UNC SCHOOL OF GOVERNMENT

PROPERTY TAX BULLETIN NO. 169 | SEPTEMBER 2015

New Exclusion for Improvements to Residential and Commercial Real Property

Christopher B. McLaughlin

For years, home builders have been pushing to exempt their real property inventory from property taxes in the same fashion that personal property inventory held by traditional merchants and manufacturers is exempt under Sections 105-275(32a), (33), and (34) of the North Carolina General Statutes (hereinafter G.S.).

Home builders got their wish, sort of, for a few years. In 2010, the General Assembly enacted G.S. 105-277.1D, which created a deferral for taxes attributable to the construction of new, unsold residential homes.[1] That deferral expired in 2013.

Now, however, the exemption is back and stronger than ever. S.L. 2015-223, to be codified as G.S. 105-277.02, expands the now-repealed deferral. Instead of deferring taxes, the new statute excludes them entirely. And the exclusion covers non-structural improvements and commercial properties, neither of which fell within the scope of the old provision.

Below is an analysis of how the new exclusion affects residential and commercial improvements. This bulletin also addresses several questions that are not fully answered by the new law. The full text of the statute is reproduced in the appendix.

Residential Property

S.L. 2015-223 excludes from taxation the increase in property value attributable to

1. subdivision of a parcel for future residential construction;
2. non-building improvements (grading, streets, utilities, etc.) for future residential construction; and
3. construction of a new single-family home or duplex.

To be eligible, the property must continue to be owned by the builder, must not be occupied by a tenant, and must not be used as a model home or for any other commercial purpose. Because the exclusion is aimed at new construction, renovations to an existing residence cannot qualify.

The exclusion is limited to three years from the date the property was first listed by the builder. Remember that all improvements begun in the previous calendar year must be listed on

Christopher B. McLaughlin is a School of Government faculty member who specializes in local taxation.

1. This deferral was created by S.L. 2009-308 and modified by S.L. 2010-140.

© 2015 School of Government. The University of North Carolina at Chapel Hill

January 1 regardless of the stage of completion. See the discussion under "Duration," below, for more details on this three-year limitation.

The builder must submit an exclusion application *annually* under the general application provisions in G.S. 105-282.1. The deadline for applications under that statute is the end of the listing period (usually January 31), but late applications may be accepted for good cause up to the close of the calendar year. Each local government is free to define "good cause" as it deems appropriate, which means that some local governments may be more lenient with late applications than others. This issue is discussed in more detail under "Late Application," below.

The new exclusion differs in some important ways from the old deferral for homebuilders' inventory in G.S. 105-277.1D. First and most importantly, the taxes attributable to the improvements are not just deferred, they are waived entirely. Second, the new exclusion covers activities undertaken in anticipation of residential construction (such as the subdivision of a parcel and grading, streets, and utility work) in addition to the actual construction. Third, a certificate of occupancy need not be issued for the exclusion to apply to a new residential structure—even partially completed structures can qualify for the residential exclusion. Fourth, the exclusion apparently does not apply to condominium or townhouse buildings that will house more than two families. The bill extends the exclusion to a "single family residence or a duplex," which seems to eliminate structures that will house three or more family units.

Commercial Property

Unlike residential property, commercial property may benefit from the new exclusion only for the increase in value attributable to subdivision or non-structural improvements, such as grading, streets, and utilities. Any improvement that requires the issuance of a building permit terminates eligibility for the exclusion.

In some respects, this new exclusion is an extension of the relatively new site infrastructure deferral under G.S. 105-277.15A that was intended to encourage landowners to prepare farmland for industrial or manufacturing development.[2] Although very few, if any, developers have taken advantage of that deferral, it is likely that more developers will be interested in this new exclusion.

Another difference between the provisions for residential and commercial property is the maximum length of the exclusion. Commercial property may receive the exclusion for up to five years after the improved property was first listed. The exclusion for residential property is limited to three years.

Table 1 summarizes the different treatment of residential and commercial property under the new law.

