UNC SCHOOL OF GOVERNMENT
THE UNIVERSITY of NORTH CAROLINA at CHAPEL HILL

PROPERTY TAX BULLETIN NUMBER 149 | AUGUST 2009

The Collection of Deferred Taxes

Christopher B. McLaughlin

Beginning with the creation of the present-use value classification in the early 1970s, the North Carolina General Assembly has relied increasingly upon deferred property tax programs when seeking to provide tax relief for the state's property owners. As of this publication, there exist eight different deferred property tax programs affecting such diverse property as working waterfronts, wildlife conservation land, and new homes yet to be sold by their builders. Although these programs differ greatly in eligibility requirements and operation, in 2008 the General Assembly codified uniform collection procedures for all deferred taxes. This bulletin explains these procedures and answers some frequently asked questions about deferred taxes.

1. What are deferred taxes?

Deferred taxes are taxes that, because of an exclusion, are not due and payable in the year in which they are levied but may become due and payable when the underlying property is no longer eligible for the applicable exclusion. As of the end of the 2009 legislative session, the following eight North Carolina General Statutes (hereinafter G.S.) address property tax exclusions that could give rise to deferred taxes:

1. G.S. 105-275(29a), a historic district property held as a future site of a historic structure;
2. G.S. 105-277.1B, the property tax homestead circuit breaker;
3. G.S. 105-277.1D, home builders' inventory (for tax years 2010 through 2012);
4. G.S. 105-277.4(c), present-use value property;
5. G.S. 105-277.14, working waterfront property;
6. G.S. 105-277.15, wildlife conservation land (beginning in the 2010 tax year);
7. G.S. 105-278(b), historic property; and
8. G.S. 105-278.6(e), nonprofit property held as a future site of low- or moderate-income housing.

Christopher B. McLaughlin is a School of Government faculty member who specializes in local taxation. McLaughlin is writing a text to update and replace William A. Campbell's seminal work, *Property Tax Collection in North Carolina*, the most recent edition of which was published more than a decade ago. This bulletin represents one chapter of the new tax collection text, which will be published in book format when completed.

Determining eligibility for these exclusions is the responsibility of the assessor, not the tax collector, and is beyond the scope of this bulletin. For detailed discussion concerning many of these exclusions, please see Shea Riggsbee Denning, *A Guide to the Listing, Assessment, and Taxation of Property in North Carolina* (Chapel Hill, NC: UNC School of Government, 2009).

2. How are deferred taxes collected?

While details vary from exclusion to exclusion, in 2008 the General Assembly codified a number of uniform collection procedures for all eight deferred tax programs.

One statute, G.S. 105-277.1F, includes several uniform deferred tax rules for due dates, interest, and liens. First, deferred taxes become due and payable on the day the property loses eligibility for the relevant exclusion as a result of a disqualifying event. Each exclusion defines "disqualifying event" differently, but for the most part the term references a change in ownership or use of the underlying property. (See Question 3 for more details on disqualifying events.) Second, interest accrues on all deferred taxes as if they had been due and payable in year of levy. For example, 2009 taxes deferred under the circuit breaker exclusion will accrue interest on January 6, 2010—the date of delinquency for all 2009 taxes—regardless of when these deferred taxes become due and payable.[1] Third, the tax for the fiscal year that begins in the calendar year of the disqualifying event is calculated as if the property were never eligible for the exclusion that year. For example, if a disqualifying event occurs at any point in 2010, no taxes would be deferred for 2010 and the full tax bill would be due and payable as usual. The 2010 taxes would be due on September 1 and delinquent on January 6, 2011. Fourth, and finally, deferred taxes remain a lien on the underlying property until they are either satisfied through payment or excused by operation of the applicable exclusion.

Another statute adopted in 2008, G.S. 105-365.1, creates uniform rules for the use of enforced collection remedies for all taxes, including deferred taxes. With one exception, deferred taxes become delinquent and subject to enforced collection remedies immediately upon the occurrence of a disqualifying event.[2] That said, most tax collectors would likely first send a bill for the deferred taxes to the responsible party before proceeding with a levy, attachment, or foreclosure.

