

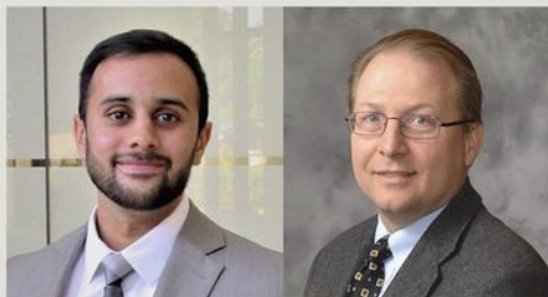
Legal Intelligencer

<https://www.law.com/thelegalintelligencer/2020/01/02/commonwealth-court-ruling-severs-dollar-cap-on-nol-carryovers/>

Commonwealth Court Ruling Severs Dollar Cap on NOL Carryovers

The Pennsylvania Commonwealth Court determined that the correct relief for finding that the \$2 million flat dollar cap on net operating loss carryovers (NOLCs) is unconstitutional is to sever the dollar cap and order a refund of taxes paid for the tax year at issue

By **Vijay Ramamurthi and Michael Ostafy** | January 02, 2020 at 01:59 PM



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The Pennsylvania Commonwealth Court determined that the correct relief for finding that the \$2 million flat dollar cap on net operating loss carryovers (NLCs) is unconstitutional to sever the dollar cap and order a refund of taxes paid for the tax year at issue, see *General Motors Corp. v. Commonwealth*, Pa. Commw. Ct., [No. 869 F.R. 2012, 11/21/2019](#); *RB Alden v. Commonwealth*, Pa. Commw. Ct., [No. 73 F.R. 2011, 11/21/2019](#) (opinion not reported). If the ruling stands, the state could be forced to give General Motors a nearly \$739,000 refund of its corporate taxes. This decision could allow other corporations that have filed refund claims based on the net operating loss (NOL) limitation, to get substantial refunds as well. Taxpayer's with similar tax situations may also submit refund claims if the three-year statute of limitations has not expired.

Pennsylvania NLCs

The taxpayer appealed from a decision of the Department of Revenue Board of Appeals that denied a refund of corporate net income taxes paid for 2001 based on the taxpayer's claim that the \$2 million flat dollar cap on the amount of net operating loss carryover (NLC) violated the uniformity clause of the Pennsylvania Constitution. The \$2 million cap created unequal treatment because smaller firms with less than \$2 million in carryover losses from prior tax years could write off their entire losses and pay no tax to the state. By contrast, GM and other business giants could write off only part of their losses that exceeded \$2 million and still have to pay taxes.

While GM's appeal was pending, the Pennsylvania Supreme Court issued an opinion in *Nextel Communications of the Mid-Atlantic v. Commonwealth*, [171 A.3d 682](#) (Pa. 2017), cert. denied, 138 S. Ct. 2635 (2018), holding that a \$3 million flat dollar cap on NLC violated the uniformity clause by creating a nonuniform classification based solely on whether the taxpayer's income

exceeded \$2 million. However, the case did not resolve the issue of an appropriate remedy.

Positions

GM argued that the appropriate remedy is to sever the flat dollar cap, which would put them in the same position as other taxpayers whose income did not exceed \$2 million. Pennsylvania argued that the General Assembly never intended an unlimited NLC deduction, and that the primary legislative intent is to protect the commonwealth's fiscal health; which would be threatened by having to refund taxes for all taxpayers who were previously subject to the cap.

That cap set by the legislature illegally created two classes of corporate taxpayers—those who could not claim at least \$2 million in business losses and those whose losses met or exceeded that cap. The court concluded that the flat dollar cap violated the uniformity clause of the state constitution.

The U.S. Supreme Court fashioned a three-factor test for determining whether relief should apply retroactively or prospectively in *Chevron Oil v. Hudson*, [404 U.S. 97](#) (1971). The test examined: whether the decision establishes a new principle of law; whether retroactive application of the decision will further the operation of the decision; and the relevant equities.

The Supreme Court made it clear in *Nextel* that it merely needed to apply existing case law to which it had steadfastly adhered for over a century in order to find that the flat dollar cap violated uniformity. Therefore, there was no new principal of law established. Also, if only the cap is severed, retroactive application would further the operation of the *Nextel* decision by reducing the taxpayer's tax liability to zero, and putting the taxpayer in the same position as the other favored taxpayers. Lastly, even if *Nextel* had

announced a new principle of law, the commonwealth did not meet its burden of showing that it would be inequitable to apply the new principle retroactively.

Remedy

Based on the above, the Commonwealth Court concluded that the intent of the General Assembly is better served by retroactively severing only the \$2 million flat dollar cap (rather than striking the entire NLC provision) and remanding the matter for recalculation of the taxpayer's 2001 tax and issuance of a refund.

The Commonwealth Court majority ruling could be appealed to the state Supreme Court.

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