N.C. Supreme Court Rules More Penalties Payable to Public Schools

North Carolina School Boards Association v. Moore

By Shea Riggsbee Denning

In the year 2015 a writer summarizing the past decade of North Carolina public school funding would almost certainly reference the summer of 2005 as memorable—even revolutionary. Not only did the General Assembly approve a long-contested education lottery,[1] but a landmark decision in *North Carolina School Boards Association v. Moore* resulted in a $120-million budget allocation to the public schools from the state's Civil Penalty and Forfeiture Fund.[2] While the media and elected officials were devoting their attention to the potential impact of an education lottery, many local government officials were trying to determine what effect the state supreme court's ruling would have on local budgets. The decision not only required that penalties collected by specific state agencies be allocated to public schools in accordance with Article IX, Section 7 of the North Carolina Constitution, it also created standards to help determine whether the constitutional provision requires other monetary payments collected at the local level pursuant to state law to be remitted to public schools.

This article discusses the constitutional provision at issue in *North Carolina School Boards Association v. Moore* (*NC School Boards*) and the precedent that guided the supreme court's analysis. It also examines the procedural history of the case as well as the implications of the court's decision. Finally, the article addresses whether the clear proceeds of certain penalties imposed by local governments pursuant to the Machinery Act are also allocable to public schools under the Article IX, Section 7 provisions.[3]

Fines, Penalties, and Forfeitures Allocated to Public Education

Article IX, Section 7 of the North Carolina Constitution provides that the "clear proceeds of all penalties and forfeitures and of all fines collected in the several counties for any breach of the penal laws of the State . . . shall be faithfully appropriated and used exclusively for maintaining free public schools." The provision, adopted in the 1875 constitution, provided for the first state constitutional allocation of money directly to local governments for public education; it effectively extended the penalties, fines, and forfeitures component of the 1868 constitution's "irreducible educational fund."[4] Since its adoption, North Carolina courts have interpreted the implications of Article IX, Section 7 in more than twenty-five decisions.[5] Several recent state appellate rulings provide essential background to understanding the North Carolina Supreme Court's opinion in *NC School Boards*.

It has long been understood that Article IX, Section 7 applies to forfeitures in criminal cases, but only recently has its application to civil penalties been identified. In 1988, in *Mussallam v. Mussallam*, for example, the North Carolina Supreme Court held that proceeds of a surety appearance bond in a civil custody proceeding were indeed subject to this provision.[6] The court interpreted Article IX, Section 7 as setting forth two categories of moneys to be appropriated to school boards: (1) the clear proceeds of all penalties and forfeitures imposed to penalize a wrongdoer for violation of state law, so long as these proceeds accrue to the state; and (2) the clear proceeds of all fines collected for the violation of criminal laws. Recognizing the relative ease of identifying fines imposed in criminal cases, the court addressed the method for determining the sort of monetary payments

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1. S.L. 2005-344 (H 1023).

2. 359 N.C.474, 614 S.E.2d 504 (2005).

3. Subchapter II of Chapter 105 of the North Carolina General Statutes (hereinafter G.S.), which contains the laws governing the ad valorem taxation of property, is entitled the Machinery Act. G.S. 105-271.

4. David M. Lawrence, "Fines, Penalties, and Forfeitures: An Historical and Comparative Analysis," *North Carolina Law Review* 65 (November 1986): 49, 57–58.

5. *Id.* at 49.

6. *Mussallam*, 321 N.C. 504, 364 S.E.2d 364 (1988).

N.C. CONSTITUTION, Article IX, Section 7 (as amended)

Sec. 7. County school fund; State fund for certain moneys.

(a) Except as provided in subsection (b) of this section, all moneys, stocks, bonds, and other property belonging to a county school fund, and the clear proceeds of all penalties and forfeitures and of all fines collected in the several counties for any breach of the penal laws of the State, shall belong to and remain in the several counties, and shall be faithfully appropriated and used exclusively for maintaining free public schools.

(b) The General Assembly may place in a State fund the clear proceeds of all civil penalties, forfeitures, and fines which are collected by State agencies and which belong to the public schools pursuant to subsection (a) of this section. Moneys in such State fund shall be faithfully appropriated by the General Assembly, on a per pupil basis, to the counties, to be used exclusively for maintaining free public schools

encompassed by the first category. The court held that the determinative question regarding whether mandatory payments in civil matters are allocable to school boards is whether the payment is punitive or remedial in nature. That is, was the payment mandated to punish the offender and deter noncompliance or, instead, to measure the damages accruing as a result of the violation?[7] The court determined that the superior court judge in *Mussallam* set an appearance bond for the defendant-husband to ensure his presence in court. When the husband failed to appear, the bond—the proceeds of which were payable to the state—was forfeited as punishment for the husband's failure to comply with the court's order. The court determined that, because of its punitive nature, the forfeited bond fell within the first category of payments owed to local school boards.

