



Agenda Item Summary Sheet

Item No. 17

Meeting Date: 2/6/06

Item Title: Late Listing Penalties - School Board Association vs. Moore County

Item Summary:

The State supreme court has ruled that late listing penalties collected by counties and towns must be remitted to the local Board of Education, the same treatment as for court fines and forfeitures. Staff proposes that the County reduce the related revenue account in the General Fund budget and also reduce the Local Current Expense account for the Board of Education by the same amount - \$16,676. The relevant section of the Local Government Law Bulletin is attached.

(Use additional Paper if necessary)

Number of Attachments: 3

Will your presentation require audiovisual equipment? Yes No

Note: All audiovisual materials must be submitted in digital format to the Clerk of the Dare County Board of Commissioners with this sheet. Acceptable formats include: VHS, DVD, audio CD, Word document, Adobe Acrobat PDF files, PowerPoint files and jpeg files.

Specific Action Requested:

Adopt budget amendment.

Submitted By: David Clawson, Finance Director

Date: 1/23/06

Dept. Head

Comments:

Signature

Date:

Finance

Comments:

Signature

Date:

1/23/06

County Attorney

Comments:

Signature

Date:

County Manager

Approval:

Signature

Date:

1/27/06

Commission Action:

DARE COUNTY

BUDGET AMENDMENT

F/Y 2005 ~~2006~~

ACCOUNT	Org	CODE Object	Project	INCREASE	DECREASE
Board of Education					
<u>Revenues:</u>					
Taxes - penalties & interest	103010	400501			16,676
<u>Expenditures:</u>					
Board of Education - Local Current Expense	104675	570001			16,676

Explanation:
Late listing penalties.

Approved by:

Board of Commissioners:

County Manager:

(sign in red)

Date:

Date:

Finance only:

Date entered:

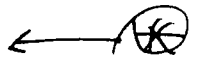
Entered by:

Reference number:

MEMBERSHIP 08 KITTY HAWK

REGULAR BILLS

PROPERTY VALUES		RESIDENTIAL	BUSINESS	UTILITY	TOTAL
9	COUNTY-WIDE	LEVY 39,626,781.81	345,052.73	00	39,971,834.54
		PENALTY 11,385.35	5,290.09	.00	16,675.44
		REAL VAL 15,713,528,400	0	0	15,713,528,400
		PERS VAL 171,717,931	138,019,563	0	309,737,494
		EXEMPT -34,346,966	0	0	-34,346,966
		DEFER -193,900	0	0	-193,900
		NET VAL 15,850,705,465	138,019,563	0	15,988,725,028
F01	AVON FIRE RE	LEVY 267,541.61	1,284.15	.00	268,825.76
		PENALTY 74.57	25.18	.00	99.75
		REAL VAL 883,803,500	0	0	883,803,500
		PERS VAL 10,526,215	4,280,525	0	14,806,740
		EXEMPT -2,524,900	0	0	-2,524,900
		DEFER 0	0	0	0
		NET VAL 891,804,815	4,280,525	0	896,085,340
F02	BUXTON FIRE RE	LEVY 169,300.38	2,892.30	00	172,192.68
		PENALTY 52.90	40.17	00	93.07
		REAL VAL 306,930,100	0	0	306,930,100
		PERS VAL 3,182,909	5,258,754	0	8,441,663
		EXEMPT -2,298,050	0	0	-2,298,050
		DEFER 0	0	0	0
		NET VAL 307,814,959	5,258,754	0	313,073,713
	FRISCO FIRE RE	LEVY 158,893.01	537.06	.00	159,430.07
		PENALTY 34.52	18.29	.00	52.81
		REAL VAL 485,144,100	0	0	485,144,100
		PERS VAL 5,152,657	1,652,398	0	6,805,055
		EXEMPT -1,399,646	0	0	-1,399,646
		DEFER 0	0	0	0
		NET VAL 488,897,111	1,652,398	0	490,549,509
F06	HATTERAS FIRE RE	LEVY 204,794.30	2,526.28	.00	207,320.58
		PENALTY 99.73	68.29	.00	168.02
		REAL VAL 503,534,000	0	0	503,534,000
		PERS VAL 9,807,516	6,315,564	0	16,123,080
		EXEMPT -1,355,966	0	0	-1,355,966
		DEFER 0	0	0	0
		NET VAL 511,985,550	6,315,564	0	518,301,114
9	MANN'S HARBOR FIRE RE	LEVY 33,945.46	909.12	00	34,854.58
		PENALTY 29.56	26.97	00	56.53
		REAL VAL 70,400,100	0	0	70,400,100
		PERS VAL 1,729,136	1,913,912	0	3,643,048
		EXEMPT -666,101	0	0	-666,101
		DEFER 0	0	0	0
		NET VAL 71,463,135	1,913,912	0	73,377,047



