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Discovery, Immaterial Irregularity, and the *Morgan* Decision

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When a local government learns that property has escaped taxation for many years, what options are available for pursuing those missed taxes? Will the Machinery Act's discovery provisions control the recovery of back taxes? Or will the Machinery Act's more generous "immaterial irregularity" provisions permit the taxing unit to reach back for ten or more tax years, with interest?

Far from theoretical, these questions routinely arise across the state, such as when a homeowner doubles the size of his or her house without informing the assessor, when annexed property is never assessed city taxes, or when special assessments are never billed.

Because these issues are so common, the interplay between discoveries under Section 105-312 of the North Carolina General Statutes (hereinafter G.S.) and immaterial irregularities under G.S. 105-394 has been an ongoing topic of debate among local tax officials. Last year's North Carolina Supreme Court decision in *In re Morgan* added even more fuel to the conversational fire by approving the collection of interest as well as back taxes on property that had been listed but not assessed for more years than could be recovered under the discovery statutes.[1]

This bulletin argues that by using both G.S. 105-312 and G.S. 105-394, tax officials can and should be more aggressive in their pursuit of taxes that were inappropriately listed, assessed, or billed.

First, assessors should always apply late-listing penalties when mandated by the discovery provisions in G.S. 105-312. Too often assessors are hesitant to apply penalties when real property is discovered, even when the situation involves improvements to real property that require penalties under the discovery provisions.

Second, tax officials should rely on the immaterial irregularity provisions in G.S. 105-394 when property has escaped taxation because of assessing or billing failures. A prime example is when a city determines that property within its physical jurisdiction has been listed by the county but never taxed by the city. Because this is a failure in the assessing or billing process and not a listing failure

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1. 362 N.C. 339, 661 S.E.2d 733 (2008).

covered by the discovery provisions, city collectors should rely on the immaterial irregularity provisions and bill for back taxes plus interest without regard to the five-year limitation on discoveries.

Third, tax officials should consider using more aggressive collection options available under the immaterial irregularity provisions for failures to list real property that are traditionally pursued through the discovery process. When real property escapes taxation due to the *assessor's* failure to list—as opposed to the failure of a taxpayer to list improvements to real property—the best approach is to recapture the taxes through G.S. 105-394 and bill for all back taxes plus interest, as in the annexation example above.

This bulletin will examine the discovery and immaterial irregularity statutes in detail, discuss the importance of the *Morgan* decision, and apply current law to specific scenarios involving the recapture of back taxes.

Discovery versus Immaterial Irregularity

At first glance the distinction between a discovery and an immaterial irregularity seems clear. G.S. 105-312, the discovery section, describes the procedure for taxing property that was not listed appropriately by the taxpayer. G.S. 105-394, the immaterial irregularity section, states that failures in the taxation process shall not invalidate any tax. In essence G.S. 105-394 prevents a taxpayer from relying on a taxing authority's failure to satisfy a particular Machinery Act requirement as an excuse not to pay an otherwise valid tax.

The distinction between a failure to list and other types of procedural failures is nicely illustrated by *In re Dickey*,[2] a case involving homeowners who submitted a listing for their newly constructed house but were never taxed on that improvement. The county inadvertently destroyed the listing form and taxed only the lot. One year later, the county realized its mistake and attempted to collect the prior year's taxes on the house using the discovery provisions. The court of appeals rejected the county's initial argument and concluded that property is "listed" once the taxpayer submits the listing form, even if the assessor never adds that property to the county tax rolls. The failure that prevented taxation was therefore not a *listing* issue but an *assessing* issue. Because the house could not be considered discovered property, the provisions of G.S. 105-312 could not apply. The county was not out of luck, however. The court agreed with the county's alternate argument that this type of procedural failure constituted an immaterial irregularity under G.S. 105-394, meaning that the back taxes were still valid and collectible.

Dickey provides solid guidance when the failure at issue involves any tax procedure other than listing. But what if a failure to list *is* the root of the problem? Is G.S. 105-312 the only possible remedy, or could G.S. 105-394 also apply? A closer examination of the two statutes reveals overlap on the subject of listing.

G.S. 105-312 creates a duty on behalf of the assessor to "see that all property not properly listed during the regular listing period be listed, assessed and taxed as provided" in the Machinery Act and mandates the procedure for taxation of "discovered property." The definitions section of the Machinery Act[3] defines "discovered property" to include the following, all of which concern listing failures:

2. 110 N.C. App. 823, 431 S.E.2d 203 (1993).
3. N.C. Gen. Stat. 105-273(6a) (hereinafter G.S.).

1. Property that was not listed during a listing period
2. Property that was listed but the listing included a substantial understatement
3. Property that has been granted an exemption or exclusion for which the property does not qualify

But the immaterial irregularity provisions also cover listing failures. G.S. 105-394 states in part "immaterial irregularities in the listing, appraisal, or assessment of property for taxation . . . shall not invalidate the tax imposed upon any property. . . ." This section provides a long list of immaterial irregularity examples, including "the failure to list, appraise or assess any property for taxation. . . ."

Where does that leave a confused assessor or tax collector? A quick reading of G.S. 105-312 suggests that the failure to list property should be resolved through the discovery process, which limits collection to the current year plus the five previous years, without interest. But G.S. 105-394 suggests that tax officials can ignore a failure to list and bill for all past taxes—including interest from the date the back taxes were originally delinquent, in light of the *Morgan* decision. How should tax officials proceed when two different statutes appear to present two different resolutions for the same situation?

