APPENDIX

APPENDIX A

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 EAP 2016

NEXTEL COMMUNICATIONS
OF THE MID-ATLANTIC, INC.,

Appellee

v.

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF REVENUE

Appellant

Appeal from the Judgment of the Commonwealth Court entered on December 30, 2015 at No. 98 F.R. 2012

ARGUED: April 5, 2017

DECIDED: October 18, 2017

OPINION

SAYLOR, C.J., BAER, TODD, DONOHUE, DOUGHERTY, WECHT, MUNDY, JJ.

JUSTICE TODD

In this direct appeal, we are called upon to determine whether the "net loss carryover" provision of the Pennsylvania Revenue Code for tax year 2007

("NLC")[1] – which restricted the amount of loss a corporation could carry over from prior years as a deduction against its 2007 taxable income to whichever is greater, 12.5% of the corporation's 2007 taxable income or $3 million – violates Article 8, Section 1 of the Pennsylvania Constitution ("the Uniformity Clause").[2] We affirm the Commonwealth Court's holding that the NLC, as applied to Appellee, Nextel Communications ("Nextel"), violates the Uniformity Clause. However, we also find that the portion of the NLC which creates the violation – the $3 million flat deduction – may be severed from the remainder of the statute, while still enabling the statute to operate as the legislature intended. Thus, we reverse the order of the Commonwealth Court eliminating any caps on net loss deductions for tax year 2007; and, correspondingly, we reverse its direction to Appellant, the Pennsylvania Department of Revenue ("Department"), to refund $3,938,220 to Nextel, which was the amount of its 2007 net income tax payment to the Commonwealth.

I. Procedural History

Nextel, which is incorporated in the state of Delaware, is a provider of various mobile telecommunication services. In 2007, Nextel earned $45,053,282 in taxable income on its business activities in the Commonwealth. Under the NLC, Nextel was entitled to deduct from its 2007 taxable income the net losses it sustained in prior tax years in the amount of $3 million or 12.5% of its 2007 taxable income, whichever total was greater. In 2007, Nextel had a cumulative

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[1] Act of March 4, 1971, P.L. 6, as amended, 72 P.S. § 7401(3)4.(c)(1)(A)(II).

[2] Pa. Const. art. VIII, § 1.

net loss dating from the tax year 1997 of $150,636,792.[3] Because 12.5% of Nextel's 2007 taxable income amounted to $5,631,660, and, hence, was greater than $3 million, Nextel claimed the 12.5% amount as a net loss deduction, thereby reducing its taxable income for 2007 to $39,421,622. Under the corporate net income tax rate of 9.9%,[4] Nextel's total tax liability to the Commonwealth on this adjusted income was $3,938,220, which Nextel paid to the Department.

Thereafter, Nextel filed a refund claim with the Department's Board of Appeals for the full amount of its 2007 tax payment, claiming, *inter alia*, that the NLC violated the Uniformity Clause of the Pennsylvania Constitution by capping the amount of its prior net loss that it could carry over into tax year 2007 at 12.5% of its taxable income. This claim was denied by the Board on the basis that it did not have the legal authority to address a constitutional challenge. Nextel then petitioned the Board of Finance and Revenue, again claiming its entitlement to a refund and asserting the right to carry over all prior net losses for use as a deduction without limitation.[5] The Board of Finance and Revenue denied the petition and

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[3] The Revenue Code provides that net losses sustained during tax year 1997 could be carried over during the following 10 tax years. Beginning in tax year 1998, and for all tax years thereafter, corporations are permitted to carry over their net losses for 20 years. 72 P.S. § 7401(3)4.(c)(1)(2)(A).

[4] *See* 72 P.S. § 7402(b).

[5] Although not natural persons, our case law recognizes the entitlement of corporations, as taxpayers obligated to pay the corporate net income tax, to the protections of the Uniformity Clause. *See Turco Paint v. Kalodner*, 184 A. 37 (Pa. 1936) and *Commonwealth v. Warner Brothers Theaters*, 27 A.2d 62 (Pa. 1942), discussed *infra*.

rejected Nextel's constitutional argument, noting that it was not empowered to pass on questions of a taxing statute's validity under our constitution, but, rather, could only apply the law as it was written.

Nextel appealed to the Commonwealth Court, which, in a split *en banc* published decision, reversed the decision of the Board of Finance and Revenue.[6] *Nextel Communications of the Mid-Atlantic, Inc., v. Commonwealth of Pennsylvania, Department of Revenue*, 129 A.3d 1 (Pa. Cmwlth. 2015). The majority first rejected the Department's argument that, because all corporations were subject to the same statutory rate of 9.9% on their taxable income, there was no Uniformity Clause violation. The majority noted that it is the effect of the application of the particular formula or method used to calculate a tax which determines whether a Uniformity Clause violation occurs.

In considering the effect of the NLC on various corporations' taxable income, the majority determined that, as written, it allowed some corporate taxpayers – those with income of $3 million or less – to reduce their tax liability to zero in the tax year 2007, if they had prior net operating losses of $3 million or more. By contrast, it imposed tax liability on other corporations with income in excess of $3 million and prior net operating losses which equaled or exceeded their taxable income, because those corporations' net loss deduction was capped (at the greater of $3 million or 12.5% of their taxable income).

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[6] This decision was authored by Judge Brobson and joined in full by Judges McGinley, Cohn Jubelirer, Leavitt, and Covey. Then-President Judge Pellegrini filed a concurring and dissenting opinion joined by Judge Leadbetter.

The majority next examined whether the NLC's application to corporate taxpayers on the basis of taxable income was reasonable, and rationally related to a legitimate state purpose. The majority observed that our Court had previously held, in *In re Cope's Estate*, 43 A. 79 (Pa. 1899) (invalidating an inheritance tax provision that exempted estates worth $5,000 or less from paying that tax), that a tax rate based on the monetary value of the property taxed, which has the effect of causing different groups of taxpayers from the same class to bear unequal burdens of taxation, or which exempts some taxpayers in the class from paying any tax at all, offends the Uniformity Clause. The majority reasoned that, because the NLC was structured to assess a corporation's tax liability on the basis of the value of a corporation's taxable income, in operation, the NLC enabled the majority of corporations with taxable income (98.8%) to avoid paying any taxes at all in 2007; but, because of the limitation on the amount of net loss carryover which a corporation was permitted to deduct, it forced a minority of those taxpayers (1.2%) to incur tax liability.[7] The majority concluded that, because this disparate tax treatment was "based solely on asset value," the NLC was the same type of taxing statute our Court held to be forbidden under the Uniformity Clause in *Cope's Estate*, and was likewise unconstitutional. *Nextel*, 129 A.3d at 11.

The majority was unpersuaded by the Department's argument that the General Assembly was justified in

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[7] These percentages were derived from data furnished by the Department showing that, in tax year 2007, 19,537 corporations had net loss carryover deductions which equaled or exceeded their taxable income. Of these, 234 corporations paid taxes because their taxable income apportioned to Pennsylvania exceeded the $3,000,000 flat deduction allowed by the NLC. See Exhibit D to Parties' Stipulation of Facts, 3/17/15, (R.R. at 43a).

limiting the amount of loss from a prior tax year which a corporation could carry over because of budgetary concerns that an unlimited deduction would result in too much lost revenue. The majority acknowledged the General Assembly's right to limit such deductions, but viewed this right as constrained by the fundamental requirement that any such limitation comport with the Pennsylvania Constitution, and, thus, in the majority's view, this concern could not excuse the NLC's violation of the Uniformity Clause.

Having determined that the NLC was unconstitutional, the majority next turned to the issue of the appropriate remedy. The majority refused to strike the NLC in its entirety from the Revenue Code as suggested by the Department, reasoning that Nextel had not made a facial challenge to the constitutionality of the NLC, nor, in reaching its decision, had the court found the NLC to be facially unconstitutional. Instead, the majority noted that Nextel had claimed only that the NLC was unconstitutional as applied to it for the 2007 tax year, and, thus, the majority concluded that the appropriate relief should be limited to remedying the improper application of the NLC to Nextel's taxable income for that tax year.