Given that the payment in *Mussallam* resulted from the forfeiture of an appearance bond, the court determined that the forfeiture was imposed as a punishment rather than as a remedial measure and was, thus, subject to Article IX, Section 7. It remained unclear, however, how the expansive *Mussallam* standard would apply to penalties and fees imposed in other civil matters in which the distinction between punitive and remedial characteristics was less well defined.

The court next applied the *Mussallam* standard in *State ex rel. Thornburg v. 532 B Street* in 1993 to determine if forfeitures occurring pursuant to the state's Racketeer Influenced and Corrupt Organizations Act were also owed to local school boards.[8] The *Thornburg* majority cited *Mussallam* but skirted the issue of whether the forfeiture was remedial or punitive, concluding instead that the proceeds were subject to Article IX, Section 7 because they resulted from forfeiture actions and accrued to the state.

Three years later the state supreme court again addressed the issue of payments subject to Article IX, Section 7, in *Craven County Board of Education v. Boyles*.[9] In this case the court determined that the local school board was entitled to sums paid by the Weyerhaeuser Company to the Department of Environment, Health, and Natural Resources (DEHNR) pursuant to a settlement agreement made for violations of environmental laws. According to the court, the payment fell within the first *Mussallam* category because Weyerhaeuser entered into the settlement agreement in lieu of contesting a civil penalty assessed by DEHNR. Thus the payments resulted from a civil penalty even though they were actually made pursuant to a settlement agreement. Implicit in its holding was the court's assumption that civil penalties imposed by DEHNR were punitive rather than remedial. Like the *Thornburg* court, the court in *Craven County* conducted no analysis of the punitive versus remedial purposes of the moneys paid.

After the *Craven County* decision, state agencies began to pay Article IX, Section 7 penalties to public schools pursuant to the procedure set forth in Section 115C-437 of the North Carolina General Statutes (hereinafter G.S.). This statute defines *clear proceeds* as the full amount of such penalties minus the actual costs of collection, which may not exceed 10 percent, and requires that it be paid directly to county school finance officers. The finance officers then distributed these funds to each local school administrative unit in the county where the act leading to the collection of the civil penalty took place; these units then budgeted the sums received in accordance with the School Budget and Fiscal Control Act. When penalty proceeds collected by state agencies were remitted to school finance officers pursuant to G.S. 115C-437, they were expended at the local level in the same manner as locally collected penalties.[10]

The remission of penalties collected by state agencies to county school finance officers ceased in September 1997 when the General Assembly established the Civil Penalty

7. *Id.* at 509–10, 364 S.E.2d at 367.

8. *Thornburg*, 334 N.C. 290, 432 S.E.2d 684 (1993).

9. 343 N.C. 87, 468 S.E.2d 50 (1996).

10. NC Sch. Bds. Ass'n v. Moore, 359 N.C. 474, 614 S.E.2d 504 (2005), Brief for Defendants-Appellants Moore, Powell, McCoy, Kirk, Ward, Cooper, Tolson, Tippett, Howard, Broad, Moeser, Fox, Ross, Fain, Buell, Lunsford, Goodman, and Van Essen at 3–4 (citing G.S. 115C-426(e)); (No. COA02-507).

and Forfeiture Fund.[11] This fund consists of the clear proceeds of all civil penalties and forfeitures collected by state agencies and payable to county schools pursuant to Article IX, Section 7. G.S. 115C-457.2, enacted in 1997, requires that amounts accruing in the Civil Penalty and Forfeiture Fund be transferred to the State School Technology Fund. From there, funds are allocated to local school administrative units on the basis of average daily membership.[12] Schools were required to use such funds to implement local school technology plans or as otherwise specified by the General Assembly.[13]

North Carolina School Boards Association v. Moore

In December 1998 the North Carolina School Boards Association and school boards from several individual counties (the plaintiffs) filed an action in Wake County Superior Court. They sought a declaratory judgment that monetary payments collected by an array of state departments, agencies, and licensing boards, as well as the University of North Carolina, are subject to Article IX, Section 7. Plaintiffs also sought a determination that Article 31A of G.S. 115C, establishing the Civil Penalty and Forfeiture Fund as described above, was unconstitutional. Plaintiffs alleged that the state civil penalty fund structure violated the mandate in Article IX, Section 7 that civil penalties "shall belong to and remain in the several counties" and "be used exclusively for maintaining free public schools."[14] The superior court entered summary judgment in plaintiffs' favor on all claims. Defendants appealed. Before the court of appeals issued its opinion, however, the General Assembly adopted an act to amend Article IX, Section 7 of the constitution to provide that the legislature could place the clear proceeds of penalties, forfeitures, and fines collected by state agencies into a state fund.[15] The constitutional amendment was approved by voter referendum in November 2004 and became effective January 1, 2005 (see sidebar).

