

Property Tax in North Carolina

Property Tax Assessment of Business Personal Property

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Introduction

All personal property (including intangible property) is subject to *ad valorem* taxation in North Carolina unless it is constitutionally exempted or classified and excluded from taxation by statute.¹ Almost all forms of intangible property are now exempt from assessment and taxation in North Carolina under legislation passed by the General Assembly in 1997.² Leasehold interests in exempted real property³ and certain forms of computer software⁴ are still, however, subject to assessment. Further, “non-business” personal property, personalty that is used by the owner for a purpose other than the production of income and not used in connection with a business (e.g., household furnishings), is also exempt.⁵

The Department of Revenue in its Personal Property Appraisal and Assessment Manual,⁶ divides business personal property into the following categories:

1. Inventories
 - A. Raw materials
 - B. Goods in process of manufacturing
 - C. Finished goods
 - D. Supplies (office, maintenance, janitorial, manufacturing)
 - E. Packaging materials
 - F. Fuels
 - G. Spare parts

¹ N.C. Const. art. V §§ 2-3.

² N.C. Gen. Stat. § 105-275(31). See also N.C. Gen. Stat. § 105-276.

³ N.C. Gen. Stat. § 105-275(31).

⁴ N.C. Gen. Stat. § 105-275(40).

⁵ N.C. Gen. Stat. § 105-275(16). The term “non-business” personal property does not include motor vehicles, mobile homes, aircraft, watercraft or engines for watercraft. The assessment of these forms of personalty is relatively straightforward.

⁶ Personal Property Appraisal and Assessment Manual, June 2007, pp. 3-2 – 3-3.

2. Depreciable Assets
 - A. Machinery and equipment
 - B. Office furniture, fixtures, and equipment
 - C. Construction work in progress (including interest during construction)
 - D. Leasehold improvements
 - E. Software packages (tangible)
 - F. Tools, dies, molds
 - G. Motor vehicles (including mounted equipment)
 - H. Pallets and containers

3. Intangible Personal
 - A. Leasehold interests in exempt real property

Exemption of Certain Inventories from Assessment

N.C.G.S. 105-275(32a) excludes from assessment inventories owned by “contractors.” N.C.G.S. 105-275(33) excludes from assessment inventories owned by “manufacturers.” N.C.G.S. 105-275(34) excludes from assessment inventories owned by “retail and wholesale merchants.” The definition of “inventories” is found in N.C.G.S. 105-273(8a), which provides:

“Inventories” means (i) goods held for sale in the regular course of business by manufacturers, retail and wholesale merchants, and contractors, and (ii) goods held by contractors to be furnished in the course of building, installing, repairing, or improving real property. As to manufacturers, the term includes raw materials, goods in process, and finished goods, as well as other materials or supplies that are consumed in manufacturing or processing, or that accompany and become a part of the sale of the property being sold. The term also includes a modular home as defined in G.S. 105-164.3(21b) that is used exclusively as a display model and held for eventual sale at the retail merchant’s place of business. The term also includes crops, livestock, poultry, feed used in the production of livestock and poultry, and other agricultural or horticultural products held for sale, whether in process or ready for sale. The term does not include fuel used in manufacturing or processing, nor does it include materials or supplies not used directly in manufacturing or processing. As to retail and wholesale merchants and contractors, the term includes, in addition to articles held for sale,

packaging materials that accompany and become a part of the sale of the property being sold.”

The term “contractor” is defined in N.C.G.S. 105-273(5a).

“Contractor” means a taxpayer who is regularly engaged in building, installing, repairing, or improving real property.”

The term “manufacturer” is defined in N.C.G.S. 105-273(10b).

“Manufacturer” means a taxpayer who is regularly engaged in the mechanical or chemical conversion or transformation of materials or substances into new products for sale or in the growth, breeding, raising, or other production of new products for sale. The term does not include delicatessens, cafes, cafeterias, restaurants, and other similar retailers that are principally engaged in the retail sale of foods prepared by them for consumption on or off their premises.”

The term “wholesale merchant” is defined in N.C.G.S. 105-273(19).

“Wholesale Merchant” means a taxpayer who is regularly engaged in the sale of tangible personal property, acquired by a means other than manufacture, processing, or producing by the merchant, to other retail or wholesale merchants for resale or to manufacturers for use as ingredient or component parts of articles being manufactured for sale.”

The term “retail merchant” is defined in N.C.G.S. 105-273(13a).

“Retail Merchant” means a taxpayer who is regularly engaged in the sale of tangible personal property, acquired by a means other than manufacture, processing, or producing by the merchant, to users or consumers.”

