

This Week in State Tax (TWIST)

November 25, 2024



Pennsylvania: State High Court Says *Nextel* Is Not Retroactive

The Pennsylvania Supreme Court has held that taxpayers who were subject to an unconstitutional limitation on net operating losses (NOLs) are not entitled to refunds for taxes paid under the now-overturned regime. In doing so, the court rejected its previous decision in *General Motors Corp. v. Commonwealth*, which held that the prohibition on flat NOL caps applied retroactively.

Starting in 2007, Pennsylvania law generally capped the amount of NOLs that a corporation could use at 12.5 percent of its taxable income or \$3 million, whichever was larger. Nextel Communications successfully argued that this scheme unfairly favored a taxpayer with a lower income (which could offset its entire taxable income up to the \$3 million cap) over one with a higher income (which could never offset more than 12.5 percent of its taxable income) in violation of the Pennsylvania Constitution's Uniformity Clause. After reviewing potential remedies for the unequal treatment, the Pennsylvania supreme court ruled in *Nextel* (2017) that eliminating the \$3 million minimum cap (and thereby limiting NOLs for all taxpayers to 12.5 percent of taxable income) was the approach that best preserved the intention of the legislature which had consistently favored some limitation on the use of NOLs. In a subsequent case, General Motors challenged a pre-2007 NOL limitation, which subjected all taxpayers to a flat \$2 million cap on NOL usage, as a violation of the Uniformity Clause. The parties agreed that the flat cap was unconstitutional, but the case made its way to the Pennsylvania supreme court on the question of whether the prohibition on flat NOL caps as established in *Nextel* should apply retroactively. In addressing the question, the *General Motors* court focused on the question of whether *Nextel* established a new principle of law. The court ruled that it had not done so, but rather had applied longstanding principles related to the Uniformity Clause, meaning the prohibition should apply retroactively and that General Motors was entitled to a refund.

The current case concerned taxes paid for tax year 2014. Like the years at issue in *Nextel* (and unlike the years at issue in *General Motors*), the NOL limitation in 2014 included both a percentage cap and a flat minimum cap. Under the rule laid down in *Nextel*, there was no question that flat cap should be invalidated. The taxpayer further argued that, under the *General Motors* decision on retroactivity, Pennsylvania was required also to remedy the disparate treatment of those affected by the percentage cap. Since it could not practically or legally require additional payments from taxpayers who benefited from the now-invalidated flat cap, the Commonwealth must instead provide relief to taxpayers that were subjected to the percentage-based limitation and allow a full NOL deduction for past years.

In a split decision, the state supreme court rejected this argument, and in doing so, repudiated its previous ruling on retroactivity in *General Motors*. The current court ruled that the *General Motors* court misapplied the Chevron test to determine retroactivity when it focused on only one of its three factors—whether the decision being applied

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established a new principle of law—and erred as well when it ruled that *Nextel* had not done so. On the “new principle of law” factor, the court ruled that the decisions relied on in *Nextel* were sufficiently distinguishable (as applying to other than corporate income taxes) to require a finding that the decision was a novel one. On the second factor (whether retroactive application would forward the operation of the decision) the court noted that many taxpayers would be ineligible for relief due to statutes of limitations having expired; remedying disparate treatment in a way that was available only to some affected taxpayers would not further the uniformity principle advanced in *Nextel*. On the third prong, the court ruled that equities did not favor retrospective application because of the “potentially devastating repercussion” a refund requirement would have on the public fisc. As all three *Chevron* prongs militated against retroactive application of *Nextel*, the taxpayer was not entitled to a refund. Contact [Mark Achord](#) for more information on [Alcatel-Lucent USA Inc. v. Commonwealth](#).

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