The most conservative approach is to conclude that the "listing" reference in G.S. 105-394 simply reinforces the discovery provisions by eliminating one possible defense to a discovery bill. G.S. 105-394 confirms that the underlying taxes remain valid regardless of whether a listing failure is attributable to a taxpayer or to an assessor. Under this approach, likely the most common action taken across the state, *all* listing failures for *all* types of property must be resolved exclusively under G.S. 105-312.

In the authors' view this conservative approach ignores a fundamental principle of statutory interpretation: When possible, a statute should not be interpreted in a manner that renders any sentence, clause, or word superfluous or redundant.[4] By concluding that the "failure to list" example in the immaterial irregularity provisions merely reinforces the authority that assessors already possess under G.S. 105-312, one would render the listing clause in G.S. 105-394 entirely redundant.

Does that mean that tax officials have the discretion to rely on the sweeping scope of G.S. 105-394 to resolve listing failures instead of G.S. 105-312 whenever they so choose? For listing failures that do not trigger discovery penalties or that have continued for more than six years, G.S. 105-394 would provide a more lucrative remedy for tax collectors than would G.S. 105-312. An aggressive interpretation of the two statutes would argue that a tax collector should ignore the discovery limitations and proceed under G.S. 105-394 whenever such an approach would produce more revenue for the taxing unit.

This aggressive approach is constrained by two additional core principles of statutory interpretation. First, when possible, one statute must not be interpreted so as to render another statute meaningless.[5] If all listing failures could be resolved under the immaterial irregularity provisions,

4. *In re* Watson, 273 N.C. 629, 634 (1968) ("[i]t is a well settled principle of statutory construction that words of a statute are not to be deemed merely redundant if they can reasonably be construed so as to add something to the statute which is in harmony with its purpose").

5. People v. Cone Mills Corp., 316 N.C. 426, 444 (1986) ("A canon of statutory interpretation is that statutes dealing with the same subject matter must be construed together and harmonized, if possible, to give effect to each.").

the discovery provisions would lose all import. Second, the specific trumps the general,[6] meaning that the specific discovery provisions of G.S. 105-312 should control when resolving a failure to list that could fall under either that statute or under the more general provisions of G.S. 105-394.

If neither the conservative nor the aggressive interpretation passes muster, what options are left? A moderate approach that respects statutory interpretation principles is to conclude that the two provisions are aimed at two different types of procedural failures. Under this moderate approach the discovery provisions in G.S. 105-312 provide the exclusive remedy only for a taxpayer's failure to satisfy his or her listing obligations. Those obligations are limited to the listing of personal property, improvements on real property, and separate rights to real property.[7] All other procedural failures, including an assessor's failure to list real property or to process a personal property listing, should be resolved through the more generous irregular immateriality provisions of G.S. 105-394.

In large part because of their respect for precedent, courts by their nature are conservative. It may be that if and when the question is presented to a North Carolina appellate court, the conservative interpretation of the interplay between G.S. 105-312 and G.S. 105-394 will prevail. However, the authors believe that the plain language of the statutes and the *Morgan* decision support a slightly more aggressive application of the immaterial irregularity provisions than has been customary among North Carolina tax officials.

Discoveries under G.S. 105-312

An accurate interpretation of G.S. 105-312 requires that it be read in tandem with G.S. 105-303, the permanent listing provisions. G.S. 105-303(b), which has required permanent listing systems for all counties since 2004, makes the assessor, not the property owner, responsible for the determination of real property ownership as of January 1 each year and for the carrying forward of real property characteristics that have remained unchanged since the previous listing period.[8] Discovery penalties, discussed in more detail below, are eliminated for the failure to list acquisitions and sales of real property, which under a permanent listing system is the obligation of the assessor rather than the taxpayer. Property owners retain the obligation to list all improvements on real property and separate rights to real property, such as timber and mineral rights, to real property. Property owners continue to have the obligation to list all taxable personal property.

The seemingly clear obligation of taxpayers to list improvements to real property has been muddied by the practice adopted by many counties of not mailing listing forms annually to all real property owners. Accompanying the advent of permanent listing was the desire to reduce the foot traffic to the assessor's office during the January listing period and to reduce operating costs by saving paper and postage. The unintended negative consequence of permanent listing systems

6. *See* State *ex rel.* Utils. Comm'n v. Lumbee River Elec. Membership Corp., 275 N.C. 250, 260, 166 S.E.2d 663, 670 (1969) ("It is a well established principle of statutory construction that a section of a statute dealing with a specific situation controls, with respect to that situation, other sections which are general in their application.").

7. G.S. 105-303(b).

8. S.L. 1999-297, sec. 3. Permanent listing is primarily directed to the determination of ownership as of January 1 each year and to the carrying forward of property characteristics that remain unchanged from the prior year. Assessors, not property owners, are obligated to list changes in real property ownership that occurred during the previous calendar year.

has been to limit contact and create greater separation between property owners and assessors, thereby increasing the likelihood of listing problems.