Three North Carolina cases have dealt with the retail merchant inventories exemption, two reported in the North Carolina Court of Appeals in appeals from the

Property Tax Commission and the third, a decision of the North Carolina Property Tax Commission which was not appealed to the Court of Appeals.⁷

The three cases establish the following principles:

1. To be eligible for the inventory exemption, the taxpayer must be “regularly engaged in the sale of tangible personal property.” *Cone Mills, supra*, seems to narrow “regularly engaged” to an inquiry into the “primary purpose” for which the taxpayer acquired the property. In that case, a textile manufacturer was selling used equipment which it had originally purchased for production purposes. In holding that the goods were not subject to the inventory exemption, the court held that the “taxpayer acquired the property primarily for use in its manufacture of textiles and only held the goods for sale after the property was no longer useful in taxpayer’s textile business. The equipment and machinery at issue were not inventory held for sale in the regular course of business by a wholesale merchant.”

2. Equipment which is used for rental purposes is not excluded as inventory. See *R. W. Moore Equipment, supra*, which held that equipment being rented or subject to rental is not “held for sale” and further held that if the equipment is “primarily” used for rental purposes, it is not entitled to the inventory tax exclusion for the rented equipment.

The Court in *R.W. Moore Equipment* also noted that “the record reflects that defendant treats the equipment as income producing property rather than inventory for financial reporting purposes, depreciating only that part of its inventory of new and used

⁷ In the Matter of the Appeal of Moore Buick-Pontiac, Inc., 89-PTC-53 (N.C. Property Tax Comm’n Feb. 13, 1991); In re Appeal of Cone Mills Corp., 112 N.C. App. 539, 435 S.E.2d 835 (1993); In re Appeal of R.W.

equipment that it uses for rental purposes. . . . This treatment renders the equipment used for rental purposes ineligible for tax exclusion because its use and consumption as income producing property is incompatible with its character as inventory.”

3. Items held for both rental and sale are also not subject to the inventory exclusion. The North Carolina Property Tax Commission held in *Moore Buick-Pontiac, Inc.*, supra, that “Automobiles and other property held primarily for rental are not inventories.” However, rental property may become inventory in a later tax year following an irrevocable transaction even if that transaction is not an outright sale. “. . . While an outright sale may not be necessary, an irrevocable change in the taxpayer’s purpose is necessary. Taxpayers must not be permitted to ‘flip-flop’ cars from rental fleet to a used car lot and back to defeat the tax.” The Commission noted that (1) removing a car from the rental fleet, (2) irrevocably removing the car from a rental location to a sales location and (3) making appropriate accounting entries would render the car inventory.

While *Moore Buick-Pontiac* is only a decision of the North Carolina Property Tax Commission, it seems consistent with the two Court of Appeals decisions. We believe that the Property Tax Commission would follow that case as precedent and, based on the other two Court of Appeals cases, believe the Court of Appeals would follow that reasoning as well.

Other than the inventories described above, all of the other business personal property assets listed above on pages 1 and 2 are assessable.

A. Situs of Personal Property for Assessment

Moore Equipment Company Inc., 115 N.C. App. 129, 443 S.E.2d 734 (1994).

While it is almost always clear which counties and cities have jurisdiction over real property so as to have the authority to impose a property tax upon it, determining the situs of personal property can be another matter altogether.

Situs – the place where something is considered to be on January 1 of each year for tax assessment purposes – is governed by both constitutional and statutory principles.

A state must have over the property pursuant to the Due Process Clause of the 14th Amendment to the U.S. Constitution in order to be able to tax the property.⁸

Case law has established the following general principles governing situs.⁹

1. Situs is an absolute essential for tax exaction.
2. The state of domicile (generally, the state of corporate headquarters location) may tax the full value of a taxpayer's tangible personal property for which no tax situs beyond the domicile has been established so that the property may not be said to have acquired a tax situs elsewhere.
3. The state of domicile may constitutionally subject its own corporations to non-discriminatory property taxes even though they are engaged in interstate commerce. It is only multiple taxation of interstate operations that violates the Commerce Clause of the U.S. Constitution.
4. The state of domicile may not levy a property tax on tangible personal property of its citizens which is permanently located in some other state throughout the tax year. Thus, even if a corporation is domiciled elsewhere, its tangible personal property is

⁸ Billings Transfer Corp. v. County of Davidson, 276 N.C. 19, 170 S.E.2d 873 (1969).