The court of appeals affirmed some of the lower court's rulings and reversed others in a September 16, 2003, opinion.[16] Plaintiffs and defendants cross-appealed to the North Carolina Supreme Court.

The state supreme court began its analysis in *NC School Boards* by reiterating the standard set forth in *Mussallam* and noting that, because none of the penalties in question were imposed in criminal proceedings, they would have to fall within the first category identified in *Mussallam* as allocable to public schools. Thus, as in *Mussallam*, the critical question in *NC School Boards* was whether the civil penalties at issue were imposed as punishment to deter noncompliance or were intended to remedy damages accruing as a result of a violation.

The supreme court cited and distinguished its view in this case from its holdings in earlier cases[17] that the label attached to a monetary payment by the legislature did not determine the payment's character. It noted that statements making a distinction between "fines" and "penalties" were made in the context of payments required for violations of *municipal* ordinances that had been declared by statute to constitute misdemeanor criminal offenses. Such distinctions lost their significance in 1980 with the court's determination in *Cauble v. City of Asheville* that both types of payments—when made as a result of municipal ordinance violations that constitute criminal offenses—are subject to Article IX, Section 7.[18] The *NC School Boards* court stated that its earlier holdings regarding labeling did not "undermine or negate the canons of construction" and that its first task in construing the statutes requiring the payments at issue was to determine legislative intent: "[T]he intent is ascertained in the first instance 'from the plain language of

11. S.L. 1997-443 (codified as G.S. 115C-457.1 through -457.3).

12. G.S. 115C-457.3.

13. G.S. 115C-102.6D(c).

14. NC School Bds. Ass'n v. Moore, 160 N.C. App. 253, 258, 585 S.E.2d 418, 423, *aff'd in part, rev'd in part*, 359 N.C. 474, 614 S.E.2d 504 (2005).

15. S.L. 2003-423.

16. Specifically, the court of appeals concluded that the Chapter 115C provisions for distributing civil penalties to public schools were constitutional. The court determined that the following payments were *not* penalties subject to Article IX, Section 7: (1) payments collected by the Department of Revenue for failure to comply with regulatory and statutory tax provisions; (2) payments collected by the Employment Security Commission from employers for overdue contributions to the unemployment insurance fund, late filing of wage reports, and tendering worthless checks; (3) payments collected by the board of trustees of The University of North Carolina for violation of traffic, parking, and vehicle registration ordinances and for the loss, damage, or late return of library materials; (4) payments pursuant to the tax on unauthorized substances; and (5) payments collected by state agencies and licensing boards for licensee failure to comply in a timely manner with licensing requirements. On the other hand, the court of appeals determined that the clear proceeds of moneys paid by an entity to subsidize a supplemental environmental project consequent to the entity's environmental violations *were* civil penalties owed to public schools. The appellate court also determined that payments collected by the Department of Transportation from owners of overweight vehicles pursuant to G.S. 20-118 and payments collected by the Department of Insurance for lapses in insurance coverage pursuant to G.S. 20-309 were penalties subject to Article IX, Section 7, as well. The court held that civil penalties paid by local public school systems to state agencies should not be returned to the offending schools for public policy reasons, notwithstanding whether such payments meet Article IX, Section 7 criteria.

17. *E.g.,* Board of Educ. v. Town of Henderson, 126 N.C. 689, 36 S.E. 158 (1900).

18. *Cauble*, 301 N.C. 340, 271 S.E.2d 258 (1980).

the statute.'"[19] Thus the court ruled that the words used by the General Assembly to describe a payment must be considered in determining whether the payment was subject to Article IX, Section 7.

State income tax penalties

The supreme court addressed the status of moneys collected by the state Department of Revenue (DOR) for late filings, underpayments, and failure to comply with statutory or regulatory tax provisions.[20] To support the claim that the clear proceeds of payments resulting from noncompliance with state income tax laws were not owed to the public schools, defendants relied upon U.S. Supreme Court jurisprudence holding that payments imposed for failure to comply with federal income tax law were remedial in nature, rather than punitive, for purposes of determining whether they constituted punishment under the Fifth and Eighth Amendments to the U.S. Constitution. Rejecting the notion that a federal court's interpretation of a federal statute governed a state court's interpretation of state law, the state supreme court analyzed the statutory language requiring payment for failure to comply with state income tax laws.