The transfer of property can also complicate these listing obligations. Consider the listing obligations related to a vacant lot owned by Doris, a developer, as of January 1, 2008. If Doris constructs a house on the lot during 2008 but does not sell the property before the end of the year, she has an obligation to list that new improvement during the January 2009 listing period. But, if Doris builds a house in 2008 and then sells it to Harry before the end of the year, who is required to list the new improvement for 2009? Doris is not the owner as of January 1, 2009, and therefore has no listing obligation for the property. Because Harry did not make any improvements to the land after his purchase, he may understandably assume that he has no obligation to update the property listing, either. Imagine the number of renovation and remodeling jobs completed each year on existing structures prior to their sale—and how many of those improvements escape listing because the new owners assume that the previous owners were responsible for updating the tax record.[9]

The permanent listing provisions' reference to G.S. 105-309(c)(4) makes clear that a taxpayer's obligation to list covers both improvements that the taxpayer constructs and, as in the case above, improvements that the taxpayer *acquires.* Harry must list the newly constructed house or risk discovery penalties when the assessor learns of the omission. This would be true even if Harry bought property on which a house had been constructed many years before the date he purchased the property. If the previous owners of that house never listed it, Harry would still be subject to listing penalties if he does not correct the omission. Harry would also be liable for listing penalties if his house is listed at a substantial understatement because its previous owners failed to list substantial improvements to the structure. The bottom line is that new property owners always bear the risk that the previous property owners did not appropriately list all improvements to the real property.[10]

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9. Many jurisdictions also miss taxable property value due to the misguided practice of not listing or taxing new construction until taxpayers receive certificates of occupancy. This practice is not only costly to the jurisdiction; it is in violation of the Machinery Act listing procedures. G.S. 105-309(c)(4) requires the listing of "building and other improvements having a value in excess of one hundred dollars ($100.00) that have been acquired, *begun*, erected, damaged, or destroyed since the time of the last appraisal of property" (emphasis added). A renovation or construction project must be listed as of the January 1 following the start of the project, not its completion.

10. The question then arises, how would a new owner discover such a listing omission? As mentioned above, since the introduction of permanent listing, in nonreappraisal years most counties do not provide property owners with enough information to determine if all improvements to the property are accurately listed. In those cases the new owners' best option might be to check their county's tax listings, available online in a growing number of counties, to confirm the completeness of their listings. Other options include asking their real estate agent to compare the information on the property's Multiple Listing Service posting with the tax records to make sure they are consistent or having their closing attorneys or paralegals obtain and inspect property tax record cards and/or land record maps as part of the title and lien search process. In advance of a reappraisal year, some counties will send detailed property valuation information to property owners in the form of a property summary or a copy of the property record card, either of which should put new owners on notice of an understated listing. This may occur as part of the requirement in G.S. 105-317(b)(7) that as part of the general reappraisal process notice be given in writing by the assessor to property owners that they are "entitled to have an actual visitation" in order "to verify the accuracy of property characteristics on record" for their property. However, most counties simply include the statement on or inserted with a prior year tax bill, on or with a prior year listing form, or in some instances,

The following example demonstrates how penalties would be calculated in a common discovery situation.

> Terry purchased Lot A in 1985. In 1998 he built a house on the lot but never listed it with the assessor. In 2009 the county discovered the omission and appraised the house based on the schedules of values, standards, and rules in place for each year the property escaped taxation. Although the county conducted a general reappraisal 2006 and has another scheduled for 2010, its tax rate has remained at $0.60 per $100 since 1998.

Assuming the county resolves the situation under G.S. 105-312, what will be Terry's total discovery bill? Because discovery penalties will apply to Terry's failure to list the improvements to his land and because G.S. 105-312(g) permits an assessor to tax discovered property for the year it was discovered plus the preceding five years, Terry's total discovery bill would be calculated as follows in Table 1.

Table 1. Discovery Bill Calculation

Year	Assessed Value of House ($)	Tax Rate	Tax Due ($)	Penalty (%)	Penalty Due ($)	Total Due ($)
2009	166,666	$0.60 per $100	1,000	10	100	1,100
2008	166,666	$0.60 per $100	1,000	20	200	1,200
2007	166,666	$0.60 per $100	1,000	30	300	1,300
2006[a]	166,666	$0.60 per $100	1,000	40	400	1,400
2005	125,000	$0.60 per $100	750	50	375	1,125
2004	125,000	$0.60 per $100	750	60	450	1,200
Total			5,500		1,825	7,325

[a]Year in which general reappraisal took effect.

Notice that interest charges do not yet apply to this discovery. G.S. 105-312 mandates that discovery bills be considered part of the current year's taxes, meaning that they are not delinquent and not subject to interest until January 6 of the following year. If the county discovers Terry's property in 2009, the $8,425 discovery bill will not accrue interest until January 6, 2010, the same date that all outstanding 2009 property taxes will become delinquent.[11]

a separate mailing. Typically, property owners view this as an opportunity to ensure that property is not overlisted, without consideration of possible underlisting.

11. This is true regardless of when the final discovery bill is determined. If Terry were to appeal the discovery appraisal figures, the matter may not be resolved until after January 6, 2010. However, interest would still accrue from that date. Under G.S. 105-312(i) a discovery bill "shall be deemed to be a tax for the fiscal year beginning on July 1 of the calendar year in which the property was discovered." Under G.S. 105-312(c)

Perhaps the most unique aspect of G.S. 105-312 is the fact that it grants the board of county commissioners broad power to reduce discovery bills or waive them entirely. Nowhere else in the Machinery Act are appointed or elected officials granted such unfettered discretion to waive taxes, interest, or penalties.

G.S. 105-381, the general taxpayer remedy section, permits refunds and releases only for taxes imposed through clerical errors, illegal taxes, or taxes levied for illegal purposes. Elected officials who authorize releases or refunds outside those limited parameters risk personal liability under G.S. 105-380.