⁹ Id. at 32, 170 S.E.2d at 883.

subject to taxation in North Carolina if the property is “situated” in North Carolina. Likewise, North Carolina may not tax tangible personal property that has acquired situs outside North Carolina. “With respect to tangible movable property, a mere General showing of its continuous use in other states is insufficient to exclude the taxing power of the state of domicile.”¹⁰

5. The burden is on the taxpayer to show that tangible personal property it owns has situs in a different jurisdiction than its home state. Situated is defined by our statutes as “more or less permanently located.”¹¹ “Temporary absence of tangible personal property from the place at which it is normally taxable shall not affect the rule of taxation.”¹² The general rule for the assessment of business personal property is that it is taxed at the “business premises” where it is situated or commonly used in connection with the business premises.¹³ Leased property is taxable where it is used by the lessee – the lessee’s business premises.¹⁴

The temporary absence of the property from the business premises on the date of assessment does not deprive that taxing jurisdiction of the right to tax the property.¹⁵

Tangible personal property owned by a non-resident is taxable at the place in North Carolina where the property is situated.¹⁶

B. Listing of Business Personal Property

¹⁰ Id. at 34, 170 S.E.2d at 884.

¹¹ N.C. Gen. Stat. § 105-304(b)(1); See In re Appeal of Bassett Industries, 79 N.C. App. 258, 339 S.E.2d 16 (1986); Appeal of Hanes Dye and Finishing Co., 285 N.C. 598, 207 S.E.2d 729 (1974).

¹² In re Appeal of Plushbottom and Peabody, Ltd., 51 N.C. App. 285, 292, 276 S.E.2d 505, 510 (1981).

¹³ N.C. Gen. Stat. § 105-304(f)(2).

¹⁴ N.C. Gen. Stat. § 105-304(f)(3).

¹⁵ N.C. Gen. Stat. § 105-304(f)(4).

All property – real and personal – is assessable in North Carolina as of January 1. Therefore, business personal property listing statements are required to reflect property situated in the county as of that date.

Taxable personal property is listed in the name of the owner of the property. It is the duty of the owner to list the property.¹⁷ Property that is subject to a conditional sale agreement should be listed in the name of the vendee, while property that is subject to a lease should be listed in the name of the vendor.¹⁸ The UCC statutorily defines whether an agreement is a lease or a conditional sale,¹⁹ and one of the more important aspects of the UCC approach is whether the option purchase price for the item is “nominal additional consideration.”²⁰ White & Summers, *Uniform Commercial Code*, defines “nominal additional consideration” according to the following threshold question: “Is the option price so low that the lessee will certainly exercise it and will, in all plausible circumstances, leave no meaningful reversion for the lessor?”²¹

¹⁶ N.C. Gen. Stat. § 105-304(d)(2).

¹⁷ N.C. Gen. Stat. § 105-306.

¹⁸ N.C. Gen. Stat. § 105-306(c)(2).

¹⁹ N.C. Gen. Stat. § 25-1-203.

²⁰ N.C. Gen. Stat. § 25-1-203(b)(4).

²¹ White & Summers, *Uniform Commercial Code* vol. 4 § 30-3, at 33 (5th ed. 2002); *see also In re Access Equipment*, 62 B.R. 642 (D. Mass. Bankr. 1986) (“[I]f at the end of the lease term the only sensible course economically for the lessee would be for him to exercise his option the transaction is really a secured installment sale . . .”) (former North Carolina law) (citing the former UCC statute, which was in effect in North Carolina in 1986); *Szabo Food Service, Inc. v. Balentine’s, Inc.*, 285 N.C. 452, 206 S.E.2d 242 (1974); *Borg-Warner Acceptance Corp. v. Johnston*, 97 N.C. App. 575, 389 S.E.2d 429 (1990); *L.C. Williams Oil Co. v. NAFCO Capital Corp.*, 130 N.C. App. 286, 502 S.E.2d 415 (1998).

Taxable personal property must be listed during January although the listing period may be extended, upon request, as late as April 15.²² The period for electronic listing may be extended to June 1.²³

The Board of Commissioners may provide for the general acceptance of completed abstracts submitted by mail or electronically. Assuming that the Commissioners have approved filing by mail, abstracts may be mailed. If mailed by the date due for filing, they are deemed timely submitted but must be postmarked by the US Postal Service with the date shown on the postmark. Abstracts submitted by electronic filing are considered filed when received in the office of the assessor.²⁴ As with other actions required by the Machinery Act, if the date for filing an abstract falls on the weekend or holiday, the time for filing is extended until the next business day.²⁵ Remember – the burden of proof is on the taxpayer to show that the abstract was timely filed.