2. This deferral was created by S.L. 2013-130 and modified by S.L. 2014-39.

© 2015 School of Government. The University of North Carolina at Chapel Hill

Table 1. Summary of New Exclusion Provisions

	Residential Property	Commercial Property
Applies to Increase in Value Attributed to . . .	Subdivision Non-structural improvements New single-family homes or duplexes	Subdivision Non-structural improvements
Maximum Duration	Three years from first listing	Five years from first listing
Disqualifications	Sale Removal from market Lease Commercial use (as model home, for example)	Sale Removal from market Issuance of building permit

Builder

The new exclusion applies only to property owners who qualify as "builders." That term is defined by G.S. 105-273(3a) to mean "a taxpayer engaged in the business of buying real property, making improvements to it, and reselling it."

Many times it will be obvious when a property owner satisfies this definition: large, well-known developers and builders will often be the taxpayers applying for the new exclusion.

But a property owner need not be an established developer or builder to qualify. First-time builders can also earn the exclusion, so long as they can demonstrate that they are now in the business of buying, improving, and reselling real estate. The fact that a particular property owner has never before bought and sold real property should not automatically disqualify that owner from obtaining the exclusion. The tax office simply needs to see some evidence that the taxpayer intends to improve and resell the property. The evidence might be advertisements by the property owner to sell the to-be-constructed home or real estate broker and contractor licenses held by the property owner. So long as the applicant provides some evidence of qualifying as a builder under the new law, the county should assume that the applicant is eligible. If later information disproves that assumption (perhaps the property owner never lists the property for sale and instead uses it as his or her permanent residence), the county can retroactively remove the inappropriately awarded exclusion using the discovery process. See "Removing the Exclusion Retroactively," below.

Duration

The duration of the new exclusion is tied to the date the improved property was "first subject to be listed." While the statute is not entirely clear, it appears that residential property that is improved in stages may qualify for multiple exclusions with different three-year limitations.

© 2015 School of Government. The University of North Carolina at Chapel Hill

Consider this hypothetical timeline for Parcel A:

February 2016:	Dave Developer purchases Parcel A for $100,000
April through June 2016:	Dave subdivides Parcel A into ten lots, grades the property, and lays out streets
January 2017:	Carolina County increases the tax appraisal of Parcel A from $100,000 to $200,000 due to subdivision and non-structural improvements
March through October 2017:	Dave builds new houses on each of the ten lots
January 2018:	Carolina County increases the tax appraisal from $200,000 to $4,000,000 ($400,000 per lot) due to new construction

Dave could apply for two separate exclusions on this property with two separate three-year durations.

The first exclusion would be for the subdivision and non-structural improvements that increased Parcel A's tax appraisal from $100,000 to $200,000 for the 2017 tax year. This exclusion would apply for the 2017, 2018, and 2019 tax years (assuming Dave did not sell the property to a residential owner before then). Dave would be taxed on the original $100,000 appraisal for those tax years. Absent any other changes, the property would be taxed at the full $200,000 appraisal beginning with the 2020 tax year.

The second exclusion would be for the new house construction that increased Parcel A's appraisal from $200,000 to $4,000,000 for the 2018 tax year. The exclusion would run for the 2018, 2019, and 2020 tax years (assuming Dave did not sell or lease the property before then). Absent any other changes, the property would be taxed at the full $4,000,000 appraisal beginning with the 2021 tax year.

Let's assume that Dave applies for and receives both exclusions. As of January 1, 2021, he still owns all of Parcel A. Here are the appraisal values at which Dave should be taxed for each year he has owned the property:

2016:	$100,000 (no exclusions)
2017:	$100,000 (first exclusion, $100,000)
2018:	$100,000 (first exclusion, $100,000; second exclusion, $3,800,000)
2019:	$100,000 (first exclusion, $100,000; second exclusion, $3,800,000)
2020:	$200,000 (second exclusion, $3,800,000)
2021:	$4,000,000 (no exclusions)

Each exclusion runs for three years from the first tax year for which the improvement in question was listed by the taxpayer. Note that this approach will require detailed and accurate record-keeping by the assessor and tax collector to make sure that the correct value is taxed for each year. This record-keeping will become more onerous if, as is likely, some of the lots are sold during the duration of one or both of the exclusions. After a lot is sold to a residential owner, that lot should be taxed at the full tax appraisal without any exclusions ($400,000 in the above example).