In contrast, G.S. 105-312(k) places no limits on the county commissioners' authority to "compromise, settle or adjust" taxes arising from discovery bills. Absent bad faith or discrimination, the commissioners' decision under 105-312(k) is final. When rejecting an appeal based upon a town's refusal to waive late-listing penalties for property that was listed a mere two days after the listing period closed, the Property Tax Commission (PTC) observed, "The decision to compromise pursuant to G.S. 105-312(k) is a purely discretionary matter; where the county board acts in good faith, its decision must stand."[12]

The authority to waive some or all of a discovery bill rests only with the board of county commissioners, not with an assessor. An assessor has an absolute duty to calculate and bill the full amount of the discovery, plus penalties, even if the commissioners have made it clear that they plan to compromise that bill with the taxpayer. An assessor who fails to pursue all applicable penalties could risk liability under the Department of Revenue's duty to enforce the Machinery Act against both taxpayers and tax officials.[13]

One final aspect of discoveries that is often overlooked: G.S. 105-312(d) requires specific notice and appeal procedures that differ from those provided for "regular" assessments. After the assessor makes a "tentative appraisal of the discovered property in accordance with the best information available," the assessor must send notice of that appraisal and inform the taxpayer that it will become final unless the taxpayer files a written objection within thirty days of the date of the notice. If the taxpayer files a timely objection, the assessor must schedule an informal conference to allow the taxpayer to demonstrate why the tentative appraisal is not accurate. In practice this conference period often extends beyond the initial meeting with the taxpayer, as the parties continue to gather information relevant to the listing or appraisal. Once the assessor provides the taxpayer a final decision regarding the appraisal, the taxpayer has fifteen days to file an appeal to the board of equalization and review or to the board of county commissioners. The standard appeal procedures in G.S. 105-322 and G.S. 105-325 would then apply. The Machinery Act does not specify when a discovery bill should be delivered to a tax collector for billing and collection, but the best practice is not to involve the collector until the formal appeal process is resolved.

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a discovery is deemed to occur on the date that the property's abstract is made or corrected, not when the final discovery bill is calculated or delivered.

12. *In re* Popkin Brother Enterprises, Inc., 90 P.T.C. 82 (Aug. 23. 1991).

13. See G.S. 105-289(g) (The Department's duties include ensuring that "proper proceedings are brought to enforce the statutes pertaining to taxation and the collection of penalties and liabilities imposed by law upon public officers, officers of corporations, and individuals who fail, refuse, or neglect to comply with the provisions of this Subchapter and other laws with respect to the taxation of property.").

The *Morgan* Decision

The *Morgan* decision stands for the relatively simple proposition that a taxing unit may use G.S. 105-394 to recapture back taxes and interest, regardless of the source or nature of the procedural failure that caused the property to escape taxation. As a result of *Morgan*, Henderson County was permitted to rely on G.S. 105-394 to collect nine years of taxes and interest on a home that was listed by the taxpayer but never assessed by the county. The sequence of events leading to this straightforward conclusion illustrates the circuitous interplay that often exists between discovery and immaterial irregularity.

Tyleta W. Morgan and her now deceased husband obtained the required permits and began building a house on their Henderson County property in 1986. By the end of 1992, they had completed 80 percent of the construction. The Morgans timely submitted a 1993 listing form for their partially completed home. However, the new construction was never measured, listed, or assessed by the county, even after the county conducted general reappraisals in 1990, 1995, 1999, and 2003. When the current county assessor took office in 2003, he initiated a measuring and listing program for the entire county. Shortly thereafter the new construction was found and added to the county tax rolls, and the county immediately issued a Notice of Discovery for 2003 and the preceding five years. [14]

At the subsequent discovery conference Mrs. Morgan contended that her husband had listed the home in 1993. A search of returned listing forms confirmed Mrs. Morgan's assertion, which meant that G.S. 105-312 could not apply. The county could not proceed under the discovery process because none of three categories of discoveries defined by G.S. 105-273(6a) existed: The new construction had been listed, meaning 105-273(6a)(a) did not apply; the property had not been substantially underlisted by the owner, meaning 105-273(6a)(b) did not apply; and, the property had not been granted an exemption or exclusion, meaning 105-273(6a)(c) did not apply.[15]

Even though the discovery provisions were not available, Henderson County still had an obligation to recover the taxes that should have been levied upon Mrs. Morgan's property. The county could not forgive these back taxes simply because the taxpayer was not at fault. In fact, any attempt to mitigate the burden to Mrs. Morgan from these valid—but omitted—back taxes would violate the tax officials' obligation to assess and collect all lawful taxes under the Machinery Act.

Several statutes combine to create this obligation. The most general of these is G.S. 105-274, which mandates that all property shall be subject to tax, unless it has been specifically exempted or excluded by the General Assembly. Because Mrs. Morgan's property was not eligible for an exemption or exclusion, it must be taxed. G.S. 105-348, better known as the presumptive notice

14. The authors wish to note that throughout the entire process, the interaction between Mrs. Morgan and the county was always respectful and courteous. The facts of the case were simply viewed from different perspectives. Mrs. Morgan thought she had done everything expected of her by the county. The county, for its part, had followed its standard mass appraisal procedures, but through an unfortunate combination factors simply failed to catch the property's omission from the county tax rolls. The Morgans' eighty-eight-acre property is posted with "No Trespassing" signs and is located more than one-half mile off of what is little more than a crude logging road in a very remote part of Henderson County. It is more than one mile from the Morgans' driveway to any state-maintained secondary road. Further, the home's unique design and use of berms hindered the effectiveness of the black-and-white orthophotography used by the county during the reappraisal process.