It is a misdemeanor for the owner of business personal property to fail to list the property for assessment. Further, it is a misdemeanor for anyone to willfully attempt or aid or abet anyone to evade or defeat property taxes.²⁶

There must be annexed to the abstract on which the property is listed an affirmation that the listing, including any accompanying statements or schedules, are “true and complete.”²⁷ The affirmation must be signed by an individual, and the individual, if signing on behalf of a business entity must either be a principal officer or a full-time

²² N.C. Gen. Stat. § 105-307.

²³ N.C. Gen. Stat. § 105-307(c).

²⁴ N.C. Gen. Stat. § 105-311(b).

²⁵ N.C. Gen. Stat. § 105-395.1.

²⁶ N.C. Gen. Stat. § 105-308.

employee officially empowered by a principal officer to list the property and sign the affirmation.²⁸

Again, willful execution of false statements makes the signer subject to prosecution for a misdemeanor.²⁹

C. Preparation of the Abstract.

N.C. Gen. Stat. § 105-309(d) requires the taxpayer to list its business personal property for taxation using a form which has been approved by the Department of Revenue. As a result, business personal property listing forms are increasingly standardized across the state, although individual variations are still found. The Department publishes a standard listing form which may be downloaded from its website (www.dor.state.nc.us), and which each county must accept. Personal property must be listed in such a fashion as to indicate the township and municipality in which it is situated.

The property listed must be “itemized by the taxpayer in such detail as may be prescribed” by the form.

If the assessor considers it necessary to obtain a complete listing, he may require the taxpayer “to submit additional information, inventories, or itemized lists of personal property.”

Further, at the request of the assessor, “the taxpayer shall furnish any information the taxpayer has with respect to the true value of the personal property the taxpayer is required to list.”³⁰

²⁷ N.C. Gen. Stat. § 105-310.

²⁸ N.C. Gen. Stat. § 105-311(a)(2)b.

The assessor possesses subpoena powers under N.C. Gen. Stat. 105-296(g) if he has “reasonable grounds” to believe that the person subpoenaed has knowledge or documents that contain information that will assist him with regard to the valuation or listing of property. Assessors will use this power when they feel it necessary.

However, “only after the abstract has been carefully reviewed can the assessor require any person operating a business enterprise in the county to submit a detailed inventory, statement of assets and liabilities, or other similar information pertinent to the discovery or appraisal of property taxable in the county.”³¹

D. Confidentiality of Information Furnished to Assessor.

By implication, it appears that business personal property listing forms (the abstract referred to in the statutes) are open to public inspection. (See N.C. Gen. Stat. § 105-296(h).) Although some assessors safeguard this information, the listing form appears to be public record.

Taxpayers who are concerned about the confidentiality of information they furnish to the assessor would be well advised to keep the information provided with the abstract to the minimum required. (Conversely, as discussed below in the section of the seminar materials dealing with discovery, the more complete the abstract, the less the chance of a subsequent successful discovery by the assessor.)

²⁹ N.C. Gen. Stat. § 105-310.

³⁰ N.C. Gen. Stat. § 105-309(d)(2).

³¹ N.C. Gen. Stat. § 105-296(h).

Although taxpayers are frequently apprehensive about public disclosure of their records, assessors, their staff, outside contractors and Department of Revenue employees with whom they consult are all subject to strict rules of confidentiality.

Confidentiality provisions as to county assessors, their staff, contractors and county or city employees:

“Inventories, statements of assets and liabilities, or other information secured by the assessor under the terms of this subsection, but not expressly required by this Subchapter to be shown on the abstract itself, shall not be open to public inspection but shall be made available upon request to officials of the Department of Revenue or of the Employment Security Commission.” N.C. Gen. Stat. § 296(h).

“Any assessor or other official or employee disclosing information so obtained, except as may be necessary in listing or appraising property in the performance of official duties, or in the administrative or judicial proceedings relating to listing, appraising, or other official duties, shall be guilty of a Class 3 misdemeanor and punishable only by a fine not exceeding fifty dollars (\$50.00).” N.C. Gen. Stat. § 296(h).

“A current or former officer, employee, or agent of a county who in the course of service to or employment by the county has access to information about the amount of a taxpayer’s income or receipts may not disclose the information to any other person unless the disclosure is made for one of the following purposes: . . . A person who violates this section is guilty of a Class I misdemeanor.” N.C. Gen. Stat. § 153A-148.1.

See N.C. Gen. Stat. § 160A-208.1 for similar provisions relating to city employees.