© 2015 School of Government. The University of North Carolina at Chapel Hill

For an example of an even more complex situation in which one builder sells a partially improved property to a second builder, see "Sale of Residential Property by Developer to Builder," below.

Effective Date

For both residential and commercial properties, the new exclusion applies to improvements made on or after July 1, 2015, and to taxes levied for tax years beginning on or after July 1, 2016. Those restrictions eliminate previously existing unsold residential and commercial improvements from eligibility for the exemption.

As discussed in the examples below, improvements made on or after July 1, 2015, will qualify for the exclusion. Improvements made prior to July 2015 will not. This may lead to situations in which only part of a new structure will qualify. Assessors may need to value a new residential structure at the percentage of completion as of July 1, 2015, and exclude only the tax attributable to the value of the construction completed after July 1. The value of the construction completed prior to July 1, 2015, should remain taxable even if the property otherwise qualifies for the exclusion.

Examples and Analysis

The statute leaves several important questions unanswered. May multiple developer/builder owners of the same property benefit from the exclusion? If so, how should the exclusion be calculated? May a builder reside in a new residential structure that is on the market and still receive the exclusion? Do homeowners who buy new homes from builders benefit from the builders' exclusion under this provision?

Here are a few examples to help answer these questions.

Subdivisions

The deferral covers activities in anticipation of future construction, including subdivision of a parcel, as in the following example.

In mid-2016, Howie Homebuilder buys a 100-acre parcel in rural Carolina County. After obtaining the required permits, Howie subdivides the land into fifty home sites, creates streets, and lays the groundwork for utilities. In late 2016, the assessor visits the property and, in light of Howie's subdivision and improvements, increases the tax appraisal of the property from $1 million to $1.8 million. Assuming that Howie submits a timely application, the taxes on the $800,000 of value that are attributable to the work done by Howie will be excluded for 2017 taxes. That exclusion will continue through the 2019 tax year unless Howie sells any or all of the property or uses it for a commercial purpose other than future sale as residences. Individual lots sold to homeowners will be taxed at full value. (See "Sale to Owner Prior to July 1," below, for more on how the property will be taxed in the year it is sold to a homeowner.)

2015 Residential Construction

Actual construction of residential structures is covered, but construction of commercial structures is not. Consider the example below.

© 2015 School of Government. The University of North Carolina at Chapel Hill

In early 2015, Bob Builder purchases a lot in Carolina County, demolishes the existing house on that lot, and builds a new single-family house. The house is completed but unsold as of January 1, 2016. The assessor appraises the new house at $400,000 and the land at $20,000. Immediately after reading a *Coates' Canons* blog post about a new exclusion for new residential construction, Bob runs down to the assessor's office and submits an exclusion application for 2016. *Some or all* of that $400,000 value should be excluded for 2016 through 2018 unless Bob sells the house or rents it out or uses it for another purpose.

Why the wishy-washy "some or all"? Because S.L. 2015-223 applies only to "improvements made on or after July 1, 2015." Had Bob built the house in 2014, it would not qualify for a 2016 exclusion even if it remained unsold. For 2015 construction, some or all of the house's value should be eligible for the exclusion. But it may be difficult to know what work was done after July 1, 2015.

The correct approach in this situation is for the assessor to demand records from the builder to determine what work was done from July 1, 2015, to December 31, 2015, and then exclude only the value attributable to that post-July 1 work. If the house was entirely complete by July 1, 2015, then none of the house's tax value should be excluded. If the house was 20 percent complete as of July 1, then only 80 percent of the value (the post-July 1 work) should be excluded. If construction of the house did not begin until on or after July 1, then the entire value of the house should be excluded.