Observing that the Uniformity Clause and the Equal Protection Clause of the United States Constitution have generally been analyzed in the same fashion, the majority found guidance from cases in which a taxpayer successfully established that a state engaged in discriminatory enforcement of its taxing laws, resulting in the taxpayer paying more than other similarly situated taxpayers, and, as a remedy, the taxpayer was afforded relief from the improperly assessed additional tax liability. *See Nextel,* 129 A.3d at 12-13 (citing *Commonwealth v. Molycorp*, 392 A.2d

321 (Pa. 1978) (after successful challenge by corporation under the Uniformity Clause to the Department's selective imposition of tax penalties for underpayment of corporate taxes against one group of corporate taxpayers, our Court determined that the proper remedy was to reverse the Department's assessment of a penalty against the corporation); *Iowa-Des Moines National Bank v. Bennett*, 284 U.S. 239 (1931) (bank which was successful in its equal protection challenge to county taxing authority's assessment of taxes on it at a higher rate than its competitors was entitled to a refund of the extra taxes it had paid, and it was not a sufficient remedy to require the bank to seek to compel the collection of additional taxes against its competitors, or to wait for the taxing authority to collect the additional taxes of its own volition); *Tredyffrin-Easttown School District v. Valley Forge Music Fair, Inc.*, 627 A.2d 814 (Pa. Cmwlth. 1993) (business that successfully challenged enforcement of amusement tax ordinance which resulted in it paying more in taxes than other similarly situated businesses was entitled to a refund of the excess taxes it paid)).

The majority reasoned that, like the taxpayers in those cases, Nextel established that it was subject to unequal treatment *vis-a-vis* other corporate taxpayers and was entitled to a similar remedy. While acknowledging that it could strike the flat $3 million deduction for the 2007 tax year, which would then make the 12.5% deduction uniformly apply to all corporate taxpayers, it rejected that alternative as, in its view, this would not correct the constitutional violation suffered by Nextel and "would only serve to highlight the fact that, while Nextel paid what it was supposed to pay, many corporate net income taxpayers in the 2007 Tax Year benefitted from the discriminatory cap and thus *underpaid* their corporate net income taxes – i.e.,

benefitted from the unconstitutional provision." *Nextel,* 129 A.3d at 13 (emphasis original). The majority thus viewed the "only practical solution" to be to allow Nextel to use its prior operating losses to reduce its corporate taxable income to zero in the 2007 tax year, and, thus, pay no taxes, just as did 98.8% of corporations in that tax year – i.e., those with $3 million or less of taxable income and an equivalent or greater amount of prior net loss deductions for that tax year. *Id.*

The majority, perceiving there would possibly be significant deleterious revenue consequences to the Commonwealth of its decision, attempted to limit its scope "to the [Department], Nextel and the 2007 Tax Year." *Id.* The majority further opined that, "[t]o the extent our decision in this as-applied challenge calls into question the validity of the NLC deduction provision in any other or even every other context, the General Assembly should be guided appropriately." *Id.* In accordance with its decision, the Commonwealth Court entered an order directing the Department to refund to Nextel the $3,938,230 it had paid in corporate net income tax for tax year 2007.

Then-President Judge, now-Judge, Pellegrini authored a concurring and dissenting opinion which was joined by Judge Leadbetter. While agreeing with the majority that the NLC violated the Uniformity Clause, Judge Pellegrini dissented from the majority's proposed remedy. Judge Pellegrini disagreed that the majority's decision could be restricted in its effect only to a determination of the amount of tax Nextel owed for tax year 2007. By contrast, he viewed the majority's characterization of Nextel's challenge as being an "as applied" one to be irrelevant to the impact of its holding, inasmuch as he viewed the practical

effect of the court's decision as allowing all corporate taxpayers to, henceforth, take an unlimited net loss carryover deduction.

Judge Pellegrini opined that he would, instead, apply Section 1925 of the Statutory Construction Act of 1972 ("SCA"), 1 Pa.C.S. § 1925, which allows courts to sever unconstitutional provisions of a statute from the remaining constitutional portions "unless the court finds that the valid provisions . . . are so essentially and inseparably connected with, and so depend upon, the void provision . . . that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one; or . . . that the remaining valid provisions, standing alone, are incomplete and are incapable of being executed in accordance with the legislative intent." 1 Pa.C.S. § 1925. Judge Pellegrini noted that the structure of the NLC, and similar net loss carryover provisions in the Revenue Code for subsequent tax years 2009, 2010, 2014 and 2015,[8] reflected the General Assembly's

[8] These sections provide, in full:

(c)(1) The net loss deduction shall be the lesser of:

(A)(I) For taxable years beginning before January 1, 2007, two million dollars ($2,000,000);

(II) For taxable years beginning after December 31, 2006, the greater of twelve and one-half per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);

(III) For taxable years beginning after December 31, 2008, the greater of fifteen per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);

(IV) For taxable years beginning after December 31, 2009, the greater of twenty per cent of taxable income

intent to limit the net loss carryover deduction a corporation could utilize in each tax year by capping it. Consequently, in Judge Pellegrini's view, the majority's decision to eliminate all caps on the amount of net loss a corporation could carry over was directly contrary to this legislative intent. Judge Pellegrini pointed out, however, that in each of these net loss carryover provisions of the Revenue Code, the flat dollar deduction could be severed from the percentage deduction, thereby leaving the percentage deduction available to all taxpayers. Judge Pellegrini deemed this to be the most appropriate course of action as it would carry out the legislative intent to limit net loss carryover deductions for a given tax year, while also protecting the public purse.

The Department filed a direct appeal with our Court, raising two issues: (1) whether the NLC violates the Uniformity Clause by capping the amount of net loss deduction a corporation can take based on its income, and (2) if so, whether severance of the $3 million flat deduction cap is the appropriate remedy, rather than allowing an unlimited net loss deduction

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as determined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);

(V) For taxable years beginning after December 31, 2013, the greater of twenty-five per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or four million dollars ($4,000,000);

(VI) For taxable years beginning after December 31, 2014, the greater of thirty per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or five million dollars ($5,000,000).

72 P.S. § 7401(3)4.(c)(1)(A)(1)-(VI).

as did the Commonwealth Court.[9] In our order granting oral argument, we also directed the parties to further brief the effect, if any, of our Court's recent opinion in *Mount Airy #1, LLC v. Pennsylvania Department of Revenue*, 154 A.3d 268 (Pa. 2016) ("*Mt. Airy*"), which declared portions of the local tax assessment on casino revenue in the Gaming Act violative of the Uniformity Clause. *Nextel v. Pennsylvania Department of Revenue*, 6 EAP 2016 (Pa. filed Oct. 16, 2016) (order).

II. Analysis

A. Uniformity Clause Challenge

The Department argues that the Commonwealth Court incorrectly held that the NLC violates the Uniformity Clause by erroneously measuring uniformity based on the effective corporate income tax rate, *i.e.*, the actual rate of tax the corporate taxpayer paid on its income,[10] rather than the statutory corporate net income tax rate of 9.9%. The Department asserts that our Court has held that a corporate income tax statute does not violate the Uniformity Clause if it applies the same rate of taxation to the same tax base, even if certain income is excluded from that tax base for some corporations because of their individual circumstances. In support of this proposition, the Department relies on *Turco Paint*, *supra* (holding that, even though a Pennsylvania corporate excise tax calculated

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[9] As these are questions of law, our standard of review is *de novo*, and our scope of review is plenary. *Wirth v. Commonwealth*, 95 A.3d 822, 836 (Pa. 2014).