The court noted that each of the payments at issue is denominated a penalty under Chapter 105 of the General Statutes.[21] Moreover, the court construed the statutory characterization of penalties "as an additional tax" to indicate legislative intent that such amounts be treated as taxes for purposes of assessment, collection, and payment—but not as indicative of the remedial versus punitive nature of the penalties.[22] The defendants argued that such penalties are remedial because they are designed to safeguard revenue and reimburse the government for the expense of investigating noncompliance with its income tax laws. The court rejected this argument, noting that the interest separately assessed on delinquent tax payments reimburses the state for loss of use of the money and that G.S. 115C-457.2, the enabling legislation for Article IX, Section 7, permits the state to retain the actual costs of collecting the penalty, up to 10 percent of the penalty amount.[23] Furthermore, the court cited its holding in *Shore v. Edmisten* that payments attributable to the general costs of investigation and prosecution of a citizen's unlawful conduct are not considered "remedial" for purposes of Article IX, Section 7.[24] Thus the court concluded that penalties assessed pursuant to G.S. 105 for violations of the state's income tax laws are indeed subject to Article IX, Section 7 of the constitution.[25]

Employment Security Commission penalties

The parties agreed that Employment Security Commission (ESC) penalties imposed on employers pursuant to G.S. 96-10 for overdue employer contributions, late filing of required reports, and checks returned for insufficient funds were akin to the penalties imposed for noncompliance with the income tax laws. They did not, however, agree about whether the ESC penalties should be considered punitive or remedial. The court again sided with the plaintiffs, concluding that the ESC penalties imposed pursuant to G.S. 96-10 were also subject to Article IX, Section 7.

As it is for income taxes, interest is assessed separately from the penalty imposed on delinquent employer contributions to the ESC. Each category of ESC payments at issue in *NC School Boards* had been labeled a "penalty" by the General Assembly. While employer contributions are deposited in the Unemployment Insurance Fund, interest and penalties collected on late contributions are placed in the Special Employment Security Administration Fund. The special fund may be used for "extensions, repairs, enlargements and improvements to buildings, and the enhancement of the work environment in buildings used for Commission business."[26] The court concluded that nothing in G.S. 96-10 suggested that the penalty was remedial or that it was designed to support the Unemployment Insurance Fund. To the contrary, the court held that the penalty is assessed, in effect, to punish an employer for failure to comply with its statutory obligations.

Traffic and parking fines imposed by state universities

The *NC School Boards* court addressed whether the clear proceeds of fines imposed by the boards of trustees for the constituent universities of the UNC system for traffic and parking violations should also be allocable to public schools.[27] The fines considered by the court are imposed pursuant to G.S. 116-44.4, which permits universities to adopt one of two mechanisms to enforce parking and traffic ordinances. Universities may adopt an ordinance providing that violation of parking or traffic regulations is an infraction, as defined in G.S. 14-3.1, punishable by a monetary penalty. Or, the universities may adopt an ordinance impos-

19. NC Sch. Bds. v. Moore, 359 N.C. 474, 488, 614 S.E.2d 504, 512 (2005) (quoting Elec. Supply Co. v. Swain Elec. Co., 328 N.C. 651, 656, 403 S.E.2d 291, 294 (1991)).

20. *Id*. at 488–91, 614 S.E.2d at 513 –14..

21. *Id*.

22. *Id*.

23. *Id*.

24. *Shore*, 290 N.C. 628, 227 S.E.2d 553.

25. NC Sch. Bds. v. Moore, 359 N.C. 474, 491, 614 S.E.2d 504, 515.

26. G.S. 96.5(c).

27. *Id*. at 494–97, 614 S.E.2d at 516–18.

ing civil penalties upon persons who violate traffic and parking regulations.[28] The ordinances at issue in *NC School Boards* were of the latter type. Pursuant to G.S. 116-44.4(m), these civil penalties were placed in a trust fund and designated for university parking, traffic, and transportation expenses. The defendants conceded that monetary penalties imposed pursuant to ordinances that designated parking and traffic offenses as infractions were subject to Article IX, Section 7. Defendants contended, however, that the civil penalties imposed pursuant to the ordinances at issue were remedial because they compensated the universities for revenue losses resulting from parking and traffic violations. Defendants pointed to the legislative requirement that such penalties be placed in a trust fund for parking and traffic expenditures as further evidence of the remedial nature of the penalties.