Delayed Eligibility

Some residential construction may not immediately be eligible for the exclusion if it is used for a commercial purpose, as in the example below.

In 2016, Dave Developer builds twenty new houses in a new Carolina County subdivision. He applies for and receives the exclusion for nineteen of those houses that remain unsold as of January 1, 2017. The twentieth new house, however, is not eligible for the exclusion because Dave is using it as a model home to attract buyers.

As of January 1, 2018, Dave is no longer using the twentieth house as a model home and submits an application to cover the former model home. That house should be eligible for the exclusion for the years 2018 and 2019 if Dave does not sell or rent or otherwise use the house for commercial purposes. The house will benefit from only two years of exclusion because S.L. 2015-223 limits the exclusion to three years from the date the improvement was first listed. Dave first listed the house in 2017, when it was used as a model home. That leaves only two years, 2018 and 2019, for the exclusion to apply.

Sale of Residential Property by Developer to Builder

One important question left unanswered by this new law is whether multiple taxpayers may benefit from the exclusion on the same property. The answer is likely yes, but each builder/owner may benefit only from an exclusion for improvements made by that builder/owner. Subsequent owners may not benefit from exclusions for improvements made by previous owners. Consider the following example.

Dave Developer purchases a 50-acre parcel in 2016 that was appraised as acreage for $100,000. He immediately subdivides the property into fifty lots and begins grading and preparing the property for streets. As a result, the property is reappraised as subdivided lots and the property's tax value rises to $500,000, or $10,000 per lot. Dave applies for the exclusion in January 2017 and receives it for the 2017 tax year, meaning that the property will be taxed at the acreage value of $100,000 (the pre-subdivision and pre-improvement tax value).

© 2015 School of Government. The University of North Carolina at Chapel Hill

In July 2017, Dave sells all fifty lots to Bob Builder. Bob immediately begins building houses on the lots. By January 1, 2018, Bob has completed construction of a house on each lot. The tax value of the fifty improved lots with the houses on them is now $400,000 per lot, or $20,000,000 for the entire 50-acre parcel. Bob submits an exclusion application for the 2018 tax year.

Is Bob eligible for the new exclusion? If so, what is the taxable value of the fifty improved lots now owned by Bob?

The author and experts at the Department of Revenue agree that the best interpretation of the new law is one that permits multiple owners to benefit from exclusions on the same property. In this example, Bob qualifies because he is a "builder" as defined by the new law. The law does not exclude one builder from eligibility due to the fact that another builder previously owned and made improvements to the property.

However, a new builder/owner may not benefit from an exclusion attributable to improvements made by a previous builder/owner. The new statute limits the exclusion to improvements made by "the builder," not "a builder," meaning that only improvements made by the current builder/owner can qualify.

In this example, Bob may not benefit from the exclusion for the subdivision and non-structural improvements made by Dave. But once Bob adds his own structural improvements (the new houses) to the property, he should receive his own exclusion for the increased appraisal relating to that construction.

The transfer of the property from one builder to another terminates any existing exclusions but does not eliminate the opportunity for additional exclusions if the new builder makes new improvements to the property. As is the case with improvements added in stages by a single developer, new exclusions earned by the new owner will be subject to their own three-year limitation based on the first date they were listed. They will not be tied to the three-year limitation applicable to previously existing exclusions originally earned by a prior owner.

Here are the correct taxable values for the property as it is improved in stages and transferred from one builder to another:

2016:	$100,000 (no exclusion)
2017:	$100,000 (first exclusion, for the subdivision and non-structural improvements made by Dave, $400,000)[3]
2018:	$500,000 (Dave's exclusion terminates due to sale to Bob; new exclusion, for the new houses constructed by Bob, $19,500,000)
2019:	$500,000 (exclusion for the new houses constructed by Bob, $19,500,000)
2020:	$500,000 (exclusion for the new houses constructed by Bob, $19,500,000)
2021:	$20,000,000 (no exclusion)

3. Note that the exclusion remains on the property for the entire year because Dave sold the property to Bob after July 1. If Dave had sold the partially excluded property to Bob prior to July 1, 2017, then the property would have been taxed in Bob's hands at its full $500,000 appraisal. See G.S. 105-285(d) and the next example.