“The Department of Revenue may furnish the following information to a local tax official:

- (1) Information contained in a report to it or to any other State department; and
- (2) Information the Department has in its possession that may assist a local tax official in securing complete tax listings, appraising or assessing taxable property, collecting taxes, or presenting information in administrative or judicial proceedings involving the listing, appraisal, or assessment or property. N.C. Gen. Stat. § 105-289(e).

“A local tax official may use information obtained from the Department under this subsection only for the purposes stated in subdivision (2). A local tax official may not divulge or make public this information except as required in administrative or judicial proceedings under this Subchapter. A local tax official who makes improper use of or discloses information obtained from the Department under this subsection is punishable as provided in G.S. 153A-148.1 or G.S. 160A-208.1 as appropriate.” N.C. Gen. Stat. § 105-289(e).

“The Department may not furnish information to a local tax official pursuant to this subsection unless it has obtained a written certification from the official stating that the official is familiar with the provisions of this subsection and G.S. 153A-148.1 or G.S. 160A-208.1, as appropriate, and that information obtained from the Department under this subsection will be used only for the purposes stated in subdivision (2).” N.C. Gen. Stat. § 105-289(e).

“The board of county commissioners may employ appraisal firms, mapping firms or other persons or firms having expertise in one or more of the duties of the assessor to assist him or her in the performance of such duties. The county may make available to such persons any information it has that will facilitate the performance of a contract entered into pursuant to this section. Persons receiving such information shall be subject to the provisions of G.S. 105-289(e) and G.S. 105-259 regarding the use and disclosure of information provided to them by the county.” N.C. Gen. Stat. § 105-299.

Confidentiality provisions as to State employees:

“An officer, employee, or an agent of the State who has access to tax information in the course of service to or employment by the State may not disclose the information to any other person [except for certain purposes]. . .” N.C. Gen. Stat. § 105-259(b).

“A person who violates this section is guilty of a Class 1 misdemeanor. If the person committing the violation is an officer or employee, that person shall be dismissed from public office or public employment and may not hold any public office or public employment in this State for five years after the violation.” N.C. Gen. Stat. § 105-259(c).

If taxpayers are concerned about confidentiality, they should consider the following:

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- a) Use discretion in what is provided with their annual listings,
- b) Discuss confidentiality concerns with their assessor prior to providing sensitive information.
- c) Provide additional information only in response to requests for supplemental information in accordance with the applicable statutory provisions and with a transmittal letter highlighting the taxpayer's security concerns and requesting care be taken in handling and storing the documents.

E. The Assessment of Business Personal Property

The assessed value of business personal property is determined based upon the annual business personal tax listings filed by the taxpayer. As with the assessment of real property, N.C. Gen. Stat. § 105-283 provides that personal property must be assessed at its "true value in money," i.e., its market value based upon the willing buyer – willing seller test. In making assessments of personal property, the assessor must consider the various elements of value set forth in N.C. Gen. Stat. § 105-317.1(a), including:

- replacement cost
- sale price of similar property
- age
- physical condition
- productivity
- remaining life of the property
- obsolescence
- economic utility – usability and adaptability for industrial, commercial or other purposes
- "any other factor" that may affect its value

"In determining the true value of taxable tangible personal property held and used in connection with the mercantile, manufacturing,

producing, processing, or other business enterprise of any taxpayer, the persons making the appraisal shall consider any information as reflected by the taxpayer's records and as reported by the taxpayer to the North Carolina Department of Revenue and to the Internal Revenue Service for income tax purposes, taking into account the accuracy of the taxpayer's records, the taxpayer's method of accounting, and the level of trade at which the taxpayer does business." N.C. Gen. Stat. § 105-317.1(b).

Our Court of Appeals, in summarizing these two statutes, observed:

"In substance these two statutes provide that all property shall be appraised at market value, and that all the various factors which enter into the market value of property are to be considered by the assessors in determining this market value for tax purposes."³²

The Department of Revenue promulgates two publications that are heavily relied upon by assessors to determine the fair market value of business personal property. These publications are the Personal Property Appraisal and Assessment Manual, used by the Department to teach the techniques of assessment of personal property, and the Cost Index and Depreciation Schedules, (trending and depreciation tables), published by the Department on an annual basis and available from its website, www.dornc.com.