[10] The effective tax rate, generally, is computed by taking the actual amount of income tax the corporate taxpayer paid in a tax year and dividing it by the amount of the corporation's taxable income for that year. Black's Law Dictionary 1691 (10th ed. 2014).

based on 3 factors – the corporation's gross receipts from Pennsylvania, its Pennsylvania payroll, and the physical property it owned in Pennsylvania – resulted in different tax liabilities for different corporations due to the fact these three factors were dissimilar for each corporation, this variance did not violate the Uniformity Clause, because the taxing statute imposed the same rate – 6% – on the same tax base for each corporation), and *Warner Brothers*, *supra* (holding that 10% excise tax applied to all corporations based on the corporation's net income under the federal tax code did not violate the Uniformity Clause, even though, under the federal tax code, the amount of capital deductions which a corporation could claim was limited and would vary from year to year, inasmuch as the tax base for all corporations was the same, and subject to the same 10% tax rate).[11] Thus, in the Department's view, these cases establish that, where, as here, a uniform tax rate is applied to the same tax base – which for a corporation it considers to be its net taxable income – there is no Uniformity Clause violation.

The Department recognizes that our Court has found other types of taxes which exclude from their tax base varying amounts of property to be violative of the Uniformity Clause, because their operation resulted

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[11] The current corporate net income tax statute, like these predecessor statutes, characterizes the nature of the tax imposed as an excise tax, *see* 72 P.S. § 7402(a), but this designation is merely semantical, as we have subsequently endorsed the proposition that, despite this description, the true nature of the tax is "a direct tax on corporate net income." *C.C. Collings & Company, Inc. v. Commonwealth*, 488 A.2d 1187, 1193 (Pa. Cmwlth. 1985), *aff'd on the basis of the Commonwealth Court opinion*, *Commonwealth Securities and Investments, Inc. v. Commonwealth*, 514 A.2d 1373 (Pa. 1986).

in members of the same class of taxpayers paying unequal amounts of taxes. Department Brief at 18-20 (citing *Amidon v. Kane*, 279 A.2d 53 (Pa. 1971) (personal income tax which was levied on a taxpayer's taxable income, as defined under the Internal Revenue Code, which resulted in individual taxpayers having various portions of their income exempted from taxation, violated the Uniformity Clause), and *Clifton v. Allegheny County*, 969 A.2d 1197 (Pa. 2009) (property tax assessment scheme that used an outdated base year valuation method, which undervalued some properties not reassessed since that base year, while assigning a higher market value to similar properties assessed after the base year, thereby resulting in the more recently assessed homeowners paying higher amounts of property taxes than those with base year assessments, contravened the Uniformity Clause)).

However, the Department views those cases as distinguishable from the case at bar, contending that our Court, in *Turco* and *Warner Brother*s, has explicitly sanctioned the use of a different uniformity analysis with respect to corporate taxes, as opposed to income taxes, due to the way corporations operate. The Department notes that corporations are created for the purposes of producing profits, and deductions from corporate income, which are costs associated with producing that income, are applied first to establish the tax base before any uniformity analysis is conducted. The Department avers that, in those situations, the uniformity analysis merely considers whether the tax is imposed on that base at a fixed statutory rate, and, if so, the uniformity analysis comes to an end. However, the Department contends that individuals behave differently, and there is no necessity of determining their tax base by considering the costs

of producing their income; rather, the deductions or exemptions are applied to compute the tax owed.

The Department avers that the corporate income tax structure is also distinct from the estate tax at issue in *Cope's Estate*, as all corporate taxpayers pay the same rate, while in that case the tax at issue was what it characterizes as a "classically graduated" tax where the rate of taxation increased based on the value of an estate. Department Brief at 22. The Department also notes that a number of other taxes, such as excise or occupation taxes, have uniform tax rates for all taxpayers, yet, when applied, produce unequal tax burdens for taxpayers who pay them, because they produce an effective rate of taxation which varies by income, since people with lower incomes pay a greater proportion of their income as the result of these taxes. The Department contends that the effect of the Commonwealth Court decision calls into question the constitutionality of these taxes, as well as other income taxes that utilize deductions in the federal tax code as a basis to compute taxable income, which again results in a variable tax rate for taxpayers dependent on which deductions they claim.

Alternatively, the Department argues that, even if the $3 million flat deduction implicates uniformity, it nevertheless is constitutional because the Uniformity Clause requires only substantial, not perfect, uniformity. The Department claims that, because only 234 out of 19,537 corporations (1.2%) were unable to reduce their taxable income to $0 since their income was above $3 million, and because those corporations were still able to take a net loss deduction, the NLC deduction provision was "as nearly uniform as practicable," and thus satisfied the constitutional requirement of "rough uniformity." Department Brief at 24.

With respect to *Mt. Airy*, the Department argues that the issue in this case is fundamentally different from the question presented in that case, which concerned a challenge under the Uniformity Clause to the statutory tax rate, rather than a uniformity challenge to the calculation of the tax base, as in this case. Thus, the Department maintains that *Mt. Airy* did not address any issue involving a calculation of the tax base, noting that our Court specifically avoided opining on whether a uniformity violation could arise out of disparate effective tax rates. The Department also points out that our Court recognized in *Mt. Airy* that the Uniformity Clause allows "a bit more flexibility in the context of corporate taxation," which the Department suggests counsels against finding a uniformity violation in this instance. Department Supplemental Brief at 7 (quoting *Mount Airy*, 154 A.3d at 277).[12]

[12] The Majority Caucus of the Pennsylvania House of Representatives has filed an *amicus* brief which largely tracks the arguments of the Department on this issue. The Majority Caucus additionally criticizes the Commonwealth Court for focusing on the "divergent tax burdens" on corporations which application of the tax will produce, Majority Caucus Brief at 12 (quoting *Nextel*, 129 A.3d at 9), rather than the statutorily imposed rates of taxation and the statutorily provided amount of the NLC deduction, both of which it contends are uniform. The Majority Caucus echoes the Department's concerns regarding the impact of the Commonwealth Court decision on a number of other taxes which, although having uniform tax rates, result in unequal tax burdens for taxpayers in application based on the taxpayers' income. The Majority Caucus agrees with the Department that the effect of the Commonwealth Court decision calls into question the constitutionality of these taxes, and other income taxes which utilize deductions in the federal tax code as a basis to compute taxable income.

In response, Nextel maintains that, as the Commonwealth Court determined, the NLC violates the Uniformity Clause because it allows corporations with net loss carryover in excess of their 2007 income to deduct their losses without limitation if they have $3 million or less in taxable income, and thereby reduce their taxable income to $0, while limiting the amount of loss that corporations with over $3 million in taxable income may deduct, obligating those corporations to pay some income tax. Nextel notes that our Court has held tax laws which, although imposing a uniform rate of tax, provide "dollar-value thresholds for exemptions and deductions" from the tax, to be violative of the Uniformity Clause because they resulted in similarly situated taxpayers shouldering unequal burdens of taxation. Nextel Brief at 9-12 (citing *Cope's Estate*, *supra*, and *Kelley v. Kalodner,* 181 A. 598 (Pa. 1935) (personal income tax which provided for a flat exemption from taxation for single taxpayers with taxable income below $1,000, and below $1,500 for married taxpayers, violated the Uniformity Clause). Nextel asserts that the NLC's $3 million limitation operates the same as this type of dollar value threshold.

Addressing the Department's contention that there is no Uniformity Clause violation because the same statutory rate of 9.9% is applied to the same tax base, Nextel disputes that the tax base – what it considers to be a corporation's taxable income – is the same for it and all other corporate taxpayers, because the $3 million limit on net loss carryover deductions led to it and 26 other corporate taxpayers having taxable incomes, whereas 19,303 other corporate taxpayers with income falling under the $3 million limit and net loss carryovers in excess of their income had no taxable income.