© 2015 School of Government. The University of North Carolina at Chapel Hill

Of course, if Bob were to sell any of the new homes to a residential owner prior to 2021, those lots would lose any remaining exclusions and would be taxed at the full appraisal of $400,000 each.

Sale to Owner Prior to July 1

G.S. 105-285(d) applies to the new exclusion in the same way that it applies to all other real property exemptions and exclusions. When real property is transferred from an exempt or partially exempt owner to a taxable owner prior to July 1, that property is taxable for the entire year as if the taxable owner owned the property as of January 1. This statute may produce some unpleasant surprises for homeowners who purchase property that was receiving the new residential property improvement exclusion in the first half of the calendar year. Consider the following example.

As of January 1, 2017, Bob Builder owns Parcel A, on which he built a new house in 2016. Bob applies for and receives the new residential property improvement exclusion for 2017 taxes. Thanks to the exclusion, Bob is taxed at Parcel A's pre-improvement value of $10,000 rather than at the full $400,000 tax value of the parcel with the new house.

In March 2017, Bob sells Parcel A to Tommy TarHeel, who plans to live there. Prior to the closing, Tommy's attorney contacts the county tax office to learn what the taxes are on Parcel A. The county tax office informs the attorney that due to the exclusion applied to the property, the only taxes on Parcel A for 2017 are the taxes owed on the reduced $10,000 value. Tommy and Bob apportion the taxes owed on the $10,000 at closing.

Tommy is thrilled with his new home. He is less thrilled when the county later sends him a 2017 tax bill for Parcel A based on the full $400,000 value. Tommy calls the county tax office in a rage, demanding to know why they are taxing him on a $400,000 value when they told his attorney back in March that the 2017 tax value for Parcel A was only $10,000. The tax office patiently explains G.S. 105-285(d) to Tommy, who refuses to listen, utters several choice epithets, and hangs up in a huff.

Although the tax office correctly calculated the taxes on Parcel A for 2017, it could have better communicated the potential impact of G.S. 105-285(d). Attorneys who obtain tax information on properties receiving the exclusion should be reminded of how G.S. 105-285(d) might affect the new owners' tax bills for the coming fiscal year. County tax websites might need to be reconfigured so that they clearly indicate the full taxable value of a property receiving this exclusion and the fact that the property will be taxed at the higher value if it is sold by the builder prior to July 1.

What if Tommy' s attorney had obtained from the tax office a written "statement of amount of taxes due" under G.S. 105-361 that certified only the taxes on Parcel A's reduced $10,000 value? Those statements are binding on the tax office, and the lien for any taxes mistakenly omitted from the statement is waived. Tommy might argue that the failure to include on that statement the taxes on the full $400,000 value for Parcel A waived the tax lien for those additional taxes.

Unfortunately for Tommy, his argument should not be a winning one. At the time that Tommy's attorney obtained the statement of taxes owed on Parcel A, all that was owed were the taxes on the reduced $10,000 value of the property when it was held by Bob Builder. Those were the only taxes that were *required* to be included on the statement. The potential increase in taxes that might occur after a sale to Tommy did not need to be included on the statement,

© 2015 School of Government. The University of North Carolina at Chapel Hill

and therefore the lien for the taxes was not waived under G.S. 105-361.[4] Once the new exclusion takes effect, counties should make it their practice to share information about the potential tax increase with buyers and their agents and attorneys. Their failure to do so, however, will not trigger any consequences under G.S. 105-361.

If the sale to the homeowner occurs on or after July 1, then G.S. 105-285 is not a concern. The homeowner will be taxed for the current fiscal year at the reduced value thanks to the exclusion earned by the builder. The exclusion will be removed for the next fiscal year and the property will be taxed at its full value.

Builder Lives in Newly Constructed Home

If a tenant occupies a new house, that house is not eligible for the exclusion. But what if the owner/builder occupies the house, as in the example below?