All counties in North Carolina appraise business personal property (such as manufacturing equipment, computers, furniture and fixtures) by using trending and depreciation tables published annually by the State of North Carolina. These tables were originally developed by the State in the late 1970s and early 1980s. Items of equipment other than computers and furniture and fixtures are assigned to a class based upon the business of the taxpayer. The historic installed cost of the equipment is "trended" to current reproduction cost using trend data derived from the Bureau of Labor Statistics

annual producer price index studies. The trended cost is then depreciated, generally using depreciation tables developed by the Internal Revenue Service about thirty years ago. Subject to certain exceptions, assets are depreciated to a residual value of 25%. Once the asset reaches that level of depreciation, its value declines no further.

While acceptable for mass appraisal purposes and a vast improvement over the varied assessment techniques used before their development, the State's tables generally are not designed to account for significant external and functional obsolescence. Manufacturing equipment subject to significant external obsolescence – the textile industry is a good current example – may be over-assessed under the tables in use in North Carolina. Companies which have been subjected to foreign competition and which have seen their margins damaged typically have also seen the value of their manufacturing equipment plummet.

Similarly, computer intensive manufacturing equipment and equipment used in high-tech manufacturing, as well as computers themselves, are probably over-assessed due to both industry over-capacity (external obsolescence) and continuing technological change (functional obsolescence). As manufacturing has become more computer intensive, equipment valued using tables do not reflect the rapid depreciation of computerized equipment may be over assessed.

Despite all of the evidence of industry over-capacity, technological change and foreign competition, most county assessors are inclined to stick with the State's trending

³² In re Appeal of Bosley, 29 N.C. App. 468, 471, 224 S.E.2d 686, 688 (1976), cert. denied, 290 N.C. 551, 226 S.E.2d 509 (1976).

and depreciation tables and will continue to assess plants' machinery and equipment under the State's tables, unless the taxpayer challenges the assessed value.

One opportunity to challenge an assessment that occasionally presents itself occurs when an industrial plant is sold with its installed machinery and equipment in place. Typically, the purchaser will pay a lump sum for the real estate and the installed personal property and then will allocate a portion of the purchase price to real estate, a portion to machinery and equipment, and a portion to other acquired assets, such as inventory and to intangibles, such as accounts receivable. Not infrequently, the purchase price of the real estate and buildings thereon and machinery and equipment will be significantly less than the assessed value of these assets.

Since personal property is assessed – and its fair market value determined – on an annual basis, the new property owner has the opportunity to raise the question of the assessed value of its business personal property as of January 1 of the year following the purchase by listing the allocated purchase price as the cost of the property on the annual business personal property listing form. It may then argue that the last year's sale represents the fair market value of the personal property. The Department of Revenue teaches assessors to apply the trending and depreciation schedules to the original cost of the property, i.e., the cost to the original owner, including the cost of freight, tax and installation.³³ However, some business personal property listing forms used by counties make reference to the assets being listed at their installed purchase cost or words to that

effect. Clearly a taxpayer should raise the issue with the assessor and disclose what it is doing to avoid the possibility of a discovery assessment, with penalties. If the assessor refuses to accept the listing, the taxpayer may list as directed and then appeal the assessment.

F. Appeal of Assessed Values of Business Personal Property

1. Procedure

In some counties, notice of assessed value of business personal property will be mailed in the spring; in most counties, the taxpayer notice will be in the form of the annual tax bill, generally mailed in August.

Appeals of the assessed value of business personal property follow a process similar to the appeal process for real estate.

Once the notice of assessed value is received, the taxpayer may request a conference to discuss his concerns with the assessor. While this process might be most usefully conducted during the listing process before the assessment is rendered, before appealing to the board of equalization and review, the taxpayer should give the assessor the courtesy of a call. It may be that informal discussions and the production of information supporting the taxpayer's contention as to obsolescence not reflected on the State's tables will produce a satisfactory result.

Assuming that the assessor stands by his assessment and relies on the State's trending and depreciation tables despite evidence of additional depreciation, the property

³³ The Department of Revenue takes the position in its Personal Property Appraisal and Assessment Manual that in the event of such a purchase, the assets should be reported at their original historical installed cost.

owner may appeal to the county board of equalization and review, then to the Property Tax Commission, and thereafter, if necessary, to the appellate courts.

The discussion in our manuscript on real property assessment appeals sets forth the procedure for hearings before the board of equalization and review, hearings before the Property Tax Commission, the scope of appellate review, presumptions and burden of proof. This discussion applies equally to appeals regarding business personal property, subject to the following discussion of the appeal process for challenging the assessed value of business personal property.

Traditionally, most counties did not provide notice of the annual assessed value of business personal property until tax bills were mailed, generally in August. Some counties provided notice of assessed value earlier in the year. The statutes were silent as to a taxpayer's appeal rights and the time limits and procedures for appealing the assessment of business personal property.

