North Carolina Property Tax Update

NCACPA NC State and Local Tax Conference

December 9, 2015                          Greensboro, North Carolina

Charles H. Mercer, Jr.  
Reed J. Hollander  
Nelson Mullins Riley & Scarborough LLP  
Raleigh, NC
Appraisal of Property for NC Property Tax Purposes

- All property is assessed at 100% of its appraised value.

- The primary issue in almost all contested property tax valuation cases is the appraisal of the property.

- However, there are secondary issues that can be vitally important in a tax case.
Appraisal of Property for NC Property Tax Purposes

- Real property is appraised octennially (every eight years) or earlier, at the discretion of the county. Value (usually) remains the same during the entire cycle.

- Physical changes to the property after the revaluation year can affect the tax value. Examples: additions or destruction/damage.

- Personal property is appraised annually.
Appraisal of Property for NC Property Tax Purposes

- While all real property should be valued using three approaches to value (cost, sales, and income), the primary method is as follows:
  - Residential property/land = Sales Comparison
  - Industrial/commercial (non-income producing) = Cost Approach
  - Income producing (rental) = Income Approach
Appraisal of Property for NC Property Tax Purposes

- Personal property is appraised by counties primarily through use of depreciation tables.
  - Department of Revenue annually publishes recommended tables
  - County-developed tables (primarily in larger counties)
Appraisal of Property for NC Property Tax Purposes

- State law requires that the appraiser consider multiple factors in valuing property.
  - Replacement cost
  - Sales price of similar property
  - Age
  - Physical condition
  - Productivity
  - Remaining life
  - Obsolescence
  - Economic utility
  - Any other factor affecting the value of the property

- BUT – the county will not likely consider any of these factors that are unique to your particular property unless you inform them!
Listing of Personal Property

- An annual listing form must be submitted to each county in which you own property (or hold property under a conditional bill of sale), listing the property with situs in that county.

- Situs issues can be complex with property that is moved from county to county. For property moved around, situs will likely be the primary place of business of the owner in North Carolina.

- Failure to list property carries significant penalties if the unlisted property is later discovered.
Listing of Personal Property

- 105-309: requires the filing of a "tax list" or "abstract" identifying personal property and real property improvements
  - The statute has detailed requirements about what must be listed and who may sign the abstract
- Generally, counties require the following to be listed:
  1. Machinery and Equipment
  2. CIP
  3. Office furniture and fixtures
  4. Computer equipment
  5. Leasehold improvements
  6. Expensed items
  7. Supplies
  8. Vehicles (unregistered)
  9. Leased property (although the owner has the primary duty to list)
  10. Leasehold interests in exempt real property
  11. Real estate improvements
Removing Sold or Retired Property

- Typically, personal property tax listings are based on company fixed asset lists/depreciation schedules.

- When you dispose of an asset (sold, junked, or otherwise), retire it, or move it to a different county, be sure to update your fixed asset list/depreciation schedule to reflect its current location and ownership.

- Otherwise, you'll end up paying taxes on assets you don't own or use. Be sure to correctly identify idled assets also.
Real vs. Personal Property

N.C. Gen. Stat. 105-273 provides definitions:

- (13) "real property," "real estate," and "land" mean any of the following: the land itself, buildings, structures, improvements, or permanent fixtures on the land, all rights and privileges belonging or in any way appertaining to the property, and mobile homes that are permanently affixed to land and meet other requirements of the definition.

- Personal property is defined as either:
  - (8) "intangible personal property," meaning patents, copyrights, secret processes, formulae, good will, etc. Including leasehold interests in exempted real property or "other like property"; or
  - (14) "tangible personal property," means "all personal property that is not intangible and that is not permanently affixed to real property."
Real vs. Personal Property

- "Tangible personal property" can become "real property"
  - Ex. Building HVAC unit once installed in a building and permanently affixed thereto, may be real property.

- The DoR and many counties differentiate real versus personal property based on whether the property is used as part of a "process" versus used as part of the general building requirements. E.g. HVAC for building comfort vs. HVAC for cooling a manufacturing line.

- NC DoR and some counties publish manuals to provide guidance to taxpayers.

- Area of significant dispute - no clearly established law on this issue.
Leasehold Improvements

- Improvements to real property made by the tenant (upfitting). Commonly viewed as personal property by counties and not taxed as part of the real estate.