Nextel also disputes the Department's assertion that the NLC is constitutional under our holding in *Turco Paint*, reasoning that, under the taxing statute in that case, every corporate taxpayer was taxed on the same tax base, namely, the amount of its income which could be apportioned to Pennsylvania. Nextel also discounts the applicability of *Warner Brothers* on the grounds that the constitutional issue in that case was whether the legislature unconstitutionally delegated its taxing authority to Congress by using corporate net income as determined by the federal tax code, with all allowable deductions, as the tax base for the corporate income tax.

Nextel proffers that our Court recognized in *Amidon* that, even though a taxing statute imposes a flat rate of taxation on income, it may nevertheless operate in a manner which causes a disparity in the effective tax rate paid by various groups of taxpayers subject to the tax, and that the difference in effective tax rates may trigger a Uniformity Clause violation. Nextel notes that, in *Amidon*, the personal income tax statute at issue in that case, which used taxable income as the tax base, defined such income in the same manner as the federal tax code that allowed various exemptions and deductions. Because the amount of a person's taxable income varied widely from taxpayer to taxpayer, depending on which deductions he or she elected to take because of his or her lifestyle, the effective rate of taxation he or she was subject to also varied widely, thereby violating uniformity. Nextel contends that the NLC likewise operates to subject it and the 26 other corporations which paid corporate income taxes to a higher effective rate of taxation – 8.74% – whereas 19,303 other corporations paid an effective tax rate of 0%.

Nextel also argues that the NLC deduction provision does not satisfy "rough uniformity" due to the disparity between its effective tax rate and the effective tax rate of the majority of other Pennsylvania corporations. Specifically, Nextel maintains that rough uniformity means that immaterial deviations are permitted, but asserts that the difference between a tax rate of 8.74% and a tax rate of zero cannot be considered an immaterial deviation.

Regarding our *Mt. Airy* decision, Nextel asserts that its holding is directly applicable to this case, as *Mt. Airy* involved a tax which classified casinos based solely on the quantity of their receipts, inasmuch as casinos with receipts over $500 million paid a 2% tax, while casinos with receipts of $500 million or less paid a flat $10 million tax; Nextel avers this framework is similar to the tax in the instant case which classifies corporations based upon the quantity of their income. Nextel notes that, in *Mt. Airy*, our Court concluded that "such quantitative distinctions lack uniformity because any 'classification that is based solely on a difference in quantity . . . is necessarily unjust, arbitrary, and illegal.'" Nextel's Supplemental Brief at 6 (quoting *Mt. Airy*, 154 A.3d at 277). Nextel maintains that we should reach the same conclusion in this case, emphasizing that, although we have recognized that the Uniformity Clause allows more flexibility in the corporate context, we have never permitted tax classifications between corporations based on the quantity of their property.[13]

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[13] A variety of *amici* have filed briefs in support of Nextel's position on this issue, respectively: the Council on State Taxation; the Institute for Professionals in Taxation; the Pennsylvania Business Council; the Greater Philadelphia Chamber of Commerce; the Greater Pittsburgh Chamber of Commerce; and the

Having discussed the arguments of the parties, we begin our analysis of this issue. The relevant constitutional provision at issue in this appeal – better known by its colloquial description, "the Uniformity Clause" – is Article 8, Section 1 of the Pennsylvania Constitution, which provides:

> All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws.

Pa. Const. art. 8, § 1.

Pennsylvania Chamber of Business and Industry. All *amici* express agreement with Nextel's legal analysis as to why the NLC violates the Uniformity Clause, and the Council on State Taxation echoes Nextel's contention that our decisions in *Kelley* and *Amidon* established that the Uniformity Clause applies both to the rate of taxation imposed by a taxing statute, as well as to the tax base as determined by measuring the effective tax rates for various taxpayers within the same class.

Amici from the various Chambers of Commerce and the Chamber of Business and Industry also advance the policy argument that restrictions on deductions for net losses which target only large companies discourage those companies from making expensive capital investments and undertaking costly research, contending they are usually the only ones fully capable of funding such research. *Amici* argue that such endeavors often cause those companies to sustain significant losses, and *amici* contend those companies should be able to fully deduct such losses against their income over a longer period of time than just one tax year, particularly if they are operating in industries susceptible to highly cyclical profit variability, which can abruptly reduce a corporation's income for a particular tax year. *Amici* assert that the imposition of a cap on how much loss can be carried over from year to year by large companies interferes with their ability to more readily absorb these losses as part of their long-term operations, as it restricts them from fully using those losses for years when they are more profitable.

This provision was part of a larger package of constitutional provisions the people of the Commonwealth approved in adopting the "Reform Constitution" of 1874 for the purpose of altering certain legislative practices which had become commonplace during the 19th century, but which, by the latter part of that century, had fallen into serious disfavor with the populace, who rightly perceived that these practices were intended to advance private or personal interests at the expense of the public's welfare.[14] *Pennsylvania State Association of Jury Commissioners*, 64 A.3d 611, 615 n.9 (Pa. 2013). The Uniformity Clause, the language of which has remained unchanged since its initial ratification by the voters, was a direct response to the legislative use of special tax laws applicable only to particular industries or individuals.[15] [16] Robert

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[14] These practices included: the passage of local and special laws to confer special benefits or legal rights to particular individuals, corporations, or groups, benefits which were not afforded the general public; deceptive titling of legislation to mask its true purpose; the mixing together of various disparate subjects into one omnibus piece of legislation; and holding quick votes on legislation which had been changed at the last minute such that its provisions had not been fully considered by members of both houses.

[15] At the time of its enactment, the Uniformity Clause was located in Article 9, Section 1 of the Constitution.

[16] There have been two proposals to amend the Uniformity Clause since its inclusion in the Constitution in order to allow progressive rates of taxation, one in 1913 and one in 1928, but both were rejected by the voters of the Commonwealth. The voters did, however, approve constitutional amendments allowing the legislature to grant special tax treatment for forest and agricultural preserves, as well as for individuals in need of special tax treatment due to their "age, disability, infirmity or poverty." Pa. Const. art. 8, § 2

E. Woodside, *Pennsylvania Constitutional Law* 576 (1985).

The use of such special tax laws in Pennsylvania to favor particular industries began in the early part of the 19th century as part of a broader effort underway at the time by many state governments to foster "internal improvements" within their borders, *i.e.*, the construction of large physical transportation infrastructures such as canals, locks, dams, and ports on rivers to support the development of industries such as agriculture, coal mining, and timbering, and, later, as the Industrial Revolution came to America, iron and steel production. 1 Wade G. Newhouse, *Constitutional Uniformity and Equality in State Taxation*, 1731-32, 1735-37 (2d. ed. 1984). Although the Pennsylvania legislature directly financed many of these ventures for the benefit of private industries through bond issues which were repaid through tax dollars, it also provided indirect subsidies by bestowing upon these industries preferential tax treatment. *Id.* at 1203-04.

Most notably, a primary beneficiary of support from our Commonwealth's public fisc was the railroad industry, which received generous assistance from the General Assembly through the appropriation of funds for the construction of railroad lines, and the direct award of charters to individuals for the creation and exclusive operation of railroad companies in certain geographic areas. Harold E. Cox and John F. Myers, *The Philadelphia Traction Monopoly and The Pennsylvania Constitution of 1874*: *The Prostitution of an Ideal,* Journal of Pennsylvania History vol. 35, no. 4, 1 (1968). By the era of the Civil War, the railroad companies had acquired such influence over the Pennsylvania legislature that they routinely obtained

the passage of special legislation advancing their interests. *The Railroad in Pennsylvania*, Explore Pa. History, *at http://explorepahistory.com/story.php?storyId=1-9-10&chapter*=1.[17] In the field of taxation, the railroads were particularly successful at securing special tax legislation through the efforts of their lobbyist Simon Cameron, who later became President Lincoln's Secretary of War, such that, in 1861, the legislature voted to exempt them *entirely* from taxation. *Simon Cameron Historical Marker*, Explore Pa. History, *at* http://explorepahistory.com/hmarker.php?markerId=1-A-3ADExplore.