Consider the application of these uniform rules to the following scenario. A taxpayer begins participating in the present-use value program for agricultural property in 2009 and sells the

---

1. One of several unique aspects of the circuit breaker is that interest can accrue indefinitely on deferred taxes because a "gap" in eligibility may arise without a disqualifying event. A participating taxpayer may lose circuit breaker eligibility due to an increase in income or a failure to submit the annual application, but because no disqualifying event occurs, the deferred taxes do not become due and payable. This gap could continue for years, meaning that the interest owed when a disqualifying event occurs could be substantially larger than the principal taxes. For a detailed discussion regarding eligibility gaps and other unique aspects of the circuit breaker, please see Christopher B. McLaughlin, "The Homestead Circuit Breaker: Implications for Local Tax Offices," *Property Tax Bulletin No. 145* (October 2008), *available at* www.sog.unc.edu/pubs/electronicversions/pdfs/ptb145.pdf.

2. N.C. Gen. Stat. (hereinafter G.S.) § 105-365.1(a). The lone exception exists under the circuit breaker when the disqualifying event is the death of the owner. In such a situation, the deferred taxes do not become delinquent until the first day of the ninth month after the date of death. Presumably this delay exists so that the estate can be resolved before enforced collection remedies may begin.

property to a developer—a disqualifying event—in March 2015. The present-use value exclusion provides that the three most recent years of deferred taxes are due and payable upon the occurrence of a disqualifying event. The deferred taxes plus interest from 2012, 2013, and 2014 would become due and payable and would constitute a lien on the property until satisfied. Interest would have begun to accrue in January 2013 for the 2012 deferred taxes, in January 2014 for the 2013 deferred taxes, and in January 2015 for the 2014 deferred taxes. Enforced collection actions could begin immediately for both the principal taxes and interest. Taxes for 2015 would be calculated with no deferral, due on September 1, 2015, and delinquent in January 2016.

The deferred taxes from 2009, 2010, and 2011 would never become due and payable and would no longer be a lien on the property. This is true of all deferred taxes beyond those that are made due and payable by a disqualifying event. (Please see Table 1, below, for a summary of which deferred taxes become due and payable under each exclusion.) Although these "uncollectible" deferred taxes essentially disappear, this has no impact on a tax collector's annual settlement. The tax collector is never charged with their collection and, therefore, never needs to include these taxes in the settlement calculations.[3]

That said, there are still several reasons for a tax collector to maintain accurate records of all deferred taxes: to facilitate their eventual collection, to keep the board informed about the existence and magnitude of these taxes, and to provide taxpayers notice of these outstanding amounts. At present, the circuit breaker is the only deferred tax program that requires the tax collector to provide annual notice of the amount of deferred taxes that are a lien on the property.[4]

3. What is a disqualifying event?

The definition of the term "disqualifying event" depends on the exclusion involved, as does the number of years of deferred taxes that become due and payable upon such an event. Table 1, below, provides a brief summary for each of the eight deferred tax exclusions, but tax collectors are strongly advised to refer to the most recent versions of the relevant statutes before initiating collection actions.

3. A tax collector need only include in the settlement "the total amount of taxes in his hand for collection" for the current and previous tax years. G.S. 105-373(a)(3) and (b). Deferred taxes that never become due and payable are never placed in the tax collector's hands for collection.

4. G.S. 105-277.1B(h) ("On or before September 1 of each year, the collector shall notify each residence owner to whom a tax deferral has previously been granted of the accumulated sum of deferred taxes and interest"). The statute provides no guidance as to the form of notice, however, meaning tax collectors are free to determine the most efficient and effective method of conveying this information to taxpayers. The deferred taxes and interest could be included on the tax bill or on a separate notice, and the amounts could be broken out by year or could simply be reported as a lump sum.