drivers to maintain insurance was remedial, the civil penalty imposed upon insurers also was remedial.⁴⁶ The court disagreed, noting that the title of the chapter enacting the civil penalty was AN ACT TO REWRITE G.S. 20-309(E) TO PROVIDE FOR NOTICE OF TERMINATION RATHER THAN INTENT TO TERMINATE BY CARRIERS OF MOTOR VEHICLE LIABILITY INSURANCE COVERAGE AND PENALTY FOR NONCOMPLIANCE.⁴⁷ Moreover, as with the penalties imposed for axle-weight limit violations, defendants failed to show that the penalty was designed to compensate for particular damages incurred by the state or another victim. The court thus concluded that the clear proceeds of penalties imposed on both owners and insurers pursuant to G.S. 20-309(e) are owed to public schools pursuant to Article IX, Section 7, provisions.

Other payments considered in North Carolina School Boards Ass'n

The North Carolina School Boards Ass'n court addressed several other monetary payments imposed for a party's failure to comply with state law. The court concluded that the following are remedial in nature and thus not subject to Article IX, Section 7: the excise tax on unauthorized substances; fees collected by UNC system university libraries for loss, damage, or late return of borrowed materials, and late fees paid to state agencies and licensing boards. The court agreed with the plaintiffs that the following payments were penalties owed to public schools under the state constitution: moneys collected by the Department of Transportation pursuant to G.S. 20-188(e) for violations of axle-weight limits, penalties collected by the Department of Transportation pursuant to G.S. 20-309(e) for lapses in insurance coverage, and payments made by an entity to fund a supplemental environmental project pursuant to a settlement agreement made with the DENR as a result of the entity's environmental violations.

Implications for Payments Required by the Machinery Act

North Carolina School Boards Ass'n raised significant questions regarding whether payments routinely

⁴⁶ *Id.*

⁴⁷ *Id.* at ___, 614 S.E.2d at 521-22 (citing 1975 N.C. Sess. Laws ch. 302, sec. 1 (emphasis added)).

collected by local governments, which had not been allocated to public schools, were also subject to Article IX, Section 7. The status of three types of payments required by the Machinery Act, G.S. Chapter 105, Subchapter II, in addition to the principal amount of ad valorem taxes, merit attention: (1) penalties imposed for the late-listing or failure to list property for ad valorem taxation; (2) penalties imposed for the submission of a worthless check (or e-check) in payment of ad valorem taxes, and (3) interest imposed upon property taxes that are not timely paid. While North Carolina School Boards Ass'n did not address the nature of penalties imposed pursuant to the Machinery Act, it established the framework for determining whether such penalties, which result from violations of state law, are subject to Article IX, Section 7. Analysis of payments required by the Machinery Act in light of the factors identified in North Carolina School Boards Ass'n provides some indication of whether future courts would consider such payments subject to Article IX, Section 7, provisions.

Penalties imposed for failure to list property for taxation



Property owners must list with the county improvements to real and personal property that is subject to taxation.⁴⁸ County tax assessors must "discover" property that is not properly listed with the county during the regular listing period, which is the month of January unless extended by the county.⁴⁹ A presumption applies that such property should have been listed by its owner for the preceding five years.⁵⁰ Thus, when property is discovered, it is taxed for the year in which it was discovered and for any of the preceding five years during which it escaped taxation.⁵¹ The assessor must add a penalty of 10 percent of the amount of the tax for the earliest year in which the property was not listed, plus an additional 10 percent of the same amount for each subsequent listing period that elapsed before the property was discovered.⁵²

Penalties are computed separately for each year in which the owner failed to list.⁵³ The year, the tax

⁴⁸ G.S. 105-301 and -306

⁴⁹ G.S. 105-307; G.S. 105-312

⁵⁰ G.S. 105-312(f)

⁵¹ G.S. 105-312(g).