There was considerable popular anger generated by such preferential tax treatment, as it was perceived that the burdens of taxation, and its benefits, were not being equally shared. This anger fueled the clamor for a constitutional convention dedicated to constraining the power of the legislature to enact preferential local and special legislation, which the legislature ultimately acquiesced to by authorizing the constitutional convention of 1872-1873. Donald Marritz, *Making Equality Matter (Again): The Prohibition Against Special Laws in the Pennsylvania Constitution*, 3 Widener J. of Pub. L. 161, 191 (1993). The Uniformity Clause was, thus, the specific remedy fashioned by the delegates to that convention to eliminate the power of the legislature to enact special tax legislation, and its paramount purpose in requiring uniformity of taxation "was to prevent certain groups from having to

[17] Explorepahistory.com, an online resource for information about Pennsylvania history, was cooperatively created, and is currently maintained, by the Pennsylvania Historical and Museum Commission, various academic bodies – including the Pennsylvania State University – Pennsylvania historical associations, and the Pennsylvania Public Television Network.

shoulder the burden of progress from which all would benefit." Kristen E. Hickman, *The More Things Change, The More They Stay the Same: Interpreting the Pennsylvania Uniformity Clause*, 62 Alb. L. Rev. 1965, 1704 (1999); *see also Fox's Appeal*, 4 A. 149, 153 (Pa. 1886) ("[The Uniformity Clause] was intended to and does sweep away forever the power of the legislature to impose unequal burdens upon the people under the form of taxation. The evils which led up to its incorporation into the organic law are well known. The burden of maintaining the state had been, in repeated instances, lifted from the shoulders of favored classes, and thrown upon the remainder of the community.").

The language of the Uniformity Clause chosen by the framers of the 1874 Constitution requires uniformity of taxation on "the same class of subjects." Pa. Const. art. 8, § 1. It was unique in that it was the first such clause of any state constitution to require uniformity within classes of the subjects of taxation. Newhouse, *supra*, at 1713. Accordingly, the Uniformity Clause does not deprive the General Assembly of its power to create reasonable classifications of subjects of taxation:

> Classification for the purpose of taxation may be based on the existence of differences recognized in the business world, on the want of adaptability of the subjects to the same method of taxation, upon the impracticability of applying to them the same methods so as to produce justice and reasonably uniform results, or upon well grounded considerations of public policy.

Appeal of Borough of Aliquippa, 175 A.2d 856, 863 (Pa. 1961). However, consistent with the framers' intent to ensure that future tax obligations would be borne

equally by all those who are required to meet them, the Uniformity Clause mandates that "there must be no lack of uniformity within the class, either on the given subject of the tax or the persons affected as payers." *Saulsbury v. Bethlehem Steel Co.*, 196 A.2d 664, 666 (Pa. 1964).[18]

Although the paramount purpose of the Uniformity Clause is to ensure that all tax laws produce equality in the assignment of the tax burden within a particular class, it does not require absolute equality or perfect uniformity in this regard. Rather, if there is "substantial uniformity, which means as nearly uniform as practicable in view of the instrumentalities with which and subjects upon which tax laws operate," the constitutional requirement has been met. *Clifton*, 969 A.2d at 1210 (*quoting Delaware, L. & W. R. Co.'s Tax Assessment*, 73 A. 429, 430 (Pa. 1909)). All courts have a duty "in dealing with this subject to enforce as nearly as may be equality of burden and uniformity of method in determining what share of the burden each taxable subject must bear." *Id.* Consequently, when "a tax law directly, necessarily, and intentionally creates an inequality of burden, it . . . becomes imperative to inquire whether this inequality, thus intentionally

[18] The Uniformity Clause does not, however, require that each taxpayer in a particular class pay the same dollar amount in taxes, only that the tax obligation imposed by a particular tax be borne evenly by each member of the class. The actual amounts paid by each taxpayer will, of course, vary based on the actual value of his or her income or property subject to the tax. *See Turco Paint*, 184 A. at 40 ("[T]he same [tax], when applied to the same subject-matter, does not make the tax graded [in violation of the Uniformity Clause] simply because of the fact that one association, owning more of the particular taxable subject-matter than another, pays, on this account, a greater sum total of tax.").

created, can find any constitutional justification." *Cope's Estate*, 43 A. at 81.

When such inequality is created by a law which, by its structure, divides the subjects of a particular tax into various classes, the standard to be used in determining whether the law violates the Uniformity Clause is "whether the classification is based upon some legitimate distinction between the classes that provides a non-arbitrary, reasonable, and just basis for the disparate treatment." *Mount Airy*, 154 A.3d at 274. In light of the presumption that the legislature does not intend to violate the Constitution of the United States or Pennsylvania in enacting legislation, 1 Pa.C.S. § 1922(3), the burden of proof is on the taxpayer to show that the tax clearly, palpably, and plainly violates the Constitution by demonstrating that no reasonable distinction exists between the classes. *Allegheny County v. Monzo*, 500 A.2d 1096, 1101 (Pa. 1995); *Clifton*, 969 A.2d at 1211.

For over a century, our Court has steadfastly adhered to an interpretation of the Uniformity Clause that classifications based solely upon the quantity or value of the property being taxed are arbitrary and unreasonable, and, hence, forbidden. *See Cope's Estate*, 43 A. at 81 ("A pretended classification, that is based solely on a difference in quantity of precisely the same kind of property, is necessarily unjust, arbitrary, and illegal."); *Kelley*, 181 A. at 602 ("[A] tax which is imposed at different rates upon the same kind of property, solely on the basis of the quantity involved, offends the uniformity clause."); *Mt. Airy*, 154 A.3d at 275 ("The basic principle that '[t]he money value of any given kind of property . . . can never be made a legal basis of subdivision or classification for the purpose of imposing unequal burdens on [similarly situated

classes,' has endured through the years." (citation omitted and alteration original)).

In accordance with this principle, our Court has consistently viewed as unconstitutional tax laws which, although applicable to an entire class of taxpayers, wholly exempt some of those taxpayers from paying the tax. Such statutes are generally structured so that some taxpayers whose total income or value of their property falls below the maximum value of the exemption are required to pay no taxes at all, whereas other taxpayers with income or property value in excess of the exempted amount are required to pay taxes on the value of the non-exempted income or property, thus shouldering the entire tax burden. This contravenes the Uniformity Clause's paramount tenet that the tax burden should be borne equally by all those who are obligated to pay a tax. *See Cope's Estate*, 43 A. at 81 (The limitations on the legislature's ability to exempt property from taxation under the Uniformity Clause "are plainly intended to secure, as far as possible, uniformity and relative equality of taxation, by prohibiting, generally, the exemption of a certain part of any recognized class of property, and subjecting the residue to a tax that should be borne uniformly by the entire class.").

Thus, in *Cope's Estate*, we determined that an express exemption from inheritance tax for estates worth $5,000 or less was prohibited by the Uniformity Clause, due to the fact that taxpayers with estates below $5,000 in value paid no inheritance tax, while the remainder of taxpayers with estates with value in excess of that amount, 90-95% of taxpayers were required to pay the tax. Likewise, in *Kelley,* we determined that, because the personal income tax statute at issue in that case provided for a flat exemption from

taxation for those with income under a certain threshold ($1,000 for single taxpayers and $1,500 for married taxpayers), it was violative of the Uniformity Clause, as those taxpayers whose incomes fell below those threshold amounts paid no tax, while the rest of taxpayers who earned greater than those amounts were required to pay the tax. Our Court further opined therein that the General Assembly's purpose in providing the exemptions may have been laudable as a matter of public policy; however, salutary policy objectives did not excuse the constitutional violation:

> There can be no doubt that these exemptions were inserted for the purpose of putting the burden of the tax upon those most able to bear it, but it results in taxing those whose incomes arise above a stated figure merely for the reason that in the discretion of the Legislature their incomes are sufficiently great to be taxed. It is obvious that the application of the tax is not uniform. Although in the present case the exemption appears to be reasonable, the principle of inequality involved, if once established, might lead to grossly unfair results in the future.

