed at all).

That sounds pretty darn similar to situations 1,2, and 3, doesn't it? If refunds are justified in the first three situations of non-existent property, aren't they also justified in the last two?

I think the best answer is no. A valuation error cannot justify a refund as an illegal tax even if that error was caused by the valuation of property features that never existed.

Very few appraisals are based on actual physical inspections of the property at issue. Instead, assessors rely on the mass appraisal process which requires countless judgment calls about specific physical features and their market value.

If we open up every one of those judgment calls to retroactive review for five years under G.S. 105-381, we would do serious harm to finality of our local government tax bases. And without that finality, budgeting for local governments would become far more difficult than it already is.

No doubt, some valuation errors make compelling arguments for refunds. Consider an example similar to situation 5 above, but assume that instead of mistakenly appraising a 1,500 square-foot house as 1,700 square feet the assessor appraises it at 5,000 square feet. Is a refund justified when the judgment error is so egregious?

Despite the size of the error, I still don't think it qualifies as an illegal tax because at the end of the day it was a judgment error. And once you start refunding any judgment error, you open the door for countless retroactive appraisal reviews.

But my veteran assessor SOG colleague Ken Joyner thinks when an appraisal error is so large—appraising a house at more than 3 times its actual square footage, for example—the result must have been unintended. If so, then a refund would be justified under the clerical error criterion even if we conclude that it was not an illegal tax. In other words, any truly egregious appraisal error must have been unintended and therefore should be eligible for a refund.

Similarly, a county could adopt a rule of reason: if an appraisal error is large enough, then a refund is justified. For example, a county might adopt a policy under which appraisal errors of greater than 10% justify a refund, but errors smaller than that do not.

Both suggestions sound reasonable. But neither the Machinery Act nor property tax case law from state courts make any distinction for refunds based on the size of the error involved. If an error truly was clerical, as Ken suggests a huge error likely would be, then clearly a refund is justified. But if the error was truly one of judgment, then I don't think a refund is justified regardless of how big the error was.

Remember that the General Assembly sets policy, not mere mortals such as you and me. I can't in good faith recommend a policy, no matter how reasonable, if it contradicts the black-letter statutory law. Unless and until the law is changed or we get more guidance from the courts, my advice remains the same: local governments should construe the refund provisions in G.S. 105-381 very narrowly. Taxpayers can use the appeal process to correct erroneous value judgments for the current tax year going forward, but they cannot attack those judgments retroactively.

(Hat tip to my friend Lee Harris of Orange County for raising this interesting issue. Lee's wise counsel has been invaluable during my time at the SOG.)

Links

- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-381
- caselaw.findlaw.com/nc-court-of-appeals/1235512.html
- canons.sog.unc.edu/?p=1861