The court rejected the defendants' argument, determining that monetary payments imposed under either type of ordinance were punitive in nature. The court relied upon *Cauble v. City of Asheville*, a case decided some twenty-five years earlier. In *Cauble* the court considered whether sums voluntarily paid for violations of the city's parking meter ordinances were subject to Article IX, Section 7 provisions.[29] The court concluded that sums paid for parking violations were fines within the meaning of Article IX, Section 7, because, pursuant to state law, violation of a city ordinance was a criminal act—in other words, a breach of the penal laws of the state. The penalties imposed for that violation were, therefore, collected for a breach of the penal laws of the state, regardless of whether any criminal prosecution was instituted. The *Cauble* court held that the distinction between civil penalties and criminal fines rests upon the nature of the offense committed rather than the method used to collect the payment.

Based on the principles set forth in *Cauble*, the *NC School Boards* court concluded that the universities' adoption of ordinances imposing civil penalties for violations of parking and traffic laws did not determine the nature of the penalties themselves, given that the schools had the option of enforcing such laws through criminal fines. The court stated that the universities' use of such funds for parking, traffic, and transportation expenses did not alter the intended purpose of the required payments. The court characterized as "inescapable" the conclusion that penalties for violations of parking and traffic laws—regardless of which type of ordinance they are imposed under or the use to which they are put—were intended to deter future violations and extract retribution from violators. Moreover, the court found that the funds were not being used for a qualifying remedial purpose. The only remedial expenditure was "[t]o defray the cost of administrating and enforcing [related] ordinances,"[30] a purpose accounted for in the "clear proceeds" definition found in G.S. 115C-457.2.

Department of Transportation penalties

The court also considered whether Department of Transportation penalties collected for lapses in insurance coverage were subject to Article IX, Section 7.[31] Pursuant to G.S. 20-309(e), a person whose insurance on a registered motor vehicle lapses must pay a $50 penalty to retain the vehicle's registration plate and certify that he or she has obtained the requisite insurance. If a vehicle owner fails to make this certification, the registration is revoked for thirty days. To reregister the vehicle, the owner must pay a restoration fee of $50 plus the fee for a new registration plate. Given the consequences of failing to pay the $50 fee and making the requisite certification, the court rejected defendants' contention that the fee was "voluntary."[32] The court summarily concluded that the purpose of the fee was to penalize a vehicle owner who violates statutes requiring financial responsibility for injury and damage resulting from his or her operation of a motor vehicle.

G.S. 20-309(e) also requires insurers to notify the Division of Motor Vehicles (DMV) of the termination of an insurance policy within twenty days of the termination. An insurer failing to provide such notice is subject to a $200 penalty. The defendants argued that because the purpose of the laws requiring drivers to maintain insurance was remedial, the civil penalty imposed upon insurers also was remedial. The court disagreed, noting that the title of the chapter enacting the civil penalty was "AN ACT TO REWRITE G.S. 20-309(E) TO PROVIDE FOR NOTICE OF TERMINATION RATHER THAN INTENT TO TERMINATE BY CARRIERS OF MOTOR VEHICLE LIABILITY INSURANCE COVERAGE *AND PENALTY FOR NONCOMPLIANCE*."[33] Moreover, defendants failed to show that the penalty was designed to compensate for particular damages incurred by the state or another victim. The court thus concluded that the clear proceeds of penalties imposed on both owners and insurers pursuant to G.S. 20-309(e) are owed to public schools pursuant to Article IX, Section 7.

28. G.S. 116-44.4(g); G.S. 116-44.4(h).

29. The city occasionally took out criminal warrants against persons who failed to pay the parking penalty. 301 N.C. 340, 341, 271 S.E.2d 258, 259 (1980).

30. NC Sch. Bds. v. Moore, 359 N.C. 474, 496–97, 614 S.E.2d 504, 517–18 (quoting G.S. 116-44.4(m)).

31. *Id.* at 502–03, 614 S.E.2d at 521–22.

32. *Id.* at 503, 614 S.E.2d at 521.

33. *Id.* (citing 1975 N.C. Sess. Laws ch. 302, sec. 1 (emphasis added)).