15. Arguably, a substantial understatement of value occurred after the construction was complete because the Morgans never listed the final 20 percent of construction. However, neither the parties nor the court addressed that question, focusing instead solely on the appropriate application of G.S. 105-394.

statute, charges all property owners with notice of taxes, even if they never receive formal tax bills for all of their taxable property.[16] The fact that Henderson County had never billed Mrs. Morgan for the past taxes attributable to her new construction could not relieve her of that tax liability. Finally, G.S. 105-355 mandates that tax liens attach to taxable property as of the date the property was to be listed, regardless of when the actual tax is determined or billed. With respect to Mrs. Morgan, this statute meant that although her tax liability for 1993 was not determined until 2005, the liens for the omitted improvement attached to her property as of January 1, 1993, and again on each January 1 for each subsequent year the new construction had escaped taxation.

With these obligations in mind, the county moved forward under the immaterial irregularity provisions and calculated Mrs. Morgan's back taxes and interest for tax years 1995 through 2003, with the final bill amounting to just over $8,500.

Why did Henderson County not pursue taxes back to 1986, the year the Morgans began construction of their home? Although G.S. 105-394 contains no time limitation on the resolution of procedural failures, G.S. 105-378 bars the use of enforced collection remedies more than ten years after date the taxes originally became due. But, G.S. 105-378 does not invalidate taxes older than ten years, nor does it eliminate the liens created by those taxes. While unenforceable, those ten-years-plus liens still have some effect on the taxpayer. The liens will continue to accrue interest until a sale occurs that requires title insurance, at which time payment of the delinquent taxes are needed to clear title to the property. Nevertheless, the county questioned whether it would be appropriate policy to create liens which it could not enforce and decided to limit its efforts to tax years 1995 and later.[17]

After receiving her bill, Mrs. Morgan paid the back taxes and interest and promptly appealed to the Henderson County Board of Equalization and Review. The board upheld the decision of the county tax assessor's office, and Mrs. Morgan appealed to the PTC. PTC ruled in favor of Mrs. Morgan, holding that the county's failure to assess her residence was not an immaterial irregularity because it was not a "clerical or administrative error." The county then appealed to the North Carolina Court of Appeals, which affirmed the PTC's conclusion that G.S. 105-394 requires a clerical or administrative error to justify the recapture of back taxes.

The county ultimately prevailed on appeal to the North Carolina Supreme Court, which adopted in its entirety the court of appeals dissenting opinion. In that opinion Judge Martha Geer observed that the plain language of G.S. 105-394 contained no reference to clerical or administrative errors and instead made the immaterial irregularity provisions applicable to all property tax omissions and errors, regardless of their source or nature. Likewise, because G.S. 105-394 does not specifically exclude interest, Judge Geer concluded that back taxes billed under the immaterial

16. Specifically, G.S. 105-348 states, "All persons who have or who may acquire any interest in any real or personal property that may be or may become subject to a lien for taxes are hereby charged with notice that such property is or should be listed for taxation, that taxes are or may become a lien thereon, and that if taxes are not paid the proceedings allowed by law may be taken against such property. This notice shall be conclusively presumed, whether or not such persons have actual notice." In other words, all persons are put on notice that they have obligations to list their property and pay property taxes in much the same fashion as they are on notice that they need a valid North Carolina driver's license to operate a motor vehicle or that they are responsible to file the appropriate state income tax returns, whether or not they receive notice from the government agencies responsible for administering state motor vehicle or revenue laws.

17. Although G.S. 105-312 contains very detailed notice and procedural requirements, G.S. 105-394 does not offer similar guidance for recapturing taxes that were never previously levied or billed. Nevertheless, for the benefit of the taxpayer, Henderson County concluded that the best approach under G.S. 105-394 was to adopt similar notice and appeal procedures as present in G.S. 105-312.

irregularity provisions must also include interest from their original dates of delinquency under G.S. 105-360. The North Carolina Supreme Court made Judge Geer's conclusions definitive and permitted Henderson County to collect all of the back taxes and interest it sought, despite the fact that Mrs. Morgan was not to blame for the omissions.

Judge Geer's opinion did not address what time limits, if any, exist on efforts to correct procedural failures under the immaterial irregularity provisions, which means the question remains open for debate. Given Judge Geer's generous interpretation of G.S. 105-394, could Henderson County have billed Mrs. Morgan for taxes as far back as 1986? The authors think so, even though Mrs. Morgan would have had a defense to any enforced collection action on taxes more than ten years old. As mentioned above, G.S. 105-378 places a ten-year limitation on enforced collections but does not create an expiration date on valid tax levies and liens. Because G.S. 105-378 is a limitation on tax collection and not tax assessment, arguably it should be irrelevant to an assessor's decision to pursue prior year's taxes. In the case of real property, liens arising beyond the ten-year reach of a county's enforced remedies will ultimately be resolved either through voluntary payment or as part of a subsequent mortgage financing that will require that all liens be satisfied. Unless and until the General Assembly amends G.S. 105-394 to add a time limit to the immaterial irregularity provisions, the authors believe that, in light of the *Morgan* decision, counties should bill for all taxes that have been omitted, regardless of when the tax liens arose.[18]

Immaterial Irregularities under G.S. 105-394

Although the *Morgan* decision provides one helpful example of when G.S. 105-394 applies, it does not explain exactly how broad a reach the statute possesses. In contrast to its relatively limited definition of "discovered property," the Machinery Act provides an expansive and nonexclusive explanation of the phrase "immaterial irregularity." G.S. 105-394 offers ten different specific examples of immaterial irregularities, including the failure of tax officials to take the required oaths; the failure to list, appraise, or assess property; and the failure to advertise tax liens appropriately, plus a seemingly unlimited catch-all provision.