The North Carolina Property Tax Commission held that appeals were timely if filed with the county board of equalization and review before year end.

The law pertaining to the appeal of business personal property assessments was clarified by the 2002 Session of the General Assembly. As of January 1, 2003, taxpayers must appeal the value, situs or taxability of the property within 30 days after the initial notice of value. If the assessor does not give a separate written notice of the value to the taxpayer at the taxpayer's last known address, then the tax bill will serve as the notice of value. Upon receipt of a timely appeal, the assessor must arrange a conference with the

taxpayer to allow him to present any evidence or argument regarding the value, situs or taxability of the property. Within 30 days after the conference, the assessor must give written notice to the taxpayer of the assessor's final decision, unless the taxpayer signs an agreement accepting the value, situs or taxability of the property. If no agreement is reached, the taxpayer has 30 days from the notice to request a review by the local board of equalization and review. The taxpayer will have 30 days to appeal a decision of the board of equalization and review to the Property Tax Commission. N.C. Gen. Stat. § 105-317.1(c); N.C. Gen. Stat. § 105-322(d).

Should a taxpayer receive a notice of assessed value and the taxpayer take no action to appeal, it will be without a remedy to challenge that year's assessment of business personal property unless it can prove that it is entitled to a refund under G.S. 105-381 – a challenging proposition.

2. The Appraisal of Business Personal Property on Appeal

The appraisal of machinery and equipment presents significant challenges to the use of the three approaches to value – comparable sales, cost and income. Since this equipment is generally not rented, it is difficult to develop an income stream to be capitalized. Many leases of business personal property or capital leases used for financing purposes and are not true leases with an income stream which can be capitalized. Machinery and equipment, once shut down and sold from a plant, frequently sells for pennies on the dollar. Such a sale, while it may reflect fair market value, may be regarded as a liquidation sale not reflective of fair market value. Some plants are sold, however, with machinery and equipment in place for continued use and these sales ought to be good

market indicators once allocation issues are sorted out. The cost approach, with proper consideration given to physical depreciation and all forms of obsolescence, seems to be generally accepted as a workable approach. Quantification of obsolescence, however, is not easily accomplished and appraisers who really know what they are doing in this area are pearls of great price.

North Carolina case law on the appraisal of personal property is scarce.

The North Carolina Supreme Court, in a case involving the assessment of inventory, In re: Appeal of AMP, Inc., 287 N.C. 547, 215 S.E.2d 542 (1975), observed that:

“In cases where there is no market price . . . , the following factors have been considered in determining value: (1) the original cost, or cost of labor and materials; (2) the earnings the property has produced or is likely to produce if it is of commercial value, provided the earnings are reasonably likely to continue or that they are reasonably close in point of time; and, most commonly, (3) the cost of repair or replacement with a deduction for depreciation where goods are replaced . . .

“Cost of replacement or repair, with suitable adjustments for the fact that the . . . property was old and had depreciated in value, is . . . the most commonly considered factor in fixing value of personal property that has no market.”

In re Appeal of Bosley, supra, discussed the valuation of household furnishings, which are now exempt. The Court of Appeals ruled in an appeal of the assessed value of a mobile home, that valuation of personal property, using the same method used to value real property (the County’s schedule of values) was arbitrary and illegal.³⁴

³⁴ In re Appeal of Murray, 179 N.C. App. 780, 635 S.E.2d 477 (2006).

The use of published guides to value long-haul tractors was sanctioned in two North Carolina Supreme Court cases, In re Block Company, 270 N.C. 765, 155 S.E.2d 283 (1967), and In re McLean Trucking Co., 281 N.C. 375, 189 S.E.2d 194 (1972).

Little guidance as to which appraisal methods should be used for particular types of personal property is to be found in North Carolina case law. Lacking good comparable sales and income data, most appraisers in cases tried before the Property Tax Commission tend to rely on the cost approach.

Valuing Machinery and Equipment, published by the American Society of Appraisers in 2000, is an invaluable text on the subject of personal property appraisal.

Appeals of assessments of business personal property are most likely to be successful when unusual external obsolescence affects the industry in which the equipment is used and the taxpayer can make a convincing argument to the trier of fact that the State's trending and depreciation tables have failed to adequately reflect this external obsolescence.

Appeals may also be successful where rapid change due to technological innovation is going on in an industry. As new generations of manufacturing equipment are introduced, the value of older generations of equipment immediately declines due to technological or functional obsolescence.

