The District's Dime
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The DC Fiscal Policy Institute blog
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July 17, 2013

The DC Council Should Not Resolve Pepco's Tax Dispute -- Let the Courts Weigh in First

By Jenny Reed

Pepco has a tax dispute with the District. Rather than challenging the city's tax office in court – the traditional route – Pepco took its case to the DC Council, which introduced legislation that would address issues raised by its case. DCFPI testified last week that legislation is the wrong way to approach this issue, which could result in $16 million or more in cost to the District.

While the bill is depicted as addressing a flaw in DC's tax code that can lead a business's income to be taxed twice, the reality is more complex. The bill would address the tax dispute between Pepco and the District in Pepco's favor – without all the facts being known – and it could allow other individuals or businesses to claim tax refunds.

Given the complexities of current tax law as it applies to Pepco's case, and the high cost to the District of the proposed legislation, we believe it is better to require Pepco and other affected taxpayers to resolve these issues through the courts. That process could reveal the need to fix DC's tax code through legislation, but we do not know yet.

This bill appears to have come about because Pepco feels that the Office of Tax and Revenue (OTR) incorrectly denied their claim for a refund for a prior tax return, following an IRS audit that resulted in adjustments to the company's income. Pepco argues that the denial of the refund results in inappropriate double taxation of their income.

However, for several reasons, legislation is not the appropriate vehicle to resolve this issue – at least not at this time. One key issue is that DC law, prior to 2001, set a three-year statute of limitations on when a taxpayer could receive a refund when an IRS audit resulted in an adjustment their reported income. The recent audit in question was completed after the three-year period. Yet, DC has mechanisms for taxpayers to notify the tax office when a federal audit is happening that essentially removes the statute of limitations. We do not know if Pepco took advantage of this.

That is why the facts of this case need to come out, which would occur during court proceedings. This also could reveal if there are indeed flaws in DC's law and that changes are needed. At that point, we think that legislation could be necessary. DCFPI is concerned that this bill could set a precedent for the Council preemptively resolving a tax dispute without the full facts of the issue at hand and without the District able to defend its actions.

DCFPI also raised concerns about the proposed financing of the bill. Currently, it's designed not to have a fiscal impact, but that doesn't mean that there isn't a cost. In fact, the bill is designed to push the costs of the legislation, which will likely be at least $16 million, outside of DC's financial planning window making it appear as if it has no cost. DCFPI feels that this isn't a fiscally responsible way to budget and suggests that the bill be changed to reflect the full costs up front, as well as possible ways to pay for it.

To read the complete testimony, click here.