North Carolina courts have relied upon G.S. 105-394 to excuse a wide variety of procedural failures, including a transposed number in an assessment value,[19] the lack of notice in a discovery proceeding,[20] the inadvertent destruction of a listing form,[21] a drainage district's failure to levy special assessments in a timely fashion,[22] and, in *Morgan*, the unexplained failure to assess a property that was properly listed by the taxpayer.[23]

Left unanswered by these cases and by the statute itself is the question of when, if ever, could a defect in the property tax process be substantial enough so that it would invalidate a property tax procedure. Only once has a court identified a tax procedure that was "indispensable" and therefore

18. See *In re* Notice of Attachment and Garnishment Issued by Catawba County Tax Collector against Nuzum-Cross Chevrolet, Inc., 59 N.C. App. 332, 296 S.E.2d 499 (1982) ("If a time limit is to be put on the assertion of immaterial irregularities by taxing authorities under G.S. 105-394, that is a task for the General Assembly and not this Court.").

19. *Id*.

20. *Appeal of Pilot Freight Carriers, Inc*., 28 N.C. App. 400, 221 S.E.2d 378 (1976).

21. *In re* Dickey, 110 N.C. App. 823, 431 S.E.2d 203 (1993).

22. Northampton County Drainage Dist. No. One v. Bailey, 92 N.C. App. 68, 373 S.E.2d 560 (1988).

23. *Morgan*, 362 N.C. 339, 661 S.E.2d 733.

outside the scope of the immaterial irregularity provisions. In *Henderson County v. Osteen*,[24] the North Carolina Supreme Court found that the in rem foreclosure notice provisions in G.S. 105-375 were constitutionally necessary to satisfy due process concerns. The court invalidated a foreclosure sale that lacked the required notice, concluding that it would be unconstitutional for G.S. 105-394 to excuse the lack of notice.

It appears that unless a procedural failure interferes with a taxpayer's constitutional right to due process, G.S. 105-394 will excuse any and all failures in the administration of the property tax. In the authors' view tax officials should not be timid when applying this statute. All valid taxes should be assessed, levied, and collected, regardless of the type or duration of procedural failures made by a taxing unit. The only caveat is for taxing units to consider providing taxpayers with similar notices and appeal procedures when billing for back taxes under G.S. 105-394, as are available under G.S. 105-312.

When remedying procedural failures, local officials should keep in mind both the broad scope of G.S. 105-394 and the well-established legal principle that local governments do not "waive" their rights to appropriately enforce Machinery Act provisions simply due to past practices of inappropriate enforcement. For example, assume that for years a county only assessed new improvements to property when those improvements were 100 percent complete. This approach would violate the requirement in G.S. 105-309(c)(4) to list and tax all improvements over $100 in value "that have been acquired, begun, erected, damaged or destroyed since the time of the last appraisal." If the county realizes the error of its actions and begins to fully enforce both retroactively and prospectively, could a taxpayer rely on the county's past practice to avoid collection efforts? The answer is no. The concept of waiver or estoppel can be raised against private parties who fail to exercise their rights, but not against a government, which always maintains the right to enforce a valid law.[25] A tax jurisdiction should *never* hesitate to correctly apply the Machinery Act, regardless of how long it may have followed an erroneous approach.

As discussed earlier, G.S. 105-394 explicitly applies to the failure to list property, creating a potential conflict with the discovery provisions in G.S. 105-312. The benefits to a county that resolves an assessor's failure to list real property through G.S. 105-394 rather than G.S. 105-312 could be substantial. After *Morgan,* G.S. 105-394 permits a county to bill for back taxes *plus interest* from the date the taxes would have been delinquent if they had been levied in a timely fashion. Equally important, G.S. 105-394 allows a county to avoid the time limitation on discoveries and to bill for as many years of back taxes as are owed.

The authors and officials from the Property Tax Division of the North Carolina Department of Revenue believe that G.S. 105-394 should apply only to a *taxing authority's* procedural failures and not to a *taxpayer's* failures. This interpretation is consistent with the statute's general focus. With one possible exception, every example of immaterial irregularity provided in G.S. 105-394 involves a failure by tax officials, not taxpayers. The examples explicitly cover assessors, list takers, collectors, tax supervisors, and boards of equalization and review and, by implication, boards of county commissioners, county attorneys, and anyone in an administrative role that might direct a tax official to act in a manner contrary to the Machinery Act. The sole example that could be aimed at

24. 292 N.C. 692, 235 S.E.2d 166 (1977).