- Treatment of the improvements as taxable to the building owner versus the tenant may depend on multiple factors:
  - Type of improvement
  - Permanence
  - Listing on owner's or tenant's fixed asset lists

- December 23, 2011 memorandum from David Baker at NCDOR regarding "Assessment of Improvements to Leased Property" and describing a four-part analysis.
Leasehold Interests in Exempt Real Property

- If you lease real property from a tax-exempt entity (typically, the government) at below-market rates, the county may seek to tax the "leasehold interest".

- Computed based on the difference between market value and the "below-market" lease rate.

- Can be a highly complex analysis.
Discovery Assessments

- Counties frequently audit (either directly or through third-party auditors) personal property listings.

- Any unlisted or under-listed property, or property which was given an exemption/exclusion but is determined not to be exempt/excluded, may be "discovered".
Discovery Assessments

- A "discovery" typically carries additional tax, interest, and hefty penalties (10% cumulative per year for current year plus up to five years back – up to 60% penalty!)

- However, discoveries require the county to follow specific rules, and have been invalidated where counties failed to follow proper procedures.

- Examples – failure of county to conduct appraisal; failure of county to show that property was unlisted or underlisted.

- Strict protest deadlines apply – if you think you might challenge a discovery, act quickly to lodge your objection so your rights are not waived.
Immaterial Irregularities

- Assessments are not invalidated due to clerical or administrative error - 105-394

- In re Pace/Dowd Properties Ltd. 755 S.E.2d 401 (2014)
  - County improperly discovered it had wrongly classified property after taxpayer appealed valuation
  - County argued improper classification was "immaterial irregularity" for failure to appraise
  - Held: not immaterial irregularity where County did not fail to appraise, but rather did so using an arbitrary method of valuation
Exemptions/Exclusions

- While generally exempt, certain types of computer software are taxable as intangible property
  - Including "embedded software" and certain software that is capitalized under accounting standards. 105-275(40) (recently amended).

- Inventories are exempt – "goods held for sale" (difference between used goods sold and "goods held for sale")

- Supplies are taxable. Report supplies on-hand as of January 1 of the reporting year (although in audits many counties use a one-month average).
Exemptions/Exclusions

- Pollution prevention property may be exempt – 105-275(8)
  - certain real and personal property used to abate, reduce, or prevent the pollution of air, water or waste disposal, or for recycling or resource recovery from solid waste
  - only in certain circumstances, if approved by the Environmental Management Commission
Exemptions/Exclusions

- Real and personal property used for religious purposes - 105-278.3
  - Must be "wholly and exclusively used" for religious purposes
  - In re: Vienna Baptist Church 773 S.E.2d 97 (2015) [Church did not qualify for religious use exemption where building was under construction and could not legally be used or occupied.]
  - New 105-278.3(g)(3) exception for buildings under construction

(ruling that the Haliwa-Saponi Indian Tribe’s real property in Halifax County, North Carolina is used for charitable, educational, scientific and cultural purposes and therefore is exempt from property tax.)
Present Use Valuation

- Qualifying farm, forest, horticultural, and forestland is assessed at its present use value and the difference between present use and fair market valuation is deferred.

  - Similar to other deferrals, the deferred amount becomes a lien on the property
  - Requires active use/management for these purposes.
Appeal Process

- First step – Request a hearing, in writing or by personal appearance, before the County Board of Equalization and Review prior to its adjournment.

  - "Adjournment" varies widely county-to-county
  - County "informal appeal processes" don't replace the formal appeal process
  - Many counties are restricting who can appear and present evidence at the county board
Second step – If the result of the county-level appeal is not satisfactory, you have the right to appeal to the North Carolina Property Tax Commission.

- Tight deadlines to appeal (30 days from date of notice of county decision)
- Two-step appeal process to perfect the appeal – a notice of appeal and application for hearing are required
- The hearing is like a trial – witnesses, exhibits, direct and cross-examination, etc. PTC is the court of record.
- Must be represented by an attorney or represent yourself. No non-attorney representatives are allowed.
- In almost all cases, you will need an appraisal to win a valuation case.
Appeal Process

- Step three – After the Property Tax Commission, either party has the right to appeal the decision to the NC Court of Appeals. Appellate court will usually apply the "whole record" test and look to see if there is evidence sufficient to support the PTC decision.

- Step four – Possible appeal to the NC Supreme Court.
Significant Property Tax Cases

- **In re: Property of Pine Raleigh Corp., 258 N.C. 398 (1963)** [Taxpayer can appeal in any year of the revaluation; valuation of income producing property to be determined based on market lease rates, not actual lease rates.]