Other payments considered in *NC School Boards*

The *NC School Boards* court addressed several other monetary payments imposed for a party's failure to comply with state law. The court concluded that the following are remedial in nature and thus not subject to Article IX, Section 7: the excise tax on unauthorized substances; fees collected by UNC system university libraries for loss, damage, or late return of borrowed materials; and late fees paid to state agencies and licensing boards. The court agreed with the plaintiffs that the following payments were penalties owed to public schools under the state constitution: moneys collected by the Department of Transportation pursuant to G.S. 20-188(e) for violations of axle-weight limits, and payments made by an entity to fund a supplemental environmental project pursuant to a settlement agreement made with the DEHNR as a result of the entity's environmental violations.

Implications for Payments Required by the Machinery Act

NC School Boards raised significant questions regarding whether payments routinely collected by local governments, which had not been allocated to public schools, are also subject to Article IX, Section 7. Three types of payments required by the Machinery Act, G.S. Chapter 105, Subchapter II, in addition to the principal amount of ad valorem taxes, merit attention: (1) penalties imposed for the late listing or failure to list property for ad valorem taxation; (2) penalties imposed for the submission of a worthless check (or e-check) in payment of ad valorem taxes; and (3) interest imposed upon property taxes that are not timely paid. While *NC School Boards* did not address the nature of penalties imposed pursuant to the Machinery Act, it established the framework for determining whether such penalties, which result from violations of state law, are subject to Article IX, Section 7. Analysis of payments required by the Machinery Act in light of the factors identified in *NC School Boards* provides some indication of whether future courts will consider such payments subject to Article IX, Section 7 provisions.

Penalties imposed for failure to list property for taxation

Property owners must list with the county taxable personal property and improvements to real property.[34] County tax assessors must "discover" property that is not properly listed with the county during the regular listing period, which is the month of January unless extended by the county. A presumption applies that such property should have been listed by its owner for the preceding five years. Thus, when property is discovered, it is taxed for the year in which it was discovered and for any of the preceding five years during which it escaped taxation. The assessor must add a penalty of 10 percent of the amount of the tax for the earliest year in which the property was not listed, plus an additional 10 percent of the same amount for each subsequent listing period that elapsed before the property was discovered.[35]

Penalties are computed separately for each year in which the owner failed to list. The year, the tax amount for that year, and the total penalties for failure to list in that year are shown separately on tax records. Taxes and penalties for all years in which the property was not listed are then totaled on a single tax receipt. The total figure is "deemed to be a tax for the fiscal year beginning on July 1 of the calendar year in which the property was discovered."[36] Because property taxes are due September 1 and payable without interest until the following January 6, no interest accrues on discoveries until the January 6 after the discovery is made.

Pursuant to *Mussallam* and its progeny, the determinative issue regarding whether payments for discovery penalties are subject to Article IX, Section 7 has been whether such "penalties" are designed to punish a taxpayer for failure to timely list the property or to reimburse the taxing unit for its inability to invest such sums during the period in which the property escaped taxation. Although one could argue that such discovery payments are remedial, it appears far more likely that a court would characterize them as precisely what they are called—that is, penalties.

One of the strongest indicators that discovery penalties are imposed to punish taxpayers is the fact that the penalties are applied only to property not listed due to the taxpayer's failure to list. These penalties are not imposed on all property that escapes taxation, but only on property that taxpayers themselves are required to list. Taxpayers are no longer required to list real property other than new improvements, as all counties now have a permanent listing of such property. If real property escapes taxation because the assessor omitted it from the county's tax scroll, the property may be discovered but no penalties will apply. A payment designed to remediate the harm resulting from the taxing unit's loss of funds for taxes owed on the property presumably would apply regardless of whether the nonlisting was the fault of the taxpayer or the assessor. Because the penalty is applied when taxpayers fail to fulfill their statutory obligations, but not when assessors so fail, such payments appear punitive in nature.

The label "penalty" itself—in contrast to the term "interest" found in G.S. 105-360—also indicates the General Assembly's punitive mindset in requiring these payments.

34. G.S. 105-301; G.S.105-306.

35. G.S. 105-312(h).

36. G.S. 105-312(i).

Interestingly, the early Machinery Act termed the interest a "penalty."[37] While the nomenclature for interest changed in 1971, the label "penalty" is still used to describe the payment required for failure to list property.