25. See *Henderson v. Gill*, 229 N.C. 313, 49 S.E.2d 754 (1948) (state not estopped from collecting sales taxes despite incorrect advice given to taxpayers by state revenue agents). Although last year's Small Business Protection Act, S.L. 2008-107 (H 2436), now provides limited relief for retailers who incorrectly collect certain sales taxes in reliance on past audit advice from the Department of Revenue, *Henderson* still stands for the proposition that a local government never waives its right to enforce a valid law.

a taxpayer is G.S. 105-394(2), "the failure to sign the affirmation required on the abstract," but in practice even that example would excuse the failure by the *assessor* to obtain the required signature from the taxpayer.

In contrast, G.S. 105-312 is aimed primarily at the *taxpayer's* failure to list, especially since the creation of permanent listing systems for real property. By removing assessors' failures from the discovery penalty provisions, G.S. 105-303(b) strongly implies that the discovery provisions are concerned more with the taxpayer than with the assessor. Consistent with this interpretation is the language in G.S. 105-312(c), which discusses the carrying forward of real property listings. This subsection mandates that the discovery notice and appeal procedures in subsection (d) be followed for real property, but it makes no mention of subsection (g) which contains the "current-year-plus-the-previous-five" limitation on back taxes for discovered property.[26]

After comparing the explicit language and the general focus of both G.S. 105-312 and G.S. 105-394, the authors believe it is reasonable to resolve the apparent overlap involving failures to list by concluding that each statute is aimed a different type of listing failure. G.S. 105-312 should be used to resolve taxpayers' listing failures, while G.S. 105-394 should be used to resolve assessor's failures.

How would this work in practice? Consider a slightly revised version of the Terry example, above.

Terry has owned a lot since 1985 on which he built a house in 1998. For this exercise assume that neither the house nor the land has ever been listed. The county learns of the omission in early 2009. It decides to create a discovery bill under G.S. 105-312 for the house and "regular" tax bills plus interest for the past tax years for the land under G.S. 105-394. The county limits its collection efforts on the land to the ten-year period described by G.S. 105-378. To simplify the interest calculations, assume that Terry pays all of the taxes, penalties, and interest in December of 2009. Table 2 indicates how the county will calculate Terry's total tax bill.

26. The *In re Dickey* opinion provides additional support for the conclusion that G.S. 105-312 is focused on taxpayer's failures and not assessor's failures. In that case, the court rejected the county's argument that the discovery provisions covered the assessor's failure to appropriately process the listing form submitted by the taxpayer. Instead, the court concluded that as used in G.S. 105-312 the verb "list" covered only the taxpayer's submission or failure to submit the required property information to the assessor. 110 N.C. App. at 827.

Table 2. Discovery Bill Plus Immaterial Irregularity Calculation

Year	Assessed Value ($)	Tax Rate	Tax Due ($)	Penalty Due ($)	Interest ($)	Total Due ($)
2009	Lot: 33,333	$0.60 per $100	200	None	None	200
	House: 166,666		1,000	100	None	1,100
2008	Lot: 33,333	$0.60 per $100	200	None	20.50	220.50
	House: 166,666		1,000	200	None	1,200
2007	Lot: 33,333	$0.60 per $100	200	None	38.50	238.50
	House: 166,666		1,000	300	None	1,300
2006[a]	Lot: 33,333	$0.60 per $100	200	None	56.50	256.50
	House: 166,666		1,000	400	None	1,400
2005	Lot: 25,000	$0.60 per $100	150	None	55.88	205.88
	House: 125,000		750	375	None	1,125
2004	Lot: 25,000	$0.60 per $100	150	None	69.38	219.38
	House: 125,000		750	450	None	1,200
2003	Lot: 25,000	$0.60 per $100	150	None	82.88	232.88
2002[a]	Lot: 25,000	$0.60 per $100	150	None	96.38	246.38
2001	Lot: 16,666	$0.60 per $100	100	None	73.25	173.25
2000	Lot: 16,666	$0.60 per $100	100	None	82.25	182.25
1999	Lot: 16,666	$0.60 per $100	100	None	91.25	191.25
Total			7,200	1,825	667.77	9,691.77

[a]Year in which general reappraisal took effect.

Using G.S. 105-394 to remedy the failure to list Terry's real property produces a substantially greater return for the county than would the conservative approach of resolving this listing failure under the discovery process. If the county had used the discovery process for Terry's land as well as for his house, it would have been limited to six years of taxes (the current year plus the previous five) and could not have charged interest or penalties. By relying on G.S. 105-394, the county increased its potential revenue by more than 15 percent

Does the fact that G.S. 105-394 creates more of a burden on taxpayers than does G.S. 105-312 for the failure to list real property argue against this approach? As the appeals court observed in *Morgan,* although it may seem unfair to allow a county to go back ten years to list, assess, and collect interest even when the taxpayer is not to blame, "[w]hether a county should be able to do so is, however, a question for the General Assembly and not for the courts."[27] Based on this observation and the plain language of the two statutes, the authors believe ample support exists for the use of G.S. 105-394 to remedy an assessor's failure to list real property.

The decision to employ G.S. 105-394 in these situations affects the board of county commissioners as well as the taxpayer. Prior years' taxes billed under G.S. 105-394 would not be subject to

27. *In re* Morgan, 186 N.C. App. 567, 576; 652 S.E. 2d 655, 660, (2007), *rev'd*, 362 N.C. 339, 661 S.E.2d 733, (2008)..

the board's unlimited discretion to compromise discovery bills. The only acceptable justifications for waiving taxes and interest billed pursuant to G.S. 105-394 would be the very limited circumstances defined by G.S. 105-381.[28]

What Does It All Mean?