Table 1. Property Tax Deferred Tax Exclusions

Exclusion	Disqualifying Event	Number of Years of Deferred Taxes Due and Payable Upon Disqualifying Event
Historic District Property (future site of historic structure) G.S. 105-275(29a)	Historic structure is not moved to the property within five years from the first day of the fiscal year the property was classified under this exclusion.	All, up to the maximum of five
Circuit Breaker G.S. 105-277.1B	(i) Owner dies, (ii) property is transferred, or (iii) property is no longer used as a permanent residence.[a]	Three
Residential Home Builders Inventory G.S. 105-277.1D	(i) Builder transfers the residence; (ii) residence is occupied by the builder or by someone other than the builder with the builder's consent; (iii) five years passed from the time the improved property was first subject to being listed for taxation by the builder; or, (iv) three years passed from the time the improved property was first classified under this exclusion.	All, up to the maximum of three
Present-Use Value Property (agricultural, horticultural, and forestland property) G.S. 105-277.4	Property fails to meet any condition or requirement for the exclusion.	Three
Working Waterfront Property G.S. 105-277.14	Property fails to meet any condition or requirement for the exclusion.	Three
Wildlife Conservation Land G.S. 105-277.15	Property fails to meet any condition or requirement for the exclusion.	Three
Historic Property G.S. 105-278(b)	Change in an ordinance designating a historic property or a change in the property, other than by fire or other natural disaster, that causes the property's historical significance to be lost or substantially impaired.	Three
Future Site of Low- or Moderate-Income Housing G.S. 105-278.6(e)	Nonprofit organization fails to construct low- or moderate-income housing on the site within five years from the first day of the fiscal year the property was first classified under this exclusion.	All, up to the maximum of five

[a]Under the circuit breaker, a transfer does not cause a disqualifying event if (1) the property is transferred to a co-owner of the residence or, as part of a divorce proceeding or upon the owner's death, to the previous owner's spouse, and (2) the new owner continues to use the property as his or her permanent residence. G.S. 105-277.1B(i).

4. Who is responsible for deferred taxes that become due and payable?

The general rule regarding responsible taxpayers for real property taxes applies to deferred real property taxes: the taxpayers who may be targeted with enforced collection remedies are the owner of record as of the date of delinquency and all subsequent owners of record.[5]

While seemingly straightforward, this rule can create confusion when the disqualifying event is a transfer of ownership. Consider a residence that has benefited from the circuit breaker for several years while owned by Taxpayer A. Taxpayer A sells the residence to Taxpayer B, who is neither the spouse of nor the co-owner with Taxpayer A. This transfer would constitute a disqualifying event and cause the three most recent years of deferred taxes to become immediately due, payable, and delinquent. Who is responsible for these deferred taxes, Taxpayer A or Taxpayer B?

The general rule states that the owner as of the date of delinquency is the responsible taxpayer, along with all subsequent owners. In this situation, there are two possible owners of record as of the date of delinquency, which is the day the transfer was recorded and record ownership changed. At the beginning of that day, Taxpayer A was the record owner. At the end of that day, Taxpayer B was the record owner. If Taxpayer A is viewed as the record owner on the date of delinquency for enforced collection purposes, then both Taxpayer A and Taxpayer B —because of the rule concerning subsequent ownership—are responsible for the deferred taxes. But if Taxpayer B is viewed as the owner as of the date of delinquency, then Taxpayer A is *not* responsible.

Neither the Machinery Act nor North Carolina case law specifically answers this question. To maximize collection options, most tax collectors would conclude that both Taxpayer A and Taxpayer B are responsible. Unless and until a North Carolina court interprets G.S. 105-365.1 differently, this approach is clearly reasonable.

Regardless of how this question is resolved, tax collectors retain a lien on the underlying real property for the deferred taxes. As is true for all real property tax liens, this lien will survive subsequent transfers and may be foreclosed upon without first resorting to remedies against the owner's personal property.

5. G.S. 105-365.1(b)(1). This is true for all deferred taxes that relate to *real* property. However, under the circuit breaker program, it is possible for *personal* property taxes to be deferred when an eligible taxpayer owns and resides in a manufactured home that sits on land owned by another taxpayer. In such a situation, G.S. 105-365.1(b)(2) applies, and the responsible taxpayer is the listing owner in the year the deferred taxes become due. Subsequent owners of the manufactured home could not be subject to enforced collection remedies for the delinquent deferred taxes.

To browse a complete catalog of School of Government publications, please visit the School's website at www.sog.unc.edu or contact the Publications Division, School of Government, CB# 3330 Knapp-Sanders Building, UNC Chapel Hill, Chapel Hill, NC 27599-3330; e-mail sales@sog.unc.edu; telephone 919.966.4119; or fax 919.962.2707.