

New Exclusions for Residential and Commercial Real Property Improvements

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In my last post I discussed S.L. 2015-204, which creates new authority for counties to waive interest on old registered motor vehicle taxes. Today I analyze the second major property tax law passed this session, S.L. 2015-223, which is much more likely than S.L. 2015-204 to have a substantial impact on local government finances.

S.L. 2015-223 creates new exclusions for improvements to real property being held for sale. 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 G.S. 105-275(32a), (33) and (34).

Home builders got their wish, sort of, for a few years. In 2010 the General Assembly created a deferral for taxes attributable to the construction of new, unsold residential homes. That deferral "sunsetted" (in other words, disappeared) as of 2013.

But now it's back and stronger than ever. Instead of deferring taxes, S.L. 2015-223 excludes them entirely. And the new law covers non-structural improvements and commercial properties, neither of which fell within the scope of the old deferral.

Here's a summary of the new law:

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-structural 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 a builder, must not be occupied by a tenant, and must not be used as a model home or for any other commercial purposes. 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 improvements must be on January 1 regardless of the stage of completion. If a property is improved in stages, each improvement might qualify for a separate exclusion based on its own listing date.

For example, assume a builder buys a parcel in 2016 and immediately subdivides it and lays out streets.

Those improvements might cause an increase in the property's tax appraisal for 2017. If so, the builder could apply for the new exclusion to avoid taxation for 3 years (2017, 2018, 2019) on the increased value. If the builder builds several houses on the newly subdivided lots in 2017, those improvements would trigger another increase in the property's tax appraisal for 2018. The builder could apply for a second exclusion that would cover the tax attributed to the increase in value for the new home construction for the years 2018, 2019, and 2020. The two exclusions apply to the same property but would be based on different improvements and would cover different tax years.

A 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 some local governments may be more lenient with late applications than others.

The new residential property exclusion differs in some important ways from the [old deferral for homebuilders' inventory](#). First and most importantly, the taxes attributable to the improvements are not just deferred, they are waived entirely. Second, it covers activities in anticipation of residential construction (the subdivision of a parcel and grading, streets, utility work, etc.), not just 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 exclusion. Fourth, the exclusion probably does not apply to condominium or townhouse buildings that will house more than two families. The bill extends the exclusion to "single family residence or a duplex," which suggests that structures housing three or more family units will not qualify.

Commercial Property:

Unlike residential property, commercial property may benefit from the new exclusion for a maximum of five years rather than three. But the commercial property exclusion covers only the increase in value attributable to subdivision or non-structural improvements (grading, streets, utilities). Any improvement that requires the issuance of a building permit terminates eligibility for the exclusion.

In some respects, this new commercial real property exclusion is an extension of the relatively new ["site infrastructure" deferral](#) that was intended to encourage land owners to prepare farmland for industrial or manufacturing development. From what I've heard, very few (if any) developers have taken advantage of that deferral; it's likely more will be interested in this new exclusion.

This table summarizes the new exclusions available for improvements to residential and commercial property:

	Residential Property	Commercial Property
Applies to Increase in Value Attributed to	Subdivision Non-building improvements New single family homes or duplexes	Subdivision Non-building improvements
Maximum Duration	3 years from first listing	5 years from first listing
Disqualification	Sale Removal from market Lease Commercial use (as model home, for example)	Sale Removal from market Issuance of building permit

For both residential and commercial properties, the new exclusion applies to improvements made on or after July 1, 2105 and applies to taxes levied for tax years beginning on or after July 1, 2016. Those restrictions eliminate from eligibility any residential and commercial improvements that existed as of July 1, 2015. But improvements made in the second half of 2015 may qualify for the exclusion for tax years 2016 and beyond.

The statute leaves several important questions unanswered. May multiple builder/owners of the same property benefit from the exclusion? 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? For answers to these questions and more, please see Property Tax Bulletin # 169, to be released shortly.

The full text of the new law is reproduced on the next page.

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. 87-1~~ 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 single-family 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."

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.