Staff of the Property Tax Division of the Department of Revenue are willing to consider evidence from taxpayers that the trending and depreciation tables which they publish are not accurately reflecting market values. Quite reasonably, however, staff wants documented proof that adjustments should be made to the state's tables. Typically, this

will take the form of appraisals, testimony at hearings before the Commission or data indicating that the classification to which particular equipment is assigned, its useful life, patterns of depreciation or residual value are incorrect. When presented with such evidence, the Department has made changes to its tables. Examples include equipment used to manufacture double knit textiles, telecommunications manufacturing and test equipment, computers, and point of sale equipment used in the retail industry.

Since county assessors are heavily reliant upon the State's tables and the expertise of the Department of Revenue staff, advocating for changes to the tables is often the most productive course of action. Frequently, however, this activity is accompanied by appeals to the Property Tax Commission to preserve assessment years for review and by hearings on the appeals to present the evidence developed.

G. Commonly Encountered Issues

Issues frequently confronted in the appraisal of machinery and equipment include:

- Ghost assets – assets that have been disposed of but not removed from the company's fixed asset records, or retained in the plant but with no hope of resurrection, frequently having been cannibalized for use with other equipment.
- Idle equipment – usable equipment, but not in use due to lack of product demand or because it cannot be profitably operated.
- Construction in process and new construction – how to value additions to an obsolescent installed machinery and equipment base.
- Capitalized interest
- Valuation of supply and spare parts inventory
- Distinguishing between realty and personalty when the personalty is often permanently affixed to the realty.

The question of how improvements to real estate should be assessed can be both puzzling and perplexing to assessors and taxpayers alike.

The assessor is concerned that all property be assessed, whether real or personal.

The taxpayer is concerned that its property not be taxed twice – once as realty and then again as personalty.

It is often by no means clear whether a particular item should be classified as real or personal.

As a general rule, the Property Tax Commission staff, and most appraisers, tend to regard the equipment installed in the plant for plant lighting, air handling and plumbing for human comfort, distribution wiring, etc., to be part of the real estate while equipment installed for purposes of the manufacturing process to be conducted within the plant to be personalty.³⁵

The State's Personal Property Appraisal and Assessment Manual is a worthwhile resource. The Department of Revenue uses the Manual as part of its course materials for the instruction it gives assessors. Attached to these materials are pages abstracted from the Manual which provide the Department's perspective on what should be assessed as part of the realty and what should be assessed as personalty.

The Manual observes:

“Business personal property is typically identified as all property used in connection with the production of income that has not been classified as real property.”

³⁵ See Personal Property Appraisal and Assessment Manual, June 2007, p. 3-2.

“In many cases, the appraiser must rely on the owner’s statement of intent. Items that may appear to be permanently attached to realty may not be appraised as realty and should be classified as personalty.”

“In making appraisals of machinery and equipment, a good rule-of-thumb is to classify all property and investments necessary for the operation of the machinery and equipment as personalty.”

“It is important to remember that there are no absolutes in making the determination of whether assets should be classified as real or personal property. Frequently the appraiser must examine leases and other documents to determine the intent of the owner of the property.”

“. . . the appraiser may have to . . . determine . . . whether the property is there for the benefit of the process or for the benefit of the employees or the building.”³⁶

H. Current Issues

Capitalized software. As indicated above, most software is classified and excluded from taxation under G.S. 105-275(40). However, embedded software is assessable and software which is purchased or licensed from a person who is unrelated to the taxpayer and which is capitalized on the books of the taxpayer in accordance with generally accepted accounting principles is assessable.³⁷ As a result of the enactment of G.S. 105-275(40), most shrink-wrapped software, which is generally expensed, is not assessable. In addition, internally developed software is not assessable. Only software purchased from unrelated third parties, which is capitalized, is assessable.

Recently, several counties have begun to audit taxpayers’ books and discovering for assessment “capitalized salaries” associated with software. The capitalized salaries accounts of taxpayers may include compensation paid to third parties, such as consulting

³⁶ Id.

firms engaged to work on packages such as SAP, or may be the salaries of other independent contractors or of the taxpayers' employees.

These amounts are capitalized pursuant to the requirements of SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, published by the Accounting Standards Executive Committee, American Institute of Certified Public Accountants.

This is an area where law, accounting and information technology intersect, with predictably controversial and complex implications for property taxation. Clearly, not all capitalized salary accounts are assessable; equally clearly, some portions of these accounts related to the installation of software purchased from third parties and capitalized on the books of the taxpayers may be assessable. Deciding what is assessable and what is not is a team effort involving in house tax, accounting and IT personnel and the analysis of experienced property tax counsel.

³⁷ G.S. 105-275(40) a. and b.