Kelley, 181 A. at 602.

In more recent decisions, our Court has continued to adhere to the view that the Uniformity Clause prohibits taxes which, by their language, specifically exempt certain individuals subject to a tax from the obligation to pay it based on the taxpayer's income. *See*, *e.g.*, *Saulsbury* (occupational tax ordinance which imposed a flat fee of $10 on all taxpayers earning over $600 violated the Uniformity Clause by exempting those making less than that amount from the obligation to pay the tax). Indeed, even in a situation where the

statute imposing the tax did not explicitly exempt certain individuals from paying it, but, through its structure and operation, effectively guaranteed that some individuals would be entirely excused from paying any share of the tax burden, our Court has also found the tax to be in violation of the Uniformity Clause. *See Amidon*, 279 A.2d at 60 (holding that the Pennsylvania personal income tax statute, which imposed a flat 3-1/2% tax on taxable income, but also incorporated the definition of an individual's taxable income used by the United States Internal Revenue Code, violated the Uniformity Clause because the federal definition of taxable income "already reflects the federal personal exemptions for the taxpayer and his qualified dependents. Thus, built-in to the [Pennsylvania Income Tax] are *[e]xactly the same elements of nonuniformity* as were condemned in both *Kelley* and *Saulsbury*." (emphasis original and citation omitted)).[19]

With these principles in mind, we turn to the statute at issue in this case. The NLC establishes the following limits on the monetary value of a corporation's net loss deduction from its income for tax year 2007:

> (A)(II) For taxable years beginning after December 31, 2006, the greater of twelve and one-half per cent of taxable income as deter-

[19] As further noted by Justice Pomeroy in his concurrence in *Amidon*, these personal exemptions were available only to individuals under the federal tax code which that version of the Pennsylvania personal income tax statute utilized, but not to corporations; in his view this distinguished the matter from the Pennsylvania corporate net income tax at issue in *Turco Paint* and *Warner Brothers* which allowed all corporations to take the same deductions permitted them under the federal tax code. *See Amidon,* 279 A.2d at 67-69 (Pomeroy, J., concurring).

> mined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);

72 P.S. § 7401(3)4.(c)(1)(A)(II).

In determining whether this statute violates the Uniformity Clause, we do not look at its language in a vacuum; rather, we also examine how it functions when applied to establish a corporation's net income tax liability. *See Mount Airy*, 154 A.3d at 277 ("The Pennsylvania Constitution prohibits any 'method or formula for computing a tax' that will, '*in its operation or effect*, produce arbitrary, unjust, or unreasonably discriminatory results.'" (quoting *Clifton*, 969 A.2d at 1211) (emphasis added)). Consequently, although the NLC is not worded in the same fashion as the taxing provisions at issue in *Cope's Estate*, *Kelley*, and *Saulsbury*, in that it does not explicitly exempt income below a certain threshold from taxation like the taxing statutes in those cases, nonetheless it operates in a manner that creates the very same type of exemption from taxation solely on the basis of income, a scheme we determined in those decisions to be violative of the Uniformity Clause.

Under its terms, the NLC allows any corporation with taxable income of $3 million or less in 2007 to fully deduct all net losses carried over from prior years up to the entire amount of its taxable income. As a result, such corporations pay no corporate net income taxes, given that the statutory tax rate of 9.9% is ultimately applied only to a corporation's net income. 72 P.S. § 7402(b). Thus, the NLC gives corporations with $3 million or less in taxable income, and carryover losses equaling or exceeding their taxable income, a *de facto* total exemption from paying the corporate net income tax. By contrast, corporations with taxable income over $3 million are not permitted to exempt

their entire income from taxes, even if, like Nextel, they have sufficient net losses from prior years to offset it. Instead, such corporations are limited in the amount of prior net losses they can claim to the greater of 12.5% of their taxable income or $3 million, thereby requiring them to pay the corporate net income tax of 9.9% on the remaining portion of their taxable income.

It is clear, then, that the NLC, by allowing corporations to take a flat $3 million net loss carryover deduction against their taxable income, has effectively created two classes of taxpayers among corporations which have net loss carryover deductions equal to or exceeding their taxable income. The first and larger class, comprising 98.8% of all corporate taxpayers for tax year 2007, was exempted from paying any corporate net income tax simply because their income was $3 million or less, and a much smaller class of corporate taxpayers, 1.2%, was required to shoulder the entire corporate net income tax burden for that tax year due only to the fact that each of those class members had income in excess of $3 million. Because the NLC has created disparate tax obligations between these two classes of similarly situated taxpayers based *solely* on the value of the property involved – *i.e.*, the amount of each class member's taxable income – it is, as the Commonwealth Court determined, an arbitrary and unreasonable classification which is prohibited by the Uniformity Clause. *See Cope's Estate*, 43 A. at 81 (inheritance tax exemption which created two classes of individuals who inherited property – those who acquired estates with value less than $5,000 and were exempt from paying taxes, and those taxpayers whose estates were valued in excess of $5,000 who were required to pay inheritance tax – violated the Uniformity Clause, as this "pretended classification" was "based solely on a difference in

quantity of precisely the same kind of property [and was] necessarily unjust, arbitrary and illegal."); *Kelley*, 181 A. 602 (personal income tax which exempted two groups of individuals whose income fell below certain levels from paying any personal income tax, and required all other individuals with income above those levels to pay this tax, violated the Uniformity Clause due to the fact that the individuals obligated to pay the tax were chosen by the legislature "merely for the reason that [the legislature determined] their incomes are sufficiently great to be taxed."); *Saulsbury*, 196 A.2d at 666 (because the Uniformity Clause requires strict uniformity within a class of individuals subject to a particular tax, such that all members of the class are obligated to pay the tax, "[p]art of the class may not be excused, regardless of the motive behind the action.").

Our recent decision in *Mt. Airy* reaffirmed the principles set forth in these cases. The taxing statute at issue therein imposed two different levels of municipal taxation on the yearly gross slot machine revenues of casinos operating outside of the city of Philadelphia: those with yearly gross revenues of $500 million or less paid a flat assessment of $10 million to the municipality in which they operated, while those with yearly gross revenues of more than $500 million paid the municipality 2% of its gross revenues. This resulted in casinos with less than $500 million in gross revenues paying a flat amount of $10 million, while casinos with gross revenues in excess of $500 million, because of the 2% tax rate, were required to pay more than $10 million. Reiterating the principles articulated in *Cope's Estate* and its progeny, our Court held that this taxing scheme violated the Uniformity Clause since it divided casinos into two groups of taxpayers based only upon their income, which resulted in one group

with income above a certain level paying a higher tax rate than the other group with income below that level. We reemphasized that "the Uniformity Clause prohibits the General Assembly from imposing disparate tax rates upon income that exceeds a particular threshold." *Mt. Airy*, 154 A.3d at 276 (quoting *Kelley*, 181 A. at 602). Thus, our holding in *Mt. Airy* reaffirmed the central tenet of our Court's Uniformity Clause jurisprudence: a taxing statute which classifies similarly situated taxpayers solely on the basis of their income, and thereby places differing tax burdens on each class as a result, is forbidden.