Assume that Phil Flipper buys Parcel B, demolishes the home that exists on the lot, and builds an entirely new home, which he immediately lists for sale (as he looks for another lot to flip). While the new home is on the market, Phil and his family live there. Is Parcel B eligible for the new exclusion?

Parcel B is eligible, because the statute disqualifies a residential property if it is "occupied by a tenant" but says nothing about occupancy by the builder who owns the property. The author reads *occupied by a tenant* to mean *occupied by any party other than the builder/owner*. If the builder occupies the house, that is not the same as a tenant occupying the house.

Of course, the house must stay on the market to be eligible for the exclusion. Phil cannot take the house off of the sale market for the period he lives there and still benefit from the exclusion. And remember that the exclusion does not apply to renovations; if a house flipper is simply renovating old houses rather than demolishing them entirely and building new ones, the exclusion cannot apply.

Late Application

Applications for this new exclusion are initially due by the close of the listing period. But, as this example demonstrates, taxpayers may apply as late as December 31 and still receive the exclusion.

In mid-2016, Dave Developer buys a 100-acre parcel for $500,000. He immediately subdivides it into fifty lots and begins laying out streets for a residential development. Unaware of the new exclusion, Dave fails to submit an application during the listing period in January 2017.

In August 2017, Dave receives a tax bill for the 100-acre parcel with a total tax value of $1,500,000. The value increased from $5,000 per lot to $15,000 per lot due to the subdivision and improvements Dave made.

Shocked at this new tax value, Dave talks to his developer friends and learns of the new exclusion. In late August, he submits an application for the 100-acre parcel. Is Dave entitled to the exclusion?

---

4. In contrast, deferred taxes such as those created by the present use value exclusion (G.S. 105-277.3) or the circuit breaker exclusion (G.S. 105-277.1B) must be included on G.S. 105-361 statements, because they are a lien on the property despite the fact that they are not yet due or collectible. G.S. 105-361(a). The taxes excluded under the new law are not deferred, meaning that they need not be listed on a G.S. 105-361 statement (although as indicated above, best practice is to give some warning to homeowners who plan to purchase property that was receiving the new exclusion prior to July 1).

© 2015 School of Government. The University of North Carolina at Chapel Hill

Dave may be entitled to the exclusion. G.S. 105-282.1 sets the end of the listing period as the deadline for all exemption and exclusion applications other than those for the three "residential property tax relief" programs—the elderly and disabled exclusion, the disabled veterans' exclusion, and the circuit breaker exclusion. Applications for those three exclusions are due June 1.

However, that application statute also permits late applications through the end of the calendar year if the governing board or the board of equalization and review approves the application for good cause. The statute doesn't define "good cause," meaning that each local government may define that term as it wishes. A local government could choose to accept all late applications, or no late applications, or only those late applications for which the taxpayer has a really good excuse ("I was kidnapped by rabid Blue Devil fans at halftime of the last Duke-UNC game and held for ransom in the basement of Cameron Indoor Stadium until last week").

What does this mean for Dave? The county assessor is obligated initially to deny the application and to inform Dave that he can appeal that decision to the board of equalization and review (if the board is still in session) or to the board of county commissioners. The appropriate board can then decide whether Dave demonstrates the necessary good cause to justify a late application. If the board agrees to accept the late application, the assessor has no choice but to review the merits of Dave's application and grant him the exclusion if he qualifies.

If a local government board is lenient with late exclusion applications, it is possible that the local government's tax base could take some late hits thanks to the new exclusion. Depending on the size of the new development involved, a late exclusion of newly improved property could eliminate a substantial amount of tax value for up to three years.

Discovery of New Residential Construction

Standard discovery rules apply to property that might be eligible for the exclusion but was never listed by the builder. Consider the following example.

Howie Homebuilder purchases an empty lot in 2016 with a tax value of $20,000 and constructs a new house that is complete by January 1, 2017. However, he fails to list the construction with the county. In March 2018, the county sends Howie a discovery notice with a $400,000 appraisal of the new house, which is unoccupied and still on the market. Howie immediately submits an application for the residential improvement exclusion. Is Howie entitled to the exclusion? If so, for which tax years?