- **In re: Appeal of AMP, Inc., 287 N.C. 547 (1975)** [Tax assessments are presumed correct; To rebut presumption, taxpayer must present evidence tending to show that (1) either the tax assessor used an arbitrary or illegal method of valuation and (2) the assessment substantially exceeded the true value of the property.]

- **In re: Appeal of Southern Railway Co., 313 N.C. 177 (1985)** [An illegal appraisal method is one which will not result in true value under 105-283.]

- **In re: Appeal of Ocean Isle Palms LLC, 366 N.C. 351 (2013)** [County cannot change real property appraisal mid-cycle without complying with 105-287.]
Significant Property Tax Cases

- **In re: Appeal of IBM Credit Corp.** (Three Decisions)
  
  - 186 N.C.App. 223 (2007) [Once a taxpayer produces the evidence required by *AMP*, the burden of proof then shifts to the taxing authority]
  
  - 201 N.C.App. 343 (2009) [Failure to make additional depreciation deductions due to functional and economic obsolescence due to market conditions resulted in an appraisal which does not reflect “true value”]
  
  - 731 S.E.2d 444 (2012) [Tax Commission's use of a hybrid valuation method was not supported by record evidence; remanding for entry of decision in favor of IBM]
Significant Property Tax Cases

- In re: Appeal of Parkdale America/Parkdale Mills (Two Decisions)

  - 212 N.C. App. 192 (2011) [Tax Commission failed to properly apply the burden-shifting framework of IBM Credit I]

  - 741 S.E.2d 416 (2013) [Reiterating willing buyer/willing seller standard of 105-283; "emphasizing the fact that Parkdale uses these facilities industrially to produce yarn 24-hours a day ... allow[s] the County to measure the value of the properties as their subjective worth to Parkdale, ...[which is] not the same as the ... value of these properties to another willing buyer."]
Recent North Carolina Property Tax Decisions

- **In re: Super Investors, LLC, 14 PTC 0073 (2015)** [case of first impression]

- **In re: Cleveland Mall HSCM LLC and Shelby Mall LLC, 12 PTC 0319 (2015); 12 PTC 0501 (2015); 14 PTC 0217 (2015); No. COA13-198** [consolidated appeal affirming Commission's decision to adopt the county's increased valuation where taxpayer met burden of production to establish arbitrary valuation, but where county satisfied shifting burden of persuasion that in applying the proper method of valuation the property's true value was actually higher]
Recent North Carolina Property Tax Decisions

- **In re: Kathy L. Patton, 14 PTC 013 (2015)** [in order to qualify for present-use valuation for forestland must be actively engaged in the commercial growing of trees]

- **In re: Villas at Peacehaven, LLC, 10 PTC 011 (2015)** [taxpayer rebutted presumption of correctness by carrying burden of production where income approach is proper method for contiguous parcels managed as single income producing property]
Recent North Carolina Property Tax Decisions

In re: Michelin North America, Inc., 12 PTC 005 (2014) [dealing with manufacturing exemption for tangible personal property for qualifying inventory]

In re: FLS Owner II, LLC, 12 PTC 581 (2014) [installed thermal solar energy equipment as real property and not business personal property]
Recent North Carolina Property Tax Decisions

- **In re: Interstate Outdoor Incorporated**, 12 PTC 1683 (2013); 11 PTC 1062 (2013); NO. COA14-223 (2014) [affirming valuation of billboards under cost approach where county's valuation was not arbitrary or illegal and employed uniform method]

- **In re: Marie C. & Walter W. Franklin Family Trust**, 12PTC 1759 (2015) [dealing with highest and best use of auto dealership]
Tips

- Keep all your correspondence with the tax office and any auditors – including envelopes!

- Be proactive and protective. If you even think you might want to protest, do it early and correctly. Don't wait until the last minute.

- Don't assume that what you are told by the tax office is accurate. Investigate and verify.

- Maintain accurate records of your property and update regularly.
Questions?

Charles Mercer  
Partner  
Nelson Mullins Riley & Scarborough LLP  
(919) 877-3814  
charles.mercer@nelsonmullins.com

Reed Hollander  
Partner  
Nelson Mullins Riley & Scarborough LLP  
(919) 877-3816  
reed.hollander@nelsonmullins.com