Turco Paint and *Warner Brothers*, cited by the Department, do not compel a different result. In *Turco Paint*, the corporate net income tax statute at issue did not exempt portions of a corporation's net income from taxation, as the NLC does here; rather, the corporate net income tax statute imposed the same tax rate on all of a corporation's net income derived from its activities in Pennsylvania, which was determined for each corporation using the same three factors: the corporation's gross receipts from Pennsylvania, its Pennsylvania payroll, and the physical property it owned in Pennsylvania. *Turco Paint*, 184 A. at 41. Thus, although this taxation method produced some variance in the amount of a corporation's net income subject to taxation, due to the degree to which a corporation derived its income from Pennsylvania through its normal business activities, our Court did not find this variance constitutionally offensive, as it was not the product of purposeful legislative differentiation among groups of corporate taxpayers. *See id.* at 40 ("Where different rates are *legislatively imposed* on varying amounts or quantities of the same tax base, then you have a graded tax that lacks uniformity

under our Constitution." (emphasis added)). By contrast, the NLC's disparate tax treatment of corporations based on the value of their net losses and their taxable income was the product of the General Assembly's deliberate choice of statutory language.

In *Warner Brothers*, the primary constitutional challenge concerned whether the General Assembly unlawfully delegated its power to impose income taxes to the federal government by using the federal income tax code's definition of a corporation's taxable income, which limited the amount of capital losses a corporation could take against its income to $2,000. We ruled that there was no such unlawful delegation. Although the appellant in that case had also raised a Uniformity Clause challenge, we cursorily dismissed it with minimal analysis. 27 A.2d at 64. Indeed, we did not cite to or discuss *Cope's Estate* or any of its progeny.

We also reject the Department's argument that a different uniformity analysis is, as a general matter, appropriate when analyzing whether corporate taxes comport with the Uniformity Clause. The Department bases this contention on our Court's recognition in *Amidon* that the underlying purpose of corporate income tax deductions and personal income tax deductions is fundamentally different in nature, as corporate tax deductions are all directly related to the costs of the corporation incurred in performing its primary function of generating income and profit, whereas personal deductions cover a wide panoply of life activities, many of which are wholly unrelated to the production of income. *Amidon*, 279 A.2d at 63. While our Court has recognized critical differences between the corporate and personal tax codes, this recognition should not be interpreted as an endorsement of a wholly separate uniformity analysis for corporate and

personal taxes. The Uniformity Clause, and our caselaw interpreting it, is equally applicable to both types of taxes. *See Saulsbury* (the language of the Uniformity Clause "must necessarily be construed to include . . . all other kinds of tax."); *American Stores Company v. Boardman*, 6 A.2d 826, 829 (Pa. 1939) (holding that the nature of the tax imposed "makes no difference in determining its uniformity under [the Uniformity Clause] of the Pennsylvania Constitution").

We, therefore, affirm the Commonwealth Court's decision that the NLC is unconstitutional as applied to Nextel.[20]

B. Severability

Our conclusion that the NLC is unconstitutional as applied to Nextel does not end the matter. Section 1925 of the SCA` requires that a severability analysis be undertaken whenever a statute has been invalidated as the result of an as-applied constitutional challenge. *See* 1 Pa.C.S. § 1925 (requiring courts, in the event that "any provision of any statute *or the application thereof to any person or circumstance* is held invalid" to determine if the void provision may be severed from the remaining valid portions of the statute (emphasis added)); *Commonwealth v. Qu'eed Batts*, 163 A.3d 410, 441 (Pa. 2017) (noting that a severability analysis is required if a provision of a statute is invalidated "as applied to any situation or person."). Consequently, since we have determined that the

[20] Nextel has not previously argued, and does not presently allege, that the NLC is facially unconstitutional. However, as Judge Pellegrini noted in his dissent below, the distinction in this case is arguably a meaningless one, given that our decision has precedential value in future challenges to similar statutes.

NLC, as written, is unconstitutional as applied to Nextel, due to its inclusion of the $3 million flat deduction, we must determine whether this portion of the NLC is severable from its remaining provisions.

The Department argues the NLC, like any other deduction or exemption, was established as a matter of legislative grace, and, thus, can be taken away at any time. The Department highlights the legislative history of the NLC, proffering that its purpose was to encourage companies such as Nextel to make investments in new enterprises and technologies by allowing them to deduct the initial heavy costs of those investments in years in which they were more profitable. However, the Department points out that this same legislative history shows that our legislature reacted to the deleterious effects on the state budget of the costs of this deduction and that, in response, the General Assembly first eliminated it entirely in 1991, and then, when it reinstated it, included limits or "caps" on the amount of the deduction, which have been in place ever since. According to the Department, the inclusion of such caps evidences the legislature's recognition that the state budget "could not sustain an unlimited deduction." Department Brief at 26. The Department contends that the Commonwealth Court ignored the legislative intent to cap this deduction when it deemed the remedy for its finding that the NLC is unconstitutional to be the allowance of an unlimited net loss deduction for all corporations. The Department asserts that Judge Pellegrini's severability analysis in his concurring and dissenting opinion below, in which he would strike the $3 million flat deduction limit but leave intact the 12.5% deduction limit, which would then be equally available to all corporations, was an application of well settled legal principles governing severability, and the Department

maintains that our Court should follow suit and adopt this particular remedy.

Nextel responds by contending that the only proper remedy, procedurally, is the removal of the net loss limitation for Nextel in 2007, placing it in the same position as the other 19,303 taxpayers which paid no taxes at all. The only alternative, in Nextel's view, would be to apply the 12.5% limitation to the other taxpayers who paid no tax, and to assess them for the amount of tax owed on the remainder of their taxable income after they take the 12.5% deduction; however, Nextel recognizes this is not possible since there is a three-year statute of limitations under which the Department may order an additional assessment, and this time period expired in 2011 – three years from the last possible date for a corporate taxpayer to file a return for tax year 2007.[21] Nextel contends that the only remedy for a Uniformity Clause violation is to grant the disfavored taxpayer relief by refunding all the taxes it paid under the unconstitutional statute; any lesser remedy it contends would have "a chilling effect" on taxpayers who wish to make such challenges. Nextel Brief at 34. In support, Nextel cites the cases relied upon by the Commonwealth Court majority, *Molycorp*, *Iowa-Des Moines National Bank,* and *Tredyffrin-Easttown School District,* reasoning that it overpaid its taxes because of the Uniformity Clause violation and, thus, like the litigants in those cases, is entitled to the same remedy – a full refund of the excess amount of taxes paid.

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[21] According to the Department, it has not granted any waiver of this statute of limitations and is aware of no taxpayer which took the net loss deduction in 2007 that is still subject to assessment. Commonwealth's Response to Nextel's Interrogatories, 6/27/14, at 7 (R.R. at 128a).

Nextel further argues that the General Assembly would not have adopted the NLC without the $3 million flat deduction since it would deny the 19,000 plus "small businesses an important deduction, resulting in a significant burden on them." *Id.* at 40. Hence, Nextel maintains that the General Assembly, given a choice between this outcome and having no cap on the deduction at all, would have chosen the latter option as that would be beneficial to small businesses. In support, Nextel notes that the legislature eliminated net loss deduction caps entirely from 1981 to 1990, and that, when it reimposed the cap, it has always allowed small corporations to deduct the entirety of their losses for each tax year.[22]

As a general matter, "[t]he public policy of this Commonwealth favors severability." *PPG Industries v. Commonwealth Board of Finance and Revenue*, 790 A.2d 261, 267 (Pa. 2001). Section 1925 of the SCA[23]

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[22] *Amici,* the Council on State Taxation; the Institute for Professionals in Taxation; the Pennsylvania Business Council; the Greater Philadelphia Chamber of Commerce; the Greater Pittsburgh Chamber of Commerce; and the Pennsylvania Chamber of Business and Industry, have endorsed the Commonwealth Court's remedy of eliminating the cap on net loss deductions entirely for 2007, and thereby awarding Nextel a refund of all taxes it paid that year. *Amici* aver that it is preferable as a matter of policy to allow every corporate taxpayer to fully deduct all of their net losses in 2007, as such a remedy provides uniformity and would make Pennsylvania's business climate competitive with other states that impose no cap on this deduction. *Amici* contend that the alternative, striking the $3 million flat cap and leaving the 12.5% cap, would result in a broad tax increase for small businesses who have relied on the flat cap to eliminate their tax burden.