If a discovery were not involved, Howie's exclusion application would be too late for the 2017 tax year because it was not submitted by the end of the 2017 calendar year.[5] However, when property is discovered, the taxpayer has the right to appeal the value, ownership, situs, taxability, or any other issue related to the discovered property so long as he or she does so within thirty days of the discovery notice.[6] Howie may submit an exclusion application for the house covering the 2017 and 2018 tax years.

Based on the facts above, Howie should qualify for the exclusion for both 2017 and 2018. His tax value for the lot for both years should be $20,000, the pre-improvement value. He is still subject to a discovery penalty for his failure to list the lot. That penalty will be 20 percent of the 2017 taxes on the $20,000 value and 10 percent of the 2018 taxes on the $20,000 value. Interest

5. G.S. 105-282.1(a1).
6. G.S. 105-312(d).

© 2015 School of Government. The University of North Carolina at Chapel Hill

will not begin on the discovery bill until January 6, 2019, because the entire discovery bill is considered part of the 2018 tax levy.[7]

Removing the Exclusion Retroactively

The definition of "discovery" in G.S. 105-273(6a) includes "property that has been granted an exemption or exclusion and does not qualify for the exemption or exclusion." If the tax office learns that a property has received the new exclusion inappropriately, it must solve the problem using the discovery process.

Assume that Howie Homebuilder applies for and receives the new exclusion for a newly constructed residence at 123 Main Street. Howie receives the exclusion for 2017 and 2018. In mid-2018, the tax office learns that Howie has been renting the property to a tenant since early 2017.

Because occupancy by a tenant disqualifies a property from the exclusion, 123 Main Street should not have received the exclusion for 2018. The county should use the discovery process to bill and collect the omitted taxes on the full tax value of 123 Main Street for 2018, plus a 10 percent penalty.

The 2017 exclusion was appropriate assuming that the tenant was not occupying the house as of January 1, 2017, the listing date for 2017 taxes. The fact that the house was occupied by a tenant later in 2017 does not affect the 2017 exclusion; it simply disqualifies the house for the 2018 exclusion.

Discoveries are limited to the current tax year and the previous five tax years. If the tax office does not learn of an inappropriately awarded exclusion within that time limitation, it will be too late to correct the problem.

Assume the same facts as above. Howie rents his newly constructed home to a tenant from mid-2017 to 2020. He receives the exclusion for new residential construction for 2017, 2018, and 2019. In 2025, the tax office learns that Howie was renting his property during the tax years he was receiving the exclusion.

It would be too late for the county to use the discovery process to recapture the taxes that were inappropriately excluded. The earliest year the county could apply a discovery to Howie's property would be the 2020–2021 tax year (five years prior to the tax year that opens in the calendar year of the discovery). Because Howie did not receive the exclusion in the 2020 tax year, there is nothing for the county to discover.

Missed Application

Builders can lose the exclusion temporarily by failing to submit an annual application, as in the example below.

Bob Builder purchases an empty lot in 2016. Construction of the new house he builds on the lot is complete by January 1, 2017. Bob applies for and receives the new exclusion for the increased 2017 tax value due to the new home. The home remains on the market unsold for the next year, but Bob forgets to submit an exclusion application for the 2018 tax year. He is taxed for

7. G.S. 105-312(i). Regardless of what years taxes are included in a discovery bill, for collection purposes the entire bill is considered part of the tax levy for the fiscal year that opens in the calendar year of discovery. In this example, the discovery bill was issued in calendar year 2018, meaning that it will be collected as part of the 2018–2019 tax levy. Those taxes become delinquent and accrue interest on January 6, 2019.

© 2015 School of Government. The University of North Carolina at Chapel Hill

the full appraised value. In 2019, Bob still owns the house and remembers to submit an exclusion application. Is Bob permitted to receive the exclusion for 2019 after failing to apply in 2018?