One might argue that discovery penalties are remedial because they approximate interest lost due to the taxpayer's failure to pay. The first year's interest for unpaid taxes totals 10¼ percent (9 percent in subsequent years), and the penalty for failure to timely list is an additional 10 percent for the first elapsed listing period.[38] Interest does not accrue on discovered amounts until January 6 after the discovery is made. Any argument that the legislature intended discovery penalties to reimburse the taxing unit for lost investment is, however, belied by the application of a 10-percent penalty to property discovered in the year in which it is first subject to taxation. For instance, property not properly listed during the January 2005 listing period could be discovered in March 2005, timely billed, and be subject to a 10-percent penalty even before the taxes become due on September 1, 2005. If these taxes are paid before January 6, 2006, the taxing unit could not be said to have lost the availability of the funds resulting from its assessment for any period of time. Certainly, in such a case, the discovery penalty serves to punish the taxpayer rather than to remedy any harm to the taxing unit.[39]

The proposition that the penalty amount in question is remedial in nature is further rebutted by legislative history. The penalty imposed for failure to list property was set at 10 percent in 1939, at a time when a full-year's interest amounted to 7 percent.[40]

Finally, the local governing board's authority to compromise discoveries, including amounts assessed as penalties, and its lack of authority to compromise interest further demonstrate a legislative intent to punish taxpayers for failure to list taxable property.[41] The statutory authorization to waive the penalty indicates the legislature's intent to punish only deserving parties.

The North Carolina Supreme Court's analysis in *NC School Boards* indicates that the clear proceeds of discovery penalties most likely are subject to Article IX, Section 7 and so must be distributed to public schools. The use of the term "penalty" to describe such amounts, the accrual of a 10-percent penalty for the current year (even before the taxing unit may claim to have been deprived of taxes resulting from the discovery), and the governing board's authority to waive such penalties all point to this result.

Worthless-check penalties

The Machinery Act imposes a penalty of the greater of $25 or 10 percent of the amount of the check, subject to a maximum of $1,000, for the payment of taxes by check or electronic funds transfer that is returned or not completed due to insufficient funds or the nonexistence of an account.[42] The penalty does not apply if the person who wrote the check or made the electronic transfer had sufficient funds in another account to make the payment but inadvertently wrote the check or transferred the funds from the incorrect account. The supreme court's decision in *NC School Boards* makes it clear that such penalties are subject to Article IX, Section 7 provisions. First, the potential magnitude of the penalty, which may be as much as $1,000, rebuts any argument that it is primarily remedial in nature. Second, the exception to the penalty for inadvertent submission of worthless checks or transfers points to the punitive nature of the law. If the law does not apply to unintentional violations, then surely its aim is to punish, since the cost to the taxing unit presumably will be the same regardless of the payer's intent. Moreover, it is unlikely that the taxing unit would earn an average 10-percent rate of return on deposited sums in the interval between deposit of a worthless check and the ultimate payment of the tax. Finally, the supreme court's holding that worthless-check penalties imposed by the Employment Security Commission are punitive in nature indicates that a subsequent court would conclude likewise concerning worthless-check fees imposed by the Machinery Act.[43]

Interest for late payment of taxes

Finally, questions may arise regarding whether, pursuant to the supreme court's analysis in *NC School Boards*, interest imposed for late payment of property taxes is punitive in character and thus subject to Article IX, Section 7.

37. G.S. 105-345 (1970) (entitled "Penalties and discounts for nonpayment of taxes") (current version at G.S. 105-360); G.S. 105-345.1 (1970) (entitled "Penalty deemed to be interest") (repealed 1971).

38. G.S. 105-360; G.S. 105-312(h).

39. A court is unlikely to be persuaded by an argument that the penalty compensates a taxing unit for the costs of administering the audit program that resulted in the discovery and listing of the unlisted property. The court in *NC Sch. Bds. v. Moore* rejected the Department of Transportation's argument that payments required as a result of axle-weight limit violations were remedial in nature. The court stated that payments constitute restitution exempt from Article IX, Section 7 only when damages are specifically quantified and found no such quantification in the statutes governing axle-weight limits. 359 N.C. 474, 501, 614 S.E.2d 504, 520. Similarly, the Machinery Act does not quantify the injury resulting from failure to list property.

40. 1939 N.C. Sess. Laws ch. 310, sec. 1109; G.S. 105-345 (1939) (then-current version at G.S. 105-360).

41. G.S. 105-312(k), 105-380, 105-381.

42. G.S. 105-357(b)(2).

43. NC Sch. Bds. v. Moore, 359 N.C. 474, 505, 614 S.E.2d 504, 522.

The Machinery Act imposes a 2-percent penalty for the first month in which property taxes are delinquent and ¾ percent per month thereafter; interest accrues at a set percentage each month, regardless of the number of days remaining in the month after payment of the taxes.[44] As noted above, the interest rate for the first twelve months of delinquency is 10¼ percent and interest for subsequent years totals 9 percent.