Because the distinction between discovery and irregular immateriality is not always crystal clear, local tax officials in different jurisdictions may be applying different solutions to similar situations. In the hope of encouraging more consistency across the state, the authors offer four solutions for resolving common situations involving the recapture of back taxes.

Failure to List Improvements

Consider facts similar to a recent PTC case arising out of Henderson County.[29] Bell, a taxpayer, acquired his land in 1993 and began renovating and increasing the size of his residence in 1997 after obtaining all necessary zoning, building, septic and well permits from the appropriate county departments. He completed the remodeling effort in 1998 and received a certificate of occupancy for the new building from the county. However, Bell never directly informed the assessor of the improvements as required by G.S. 105-303(b). When the assessor learned of the improvements in 2005 while visiting the property for reappraisal purposes, the improvements became the subject of a discovery bill under the G.S. 105-312 discovery provisions. Bell was billed for 2005 taxes plus those for the previous five years, along with discovery penalties of 10 percent per year, all of which the county commissioners could have waived under their power to compromise. On appeal PTC can reject Bell's argument that the fact he obtained several permits and a certificate of occupancy from the county should have put the assessor on notice of the improvement and satisfied Bell's listing obligation.

Continuing with this example note that if Bell had listed the house and the assessor simply failed to assess it, as in *Morgan*, Bell would have faced a greater tax bill than he did under the discovery process, despite the fact he dutifully satisfied his listing obligations. In one sense the discovery provisions reward a taxpayer for *not* listing his or her property by providing for a six-year limitation on back taxes. See "Failure to Assess," below.

Failure to List Real Property

Assume a taxpayer purchases a subdivision lot in 2000, but the assessor fails to list the lot for taxation. When the assessor realizes the mistake in 2009, he or she should proceed under G.S. 105-394 and bill for all years in which the lot escaped taxation. Interest should be charged for each year as if the taxes had been billed in a timely fashion. No penalties would apply, and the taxes would be subject to release or refund only under G.S. 105-381.

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28. G.S. 105-381 permits a refund or release in three narrow circumstances: when the tax was "imposed through clerical error," when the tax was illegal, or when the tax was levied for an illegal purpose. The fact that a property originally may have escaped taxation due to a clerical error, such as a transposed assessment figure like in the *Nuzum-Cross* case, should not permit the release or refund of those back taxes under G.S. 105-381. In such a situation, rather than improperly *causing* the imposition of taxes, the clerical error improperly *prevented* the timely imposition of the taxes.

29. *In re* John D. Bell, 06 P.T.C. 21 (May 23, 2008).

Failure to Levy Annexed Property

Assume that in 2000, Blue Devil City annexed ten parcels previously situated in an unincorporated area of Carolina County. If in 2009 the Blue Devil City tax collector learns that only county taxes have been levied on the annexed parcels for the past nine years, how should the problem be resolved? Often, the standard response has been to create a discovery bill for the current year plus the previous five years, without interest or penalties. Other cities might view this situation as one that cannot be corrected retroactively and can only be resolved for 2009 and subsequent tax years under G.S. 105-287, a solution that would be even more harmful to city tax revenues and to the goal of an equitable distribution of the property tax burden.

However, this situation is not a failure to list subject to G.S. 105-312 or an appraisal issue subject to G.S. 105-287. Instead, this situation involves a levying and billing failure, often caused by a failure to update the annexed parcels' tax situs codes. Such a situation must be resolved using the immaterial irregularity provisions of G.S. 105-394. The municipal tax collector or, if the county bills and collects for the municipality, the assessor, should prepare bills for all tax years since the date of annexation, plus interest. No penalties would be apply, and the taxes would be subject to release or refund only under G.S. 105-381.[30]

Failure to Assess

Consider a situation similar to that in *Morgan*, where a homeowner appropriately lists a house he or she builds on a lot but for some reason the county does not assess the new house and continues to bill the taxpayer only for the value of the lot. When the assessor realizes the failure, how can he or she recapture past years' taxes on the house? This is an assessment failure, not a failure to list, meaning that the discovery provisions in G.S. 105-312 do not apply. The assessor should proceed as the Henderson County assessor did in *Morgan* and rely on the immaterial irregularity provisions of G.S. 105-394. The assessor should prepare bills for all tax years since the house was constructed, plus interest. No penalties would apply, and the taxes would be subject to release or refund only under G.S. 105-381.

Failure to Bill

Assume that a taxpayer lists his or her property, which is assessed accurately, but is mistakenly billed for only half of the appropriate tax levy. This continues for ten years before the tax collector notices the mistake. How can the assessor resolve the property that escaped taxation? Because this was not the result of a failure to list, G.S. 105-312 cannot apply. The collector should bill the taxpayer for all of the unbilled amounts, plus interest, under G.S. 105-394 and G.S. 105-348, which charges a taxpayer with notice of all taxes levied even if the taxpayer receives an incomplete bill or no bill at all. Interest would apply to the unbilled taxes from their original date of delinquency, despite the fact that the taxpayer diligently and timely paid the taxes that were actually billed. The county commissioners would not have the authority to compromise the retroactive bills.

30. Note that if the annexed property were in a county fire protection district, the municipality would be required to pay to the annexed property owners a "prorated fire protection payment," in essence a refund of the fire district taxes levied upon the annexed property owners by the county during the post-annexation period. *See* G.S. 69-25.15 and G.S. 153A-304.1. However, these payments would not affect the municipal tax collection process described above.

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