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**TESTIMONY OF JENNY REED, POLICY DIRECTOR  
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**At the Public Hearing on  
B20-348, "The Tax Clarity Equity Amendment Act of 2013"  
District of Columbia Committee on Finance and Revenue  
July 12, 2013**

Chairman Evans and members of the Committee, thank you for the opportunity to testify today. My name is Jenny Reed, and I am the Policy Director of the DC Fiscal Policy Institute. DCFPI engages in research and public education on the fiscal and economic health of the District of Columbia, with a particular emphasis on policies that affect low- and moderate-income residents.

I am here today to testify on Bill 20-348, "The Tax Clarity Amendment Act of 2013." DCFPI has concerns with legislation. While the bill has been depicted as needed to address a flaw in DC's tax code that can lead an individual or business's income to be taxed twice, the reality is more complex. In essence, the bill would address a tax dispute between the Potomac Electric Power Company ("Pepco") and the District -- in Pepco's favor -- and it would do so in a way that 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 that it is better to require Pepco and other affected taxpayers to attempt to resolve these issues through the courts. We also have concerns about the proposed financing of the legislation and suggestions for how the District should amend the bill if it proceeds.

The bill would allow any taxpayer who had their federal income adjusted by the Internal Revenue Service (IRS) prior to 2001 to claim a tax credit, based on that adjustment, for the amount of the resulting decrease in DC tax. It is DCFPI's understanding that this bill came about because the Pepco felt that the Office of Tax and Revenue (OTR) incorrectly denied their claims for a credit, but as noted, this bill would apply to any taxpayer.

Pepco argues that the denial of the credit results in inappropriate double taxation of their income. . . However, for several reasons, DCFPI feels that legislation, at this time, is not the appropriate vehicle to resolve this issue. Let me elaborate why.

One issue that has been raised is that OTR is applying two different sets of rules regarding refunds for adjustments to income made by the IRS—one set for returns for tax years prior to 2001 and one for a set after 2001. However, it's very common for tax law, when implemented, to apply only going forward and not retroactively. So it's not uncommon for different rules to be applied to tax returns based on the year they were filed.

Another issue is that under DC law prior to 2001, the District set a statute of limitations on when a taxpayer could receive a refund when an adjustment had been made to their federal tax return by the IRS. That statute of limitations was three years after a return is filed. It is my understanding that this three years also mirrors the window for when the IRS has to begin an audit for a filed federal return. It is DCFPI's understanding that this statute of limitations prevented Pepco from claiming a refund for pre-2000 returns (which are covered under the old law) that had been adjusted, because the final IRS decision over the adjustments was made after the three-year period.

Yet it seems that District law has provisions to protect taxpayers in these situations. Because IRS audits may not finish within three years, the District allows taxpayers to file a 'protective claim' that in essence notifies the District that a taxpayer is under federal audit and it may result in an adjustment. That protective claim essentially removes the statute of limitations for the taxpayer. We don't know whether Pepco sought out a protective claim when they had their federal audit and/or was able to do so within the three year window.

The normal recourse in tax disputes, when taxpayers feel that they have been treated unfairly, is the legal system. The judicial process allows for all of the relevant facts of the dispute to come out and be assessed. This bill would in effect rule in Pepco's favor without a release of all relevant facts and without giving the District's Office of Tax and Revenue a chance to defend its prior rulings.

While we don't know the total cost, the Washington Post reported that Pepco would be due a refund of close to \$16 million.<sup>1</sup> The cost would be higher if other companies sought refunds based on this legislative change. Given the magnitude of the financial impact of this legislation, and the complexities, it seems like the best place for this issue to be answered is in a court of law. To be clear, the DC Fiscal Policy Institute is not making any comment on the merits of the claims made by Pepco regarding its right to a refund. Instead, we are arguing these merits should be assessed by the courts and not by the DC Council at this time.

If this bill passes, it could allow other companies to claim refunds that have been denied by OTR without knowing the merits of their case against the District. And more important, this bill would set a precedent of having the Council intervene legislatively to preempt a tax dispute that a corporation may have with the District, without the facts of the case fully coming out and without the opportunity for the District's tax office to defend its actions.

It is possible that the outcome of a court case could show that legislative changes are needed, because it could highlight the flaws in current law. At that point, it would seem that the Council may want to enact legislation. So DCFPI is not saying that ultimately the Council should not have a role in addressing this issues, just not at this time.

Lastly, I would like to address the fiscal impact of this bill and how the bill has been structured in a way that makes the costs unclear. There is also no official fiscal impact statement for the legislation, however that doesn't mean that there is not a cost. In fact, it has been reported that if this bill were to pass, the Pepco would receive a credit of nearly \$16 million and that there are potentially other companies that could seek refunds as well.<sup>2</sup>

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<sup>1</sup> DeBonis, Mike: "Pepco Could Get Nearly \$16 million tax refund under D.C. Council bill," Washington Post, 6/19/2013, available at: [http://articles.washingtonpost.com/2013-06-19/local/40068020\\_1\\_refunds-tax-returns-revenue-committee](http://articles.washingtonpost.com/2013-06-19/local/40068020_1_refunds-tax-returns-revenue-committee)

<sup>2</sup> Ibid

The District is required to have a balanced four-year financial plan. Any legislation that is passed within that four year window, and that has a cost, must be paid for before it can be implemented. The bill however, seems designed though to push the potential costs of the legislation outside of the four year financial planning window--by not allowing the credit to take effect until January 1, 2017--and therefore makes it possible for the Council to pass the legislation without having to pay for the costs.

This is not a fiscally responsible way for the District to budget and could set a precedent that jeopardizes the long-term fiscal health of the District. We suggest that if the Council wants to make the legislation a priority that it also pay for the costs of the legislation. We suggest though that the Council consider using the District's fund balance or settlements and judgments funds to pay for the costs of implementing this legislation.

Thank you for the opportunity to testify and I am happy to answer any questions.