Beginning in January 2006 interest on delinquent payment of taxes assessed on registered motor vehicles accrues at the rate of 5 percent for the first month and ¾ percent per month thereafter.[45] Sixty percent of the first month's interest collected on unpaid motor vehicle taxes after January 1, 2006, will be transferred to the Combined Motor Vehicle and Registration Account to fund the development of a DMV computer system that will integrate the processes of taxing and registering motor vehicles.[46]

It seems unlikely that a court would consider any of the interest assessed pursuant to the Machinery Act to be a penalty. As noted in the discussion regarding discovery penalties, in 1971 the General Assembly relabeled as "interest" the amounts assessed for delinquent payment of taxes—amounts that were formerly termed "penalties."[47] Given the deference accorded the legislature's naming conventions in *NC School Boards*, it appears likely that the deliberate change of a label from "penalties" to "interest" would significantly influence any court's determination of the proper characterization of such amounts. The lack of any intimation by the *NC School Boards* court that the interest imposed by the Department of Revenue for failure to comply with state income tax laws is subject to Article IX, Section 7 bolsters the conclusion that another court is unlikely to rule that property tax interest is subject to Article IX, Section 7. As noted above, the court referenced both imposition of interest and penalties and concluded that such interest remedied harm caused by noncompliance. The statutory rate of interest under the Machinery Act also is consistent with a remedial purpose, since it is conceivable (though not likely) that a taxing unit could earn a rate of return of 10¼ percent on invested sums in a twelve-month period. It is unlikely that the additional 3-percent interest imposed for delinquent motor vehicle taxes would cause a court to conclude that such payments are penalties, even though this rate of interest was increased in conjunction with the establishment of a fund for a combined vehicle registration and taxation computer system. After all, the secretary of revenue is authorized to impose an annual interest rate of up to 16 percent for delinquent payment of income taxes, and the characterization of such sums as interest was not called into doubt by the *NC School Boards* court.[48] Furthermore, given the supreme court's refusal in that case to consider the universities' use of parking penalties as controlling, the designation of a portion of the increased interest from late payment of motor vehicle taxes to a DMV computer fund should not significantly affect the character of such interest. Even if it did, the allocation of such funds to a computer system that will largely eliminate the late payment of taxes by requiring them to be paid when the vehicle is registered or reregistered remedies the very harm caused by late payers.

Conclusion

Even though Article IX, Section 7 makes no distinction between cities and counties, the supreme court's decision in *NC School Boards* may disproportionately impact city budgeting. Local school units receive most of their funding from county coffers.[49] While counties do not appropriate funds subject to Article IX, Section 7, county commissioners have presumably considered the availability of such funds when determining how much county money to allocate to local schools.[50] Thus local schools' receipt of additional moneys pursuant to Article IX, Section 7 may not increase the schools' overall revenue, since funding from counties may decline by a proportionate amount.

North Carolina cities, unlike counties, do not generally fund local schools.[51] They therefore cannot reduce school appropriations in order to compensate the city's budget for the loss of funds from discovery, worthless-check, or other penalties—because they don't appropriate school funds in the first place. In addition to the Machinery Act penalties, the supreme court's recent holding in *NC School Boards* could render countless other municipal penalties subject to Article IX, Section 7 if those penalties are imposed for ordinance violations punishable as criminal offenses pursuant to G.S. 160A-175 and G.S. 14-4. This is because the decision considers such penalties, like the parking fines in *Cauble*, as imposed pursuant to "the penal laws of the State."[52] A municipality may, however, avert the applica-

44. G.S. 105-360(a).
45. S.L. 2005-294 (H 1779).
46. *Id.*
47. 1971 N.C. Sess. Laws ch. 806.
48. G.S. 105-241.1(i) permits the secretary of revenue to annually establish the rate of interest applicable to delinquent income taxes, subject to the requirement that interest be at least 5 percent and not more than 16 percent per year.
49. G.S. 115C-429; David M. Lawrence, *Local Government Finance in North Carolina*, 2d ed. (Chapel Hill: Institute of Government, University of North Carolina at Chapel Hill, 1990), 255–60.
50. Lawrence, *Local Government Finance*, 260, 267.
51. *Id.* at 255.
52. N.C. Const., Art. IX, Sec. 7.

tion of Article IX, Section 7 to penalties imposed pursuant to local ordinance by decriminalizing these violations. The breadth of the supreme court's holding in *NC School Boards*, combined with the depth of prior court rulings on the application of Article IX, Section 7, provides local governments with some relatively clear guideposts concerning payments owed to public schools pursuant to the state constitution. For this reason, if for no other, local school officials may look back with some satisfaction on the summer of 2005.