Yes, Bob is permitted to receive the exclusion for 2019. Failure to submit an application eliminates the exclusion for that tax year, but it does not affect the property's eligibility for an exclusion in the following year. Nor does it affect the maximum duration of the exclusion. In Bob's situation, the last year for which he could receive the exclusion would be 2019, because that is the third year after he first listed the improved property (2017). Bob will have received the exclusion for only two of those three years, but that fact does not extend the exclusion for another year.

© 2015 School of Government. The University of North Carolina at Chapel Hill

Appendix. Session Law 2015-223

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2015

SESSION LAW 2015-223
HOUSE BILL 168

AN ACT TO EXEMPT FROM PROPERTY TAX THE INCREASE IN VALUE OF REAL PROPERTY HELD FOR SALE BY A BUILDER, TO THE EXTENT THE INCREASE IS ATTRIBUTABLE TO SUBDIVISION OR IMPROVEMENTS BY THE BUILDER.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-273(3a) is reenacted and reads as rewritten:

"(3a) "Builder" means a taxpayer ~~licensed as a general contractor under G.S. 871 and~~ engaged in the business of buying real property, making improvements to it, and then reselling it."

SECTION 2. Article 12 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"§ 105-277.02. Certain real property held for sale classified for taxation at reduced valuation.

(a) Residential Real Property. – Residential real property held for sale by a builder is designated a special class of property under authority of Article V, Sec. 2(2) of the North Carolina Constitution. For purposes of this subsection, "residential real property" is real property that is intended to be sold and used as an individual's residence immediately or after construction of a residence, and the term excludes property that is either occupied by a tenant or used for commercial purposes such as residences shown to prospective buyers as models. Any increase in value of this classified property attributable to subdivision of, improvements other than buildings, or the construction of either a new singlefamily residence or a duplex on the property by the builder is excluded from taxation under this Subchapter as long as the builder continues to hold the property for sale. In no event shall this exclusion extend for more than three years from the time the improved property was first subject to being listed for taxation by the builder.

(b) Commercial Property. – Commercial real property held for sale by a builder is designated a special class of property under authority of Article V, Sec. 2(2) of the North Carolina Constitution. For purposes of this subsection, "commercial real property" is real property that is intended to be sold and used for commercial purposes immediately or after improvement. Any increase in value of this classified property attributable to subdivision of or other improvements made to the property, by the builder, is excluded from taxation under this Subchapter as long as the builder continues to hold the property for sale. The exclusion authorized by this subsection ends at the earlier of the following:

(1) Five years from the time the improved property was first subject to being listed for taxation by the builder.

(2) Issuance of a building permit.

(3) Sale of the property.

(c) The builder must apply for any exclusion under this section annually as provided in G.S. 105-282.1.

(d) In appraising property classified under this section, the assessor shall specify what portion of the value is an increase attributable to subdivision or other improvement by the builder."

© 2015 School of Government. The University of North Carolina at Chapel Hill

SECTION 3. This act is effective for taxes imposed for taxable years beginning on or after July 1, 2016, and applies to subdivision of or other improvements made on or after July 1, 2015.

In the General Assembly read three times and ratified this the 13th day of August, 2015.

s/ Philip E. Berger
President Pro Tempore of the Senate

s/ Tim Moore
Speaker of the House of Representatives

s/ Pat McCrory
Governor

Approved 2:22 p.m. this 18th day of August, 2015

©2015 School of Government. The University of North Carolina at Chapel Hill. This document may not be copied or posted online, nor transmitted, in printed or electronic form, without the written permission of the School of Government, except as allowed by fair use under United States copyright law. For questions about use of the document and permission for copying, contact the School of Government at sales@sog.unc.edu or call 919.966.4119.

To browse a complete catalog of School of Government publications, please visit the School's website at www.sog.unc.edu or contact the Bookstore, School of Government, Campus Box 3330, Knapp-Sanders Building, UNC-Chapel Hill, Chapel Hill, NC 27599-3330; email sales@sog.unc.edu; telephone 919.966.4119; or fax 919.962.2709.