⁵² G.S. 105-312(h)

⁵³ *Id.*

amount for that year, and the total penalties for failure to list in that year must be shown separately on the tax records.⁵⁴ Taxes and penalties for all years in which the property was not listed are then totaled on a single tax receipt. The total figure is "deemed to be a tax for the fiscal year beginning on July 1 of the calendar year in which the property was discovered."⁵⁵ Because property taxes are due September 1 and payable without interest until the following January 6, no interest accrues on discoveries until the January 6 after the discovery is made.⁵⁶

Pursuant to *Mussallam* and its progeny, the determinative issue regarding whether payments for discovery penalties are subject to Article IX, Section 7, has been whether such "penalties" are designed to punish a taxpayer for failure to timely list the property or, instead, to reimburse the taxing unit for its inability to invest such sums during the period in which the property escaped taxation. Although one could argue that such payments are remedial, it appears far more likely that a court would characterize discovery penalties as being precisely what they are named—that is, penalties.

One of the strongest indicators that discovery penalties are imposed to punish taxpayers is the fact that the penalties are applied only to property not listed due to the taxpayer's failure to list. These penalties are not imposed on all property that escapes taxation, but only on property that taxpayers themselves are required to list. Taxpayers are no longer required to list real property other than improvements, as all counties now have a permanent listing of such property. If real property escapes taxation because the assessor omitted it from the county's tax scroll, the property may be discovered, but no penalties apply. A payment designed to remediate the harm resulting from the taxing unit's loss of funds for taxes owed on the property presumably would apply regardless of whether the nonlisting was the fault of the taxpayer or the assessor. Because the penalty is applied when taxpayers fail to fulfill their statutory obligations, but not when assessors so fail, such payments appear punitive in nature.

The label "penalties" itself, in contrast to the term "interest" found in G.S. 105-360, also indicates the General Assembly's punitive mindset in requiring the payments at issue. Interestingly, the early Machinery

54. *Id.*

55. G.S. 105-312(i).

56. G.S. 105-360

Act termed the interest a "penalty."⁵⁷ While the nomenclature for interest changed in 1971, the label "penalty" is still used to describe the payment required for failure to list property.

One might argue that discovery penalties are remedial because they approximate interest lost due to the taxpayer's failure to pay. The first year's interest for unpaid taxes totals 10¼ percent (9 percent in subsequent years),⁵⁸ and the penalty for failure to timely list is an additional 10 percent for the first elapsed listing period.⁵⁹ Interest does not accrue on discovered amounts until January 6 after the discovery is made. Any argument that the legislature intended discovery penalties to reimburse the taxing unit for lost investment is, however, belied by the application of a 10 percent penalty to property discovered in the year in which it is first subject to tax. For instance, property not properly listed during the January 2005 listing period could be discovered in March 2005, timely billed, and subject to a 10 percent penalty before the taxes become due on September 1, 2005.⁶⁰ If these taxes are paid before January 6, 2006, the taxing unit could not be said to have lost the availability of the funds resulting from its assessment for any period of time. Certainly, in such a case, the discovery penalty serves to punish the taxpayer rather than to remedy any harm to the taxing unit.⁶¹

The proposition that the penalty amount in question is remedial in nature is further rebutted by legislative history. The penalty imposed for failure to

57. G.S. 105-345 (1970) (entitled "Penalties and discounts for nonpayment of taxes") (current version at G.S. 105-360); G.S. 105-345.1 (1970) (entitled "Penalty deemed to be interest") (repealed 1971).

58. G.S. 105-360.

59. G.S. 105-312(h).

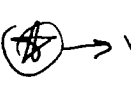
60. G.S. 105-360(a).

