

Good News, Bad News: Sanctioning the D.C. Office of Tax and Revenue

by Stephen P. Kranz, Diann L. Smith, and Charles C. Capouet



Stephen P. Kranz



Diann L. Smith



Charles C. Capouet

Stephen P. Kranz is a partner, Diann L. Smith is counsel, and Charles C. Capouet is an associate with McDermott Will & Emery LLP.

In part 2 of a two-part series on *D.C. Office of Tax and Revenue v. Shuman*, the authors describe remedies available to taxpayers contesting assessments or harassment by the D.C. tax authority.

An administrative law judge for Washington's Office of Administrative Hearings (OAH) recently gave an exceptionally good wallop to the district's Office of Tax and Revenue (OTR). Unfortunately, on appeal, a court removed the sanctions as beyond the ALJ's power, but it did not eliminate the availability of sanctions in the right forum and in the right amount. Thus, taxpayers aggrieved by the OTR, and particularly the OTR's troubled computer system, should continue to consider seeking sanctions in appropriate circumstances.

Background

As discussed in part one of this series, *D.C. Office of Tax and Revenue v. Shuman*, 82 A.3d 58 (D.C. 2013),¹ revolved around the havoc caused by an uncooperative computer system.² John and Sara Shuman, Washington residents, were entitled to a \$790 refund on their 2004 D.C. tax return. However, the OTR mistakenly entered that figure as

a tax liability owed to the district. And so began a nightmare for the Shumans that really must be read to be believed.³

The Shumans promptly contacted the OTR to fix the mistake. The OTR acknowledged the mistake, but human acknowledgement could not prevent the Shumans' continued computer-related problems. After a subsequent tax year's refund was improperly withheld to cover the mistaken liability, the Shumans filed a taxpayer's protest of a proposed assessment with the OAH.

The ALJ exercised jurisdiction over the case and held a status conference, during which an OTR representative agreed that the Shumans were entitled to receive a refund of \$790 and that the OTR had in fact sent them a check.

But the OTR was not done with the Shumans: It mistakenly sent them another refund check for \$1,799.76 as well as an offset notice for \$19,151, all for the 2004 tax year, the genesis of the problem. The OTR promised the ALJ that if the Shumans returned the mistakenly issued check, all tax liability would be resolved, and the ALJ dismissed the case without prejudice. The Shumans returned the check, but the OTR continued to send them forms and notices not only alleging that they still owed the original, imagined \$790 deficiency, but also increasing their liability to more than \$23,000⁴ and reporting the tax deficiency to the IRS.

The Shumans returned to the ALJ and asked that their case be reopened. The OTR promised the ALJ that it would manually overwrite the balance. The ALJ warned the OTR that if it "sent another erroneous notice claiming tax due for 2004 . . . [it] would be subject to potential monetary sanctions for failure to comply with a lawful order." The Shumans enjoyed six months of peace. The ALJ closed the case with the caveat that if the OTR, its computers, or its contractors sent another notice or tax bill or took any other action to collect money from the Shumans for tax year 2004, the OTR could be subject to monetary sanctions.

Any even mildly prescient reader knows what happened next. More than a year after the case was closed — for the

¹The opinion is beautifully written, with phrases such as "more astonished than pleased," emphasizing both the humanity and the absurdity of the situation.

²Kranz et al., "D.C. Court Gives Taxpayers Another Path to Fight OTR," *State Tax Notes*, Apr. 14, 2014, p. 95.

³Based on a parenthetical in the opinion, as of Dec. 2013, the mistaken entry still was not fixed in the OTR's computer system. Thus, there could be a *Shuman 2, Judgment Day*.

⁴Various OTR notices claimed the 2004 liability was \$1,380; \$1,580; \$7,292; and \$23,891.

second time — the Shumans received three more notices of offset all relating to the 2004 tax year. The ALJ reopened the case and held a hearing regarding whether the OTR should be sanctioned. The OTR’s only argument was that “the computer system would not allow the attempted corrections to be preserved.”

Even after that hearing the OTR issued more refund checks and more notices of offset. The ALJ had had enough. She issued a final order on sanctions and ordered the OTR to pay to the OAH almost \$81,000, “the amount of money OTR erroneously claimed in Notices of Offset or distributed to [the Shumans] in erroneous checks.” The ALJ also imposed escalating daily fines if the OTR failed to comply with the order to correct the malfunction in the computer system or have the system replaced within two weeks of the order’s issuance. The OTR appealed.

Can an Administrative Agency Impose Sanctions?

The D.C. Court of Appeals held that the ALJ did not have authority to issue the sanctions and rejected each: a monetary penalty, a requirement to fix the computer system, and a fine for failure to fix the computer system.

First, the court found that ordering the OTR to repair or replace its computer system and to cease sending the Shumans incorrect assessments were not lawful orders but instead impermissible injunctions because the ALJ had no authority to ensure that future assessments were accurate. Second, because the ALJ could not enjoin the OTR, she also could not impose financial penalties to compel compliance with the injunctions. The court determined that the fines for failure to comply were essentially a civil contempt procedure that only courts, not administrative agencies, have the authority to issue. Finally, the court held that the ALJ could not require the OTR to pay the OAH \$80,825.26.

It seems not to be that the ALJ *could* do something, but *what* she did, that underlies the court’s holding.

It seems not to be that the ALJ *could* do something, but *what* she did, that underlies the court’s holding. The court was troubled by the randomness of the amount she required the OTR to pay the OAH. It was tied only to the total amounts listed in the OTR’s notices to the Shumans, not to any actual calculation of costs to the taxpayers or the OAH, or a realistic amount that would deter future misconduct. The court noted that the precedent cited by the ALJ in-

volved amounts that “were minimal in comparison to the more than \$80,000 at issue.” The court was also concerned by, but did not base its decision on, the fact that the ALJ was decreeing payment to her own agency (a problem of impartiality).

The court acknowledged that the statute authorizes monetary sanctions for violating a lawful order and that sanctions for unnecessary consumption of judicial resources would not be barred. The problem was that the ALJ never issued a lawful order. The only order governed the OTR’s prospective behavior, which the ALJ was not authorized to do.

Remedy

The D.C. Court of Appeals was not happy with the practical result of its legal conclusion, making clear that it has some understanding and sympathy for what the Shumans experienced. The court noted that the taxpayers could, for example, bring an action in D.C. Superior Court for equitable relief for the type of harassment they endured. It obviously wanted to delineate when equitable remedies such as injunctions and fines can be issued. For taxpayers who want to stop abuse prospectively, the OAH is not the right forum; a claim like that should be brought directly in D.C. Superior Court.

Equally important, however, is that the decision allows the OAH to issue monetary sanctions against the OTR as long as there is a legitimate underlying order. Thus, ALJs and taxpayers should always ensure that an appropriate order is issued. Any capitulation by the OTR resulting in the ALJ merely dismissing a case without prejudice may not sufficiently protect an aggrieved taxpayer.

If the OTR fails to comply with a proper order, sanctions can be imposed. For example, if a taxpayer wins a protest of an assessment but the OTR fails to comply with the OAH’s decision, the OAH can issue sanctions against the OTR. Permissible sanctions may include requiring the OTR pay the taxpayer’s attorney fees and other damages related to its failure to comply with a lawful order.⁵ Thus, taxpayers wronged by the OTR’s intractable administrative woes should seek to be made financially whole through sanctions. ☆

⁵Sanctions awarded in favor of the taxpayer, rather than the OAH, also remove the conflict of interest aspect that troubled the court.