61. A court is unlikely to be persuaded by an argument that the penalty compensates a taxing unit for the costs of administering the audit program that resulted in the discovery and listing of the unlisted property. The *North Carolina School Boards Ass'n* court rejected the Department of Transportation's argument that payments required as a result of axle-weight limit violations were remedial in nature. *North Carolina School Boards Ass'n v. Moore*, ___ N.C. ___, ___, 614 S.E.2d 504, 520. The court stated that payments constitute restitution exempt from Article IX, Section 7, only when damages are specifically quantified, and found no such quantification in the statutes governing axle-weight limits. *Id.* Similarly, the Machinery Act does not quantify the injury resulting from failure to list property

list property was set at 10 percent in 1939,⁶² at a time when a full-year's interest amounted to 7 percent.⁶³

Finally, the governing board's authority to compromise discoveries, including amounts assessed as penalties,⁶⁴ and its lack of authority to compromise interest⁶⁵ further demonstrate legislative intent to punish taxpayers for failure to list taxable property. The statutory authorization to waive the penalty indicates the legislature's intent that only deserving parties be punished

The North Carolina Supreme Court's analysis in *North Carolina School Boards Ass'n* indicates that the clear proceeds of discovery penalties most likely are subject to Article IX, Section 7, and thus must be distributed to public schools. The use of the term "penalty" to describe such amounts, the accrual of a 10 percent penalty for the current year, even before the taxing unit may claim to have been deprived of taxes resulting from the discovery, and the governing board's authority to waive such penalties all point to this result.



Worthless check penalties

The Machinery Act imposes a penalty of the greater of \$25 or 10 percent of the amount of the check, subject to a maximum of \$1,000, for a payment of taxes by check or electronic funds transfer that is returned or not completed due to insufficient funds or the nonexistence of an account⁶⁶ The penalty does not apply if the person who wrote the check or made the electronic transfer had sufficient funds in another account to make the payment but inadvertently wrote the check or transferred the funds from the incorrect account. The supreme court's decision in *North Carolina School Boards Ass'n* makes clear that such penalties are subject to Article IX, Section 7, provisions. First, the potential magnitude of the penalty, which may be as much as \$1,000, rebuts any argument that the penalty is primarily remedial in nature. Second, the exception to the penalty for inadvertent submission of worthless checks or transfers points to the punitive nature of the law. If the law does not apply to unintentional violations, then surely its aim is to punish, since the cost to the taxing

62 1939 N.C. Sess. Laws ch. 310, sec. 1109.
 63. G.S. 105-345 (1939) (current version at G.S. 105-360).
 64. G.S. 105-312(k)
 65. G.S. 105-380, G.S. 105-381
 66 G.S. 105-357(b)(2)

unit presumably will be the same for bad checks and transfers regardless of the payer's intent. Moreover, it is unlikely that the taxing unit would earn an average 10 percent rate of return on deposited sums in the interval between the deposit of a worthless check and the ultimate payment of the tax. Finally, the supreme court's holding that worthless check penalties imposed by the ESC are punitive in nature⁶⁷ indicates that a subsequent court would conclude likewise concerning worthless check fees imposed by the Machinery Act

Interest for late payment of taxes

Finally, questions may arise regarding whether, pursuant to the supreme court's analysis in *North Carolina School Boards Ass'n*, interest imposed for late payment of property taxes is punitive in character and thus subject to Article IX, Section 7. The Machinery Act imposes a 2 percent penalty for the first month in which property taxes become delinquent and 3/4 percent per month thereafter.⁶⁸ Interest accrues at a set percentage each month, regardless of the number of days remaining in the month after payment of the taxes.⁶⁹ As noted earlier, the interest rate for the first 12 months of delinquency is 10 1/4 percent. Interest for subsequent years totals 9 percent.

Beginning in January 2006, interest on delinquent payment for taxes assessed on registered motor vehicles accrues at the rate of 5 percent for the first month and 3/4 percent per month thereafter.⁷⁰ Sixty percent of the interest collected on unpaid motor vehicle taxes after January 1, 2006, will be transferred to the Combined Motor Vehicle and Registration Account to fund the development of a DMV computer system that will integrate the processes of taxing and registering motor vehicles.⁷¹

It seems unlikely that a court would consider any of the interest assessed pursuant to the Machinery Act to be a penalty. As noted in the discussion regarding discovery penalties, the General Assembly in 1971 relabeled as "interest" the amounts assessed for delinquent payment of taxes, amounts which were

67 *North Carolina School Boards Ass'n v. Moore*, ___ N.C. ___, ___, 614 S.E.2d 504, 522.
 68 G.S. 105-360(a).
 69. *Id.*
 70. S.L. 2005-294 (H 1779).
 71 *Id.*