[23] This section provides:

§ 1925. Constitutional construction of statutes

furnishes the specific guiding principles for our severability analysis. By its terms, Section 1925 creates a general presumption of severability for every statute, subject to two exceptions:

> (1) if the valid provisions are so essentially and inseparably connected with, and so depend upon, the void provision or application, that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one, or (2) if the remaining valid provisions, standing alone, are incomplete and incapable of being executed in accordance with the legislative intent.

Robinson Township v. Commonwealth, 147 A.3d 536, 559 (Pa. 2016). In determining whether either of these two exceptions are applicable to a particular statute, legislative intent is our Court's guiding consideration. *Id.*; *see also Saulsbury*, 196 A.2d at 667 ("In determining the severability of a statute . . . the legislative intent is of primary significance."). The "touchstone"

> The provisions of every statute shall be severable. If any provision of any statute or the application thereof to any person or circumstance is held invalid, the remainder of the
>
> statute, and the application of such provision to other persons or circumstances, shall not be affected thereby, unless the court finds that the valid provisions of the statute are so essentially and inseparably connected with, and so depend upon, the void provision or application, that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one; or unless the court finds that the remaining valid provisions, standing alone, are incomplete and are incapable of being executed in accordance with the legislative intent.

1 Pa.C.S. § 1925.

for determining legislative intent in this regard is to answer the question of whether, after severing the unconstitutional provisions of a statute, "the legislature [would] have preferred what is left of its statute to no statute at all." *D.P. v. G.J.P.*, 146 A.3d 204, 216 (Pa. 2016).

Having determined that the NLC is unconstitutional as written because of its inclusion of the $3 million flat deduction, we perceive three available options: (1) sever the flat $3 million deduction from the remainder of the NLC; (2) sever both the $3 million and 12.5% deduction caps and allow corporations to claim an unlimited net loss – the remedy chosen by the Commonwealth Court majority; or (3) strike down the entire NLC and, thus, disallow any net loss carryover. Our task, therefore, is to determine which of these actions would be most consistent with the legislature's intent in enacting the NLC. An examination of the legislative history of this provision is therefore necessary to ascertain that intent. *See, e.g., Robinson Township*, (legislative history indicated that the paramount intent of the General Assembly was to have PUC exercise enforcement authority over uniform statewide siting requirements for oil and gas wells in municipalities, and, absent those uniform requirements, the legislature would not have intended the PUC to possess such power). Our independent review of the legislative history of the various incarnations of the net loss carryover provision as it has existed in Pennsylvania law yields the conclusion that the General Assembly has, over time, employed different approaches to the allowance and scope of this deduction.

Prior to 1980, the Pennsylvania Revenue Code permitted no such deduction. Act 195 of 1980 [24] introduced this deduction into the Revenue Code for the first time to, in the words of its proponents, assist new "high technology" businesses that were focused on the rapid development of new products, as well as to assist existing construction and farming enterprises which had been harmed by a recent recession. House Legislative Journal, at 2579, Remarks by Representative Pott (November 18, 1980). From its inception, and for the next 11 years, the amount of this deduction was uncapped. However, as a result of another recession which severely impacted the state's budgetary health, this deduction was wholly eliminated by Act 22 of 1991 [25] as part of a broader effort to raise revenue. Senate Legislative Journal, at 2318, Remarks by Senator Mellow (June 14, 1994). Then the legislature reinstated the deduction three years later, *see* Act 48 of 1994;[26] the reinstated version, however, which was the product of significant compromise and negotiations, included a dollar cap of $500,000 on the deduction for all corporate taxpayers. *Id.* Thereafter, for the next twelve years, subsequent versions of this deduction enacted by the General Assembly steadily increased the amount of the deduction's cap, such that by tax year 2006 it stood at $2 million. *See* 72 P.S. § 7401 (effective 12/23/03-7/6/05) (repealed). In 2006, the NLC was enacted, which was the legislature's first utilization of this type of alternative cap structure which combined a flat dollar cap with a percentage cap. At present, for tax year 2015 and beyond, the cap

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[24] Act of December 8, 1980, P.L. 1117, No. 195, § 2.

[25] Act of August 4, 1991, P.L. 97, No. 22, § 16.

[26] Act of June 16, 1994, P.L. 279, No. 48, § 10,

stands at the greater of $5 million or 30% of a corporation's taxable income. *Id.* § 7401(3)4.(c)(1)(A)(VI).

This legislative history establishes that the General Assembly first granted the deduction without any cap at all, but abandoned this approach based on its determination that such an uncapped deduction had significant deleterious consequences for our Commonwealth's fiscal health. However, our legislature perceived that the deduction provided some public benefit by encouraging investment in the development of new technologies, as well as the acquisition of the physical infrastructure necessary to implement those technologies. Thus, the legislature reintroduced the deduction in 1994, but attempted to avert the excessive drain on the public fisc the prior unlimited deduction had caused by imposing a cap on the amount of this deduction which a corporation could take in a given tax year, and the legislature has steadfastly maintained this cap in various forms for the last 23 years. *See* Majority Caucus Brief at 2-4 (discussing evolving history of corporate net loss carryover deduction and highlighting that, since its reinstitution in 1994, it "has contained a dollar cap of some stripe"). Thus, the overall structure of the NLC reflects the legislature's intent to balance the twin policy objectives of encouraging investment (by allowing corporations to deduct some of the losses they sustain when making such investments against their future revenues), and ensuring that the Commonwealth's financial health is maintained (through the capping of the amount of this deduction).

Consequently, of the aforementioned three options available to us enumerated *supra*, we determine that the legislature's intent to have the NLC jointly further both of these policy objectives can best be effectuated

by severing from the NLC the $3 million flat deduction. By striking this provision, all corporations for the tax year 2007 would be limited to taking a net loss carryover deduction of 12.5% of their taxable income for that year. Thus, each corporation will be entitled to avail itself of a net loss carryover deduction, as the legislature intended, but such deduction will be equally available to all corporations during that year, no matter what their taxable income. This fulfills the central tenet of the Uniformity Clause that the tax burden be borne equally by the class of taxpayers subject to paying it, inasmuch as it assures that all corporations will equally share in the obligation to pay corporate net income tax for tax year 2007.[27]

By contrast, we find the Commonwealth Court's chosen remedy, striking all caps in the NLC, contravenes the legislature's intent to limit this deduction. In order to avoid a repeat of the budgetary damage caused by the unlimited net loss deduction which was in effect from 1980-1991, the legislature has, since the reinstatement of this deduction in 1994, consistently required that it be capped. To remove all caps and allow unlimited net loss deductions would be clearly contrary to the wishes of the General Assembly.

Alternatively, if we were to strike the NLC in its entirety, it would eliminate *all* net loss deductions for corporations in tax year 2007, which, ironically, would leave Nextel owing more corporate taxes than it paid. This is also contrary to the General Assembly's intent to promote investment by allowing every corporation

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[27] The Revenue Department has indicated that it is not seeking the right to make additional assessments against any other taxpayer beyond the period of the statute of limitations, Department Reply Brief at 12 n.4, and our decision today does not confer such a right upon it.

doing business in Pennsylvania an opportunity to benefit from this deduction.

Accordingly, we sever only the $3 million flat deduction from the NLC. As a result, Nextel is not entitled to have its 2007 tax assessment forgiven as, even with the offending provision of the NLC stricken, it is subject to the same tax liability for tax year 2007 as previously assessed by the Department. It is for this reason that Nextel is also not entitled to the relief granted the taxpayers in *Molycorp*, *Iowa-Des Moines National Bank,* and *Tredyffrin-Easttown School District.* Those cases did not involve a constitutional challenge to the structure of a taxing statute; rather, they all involved discriminatory application of an *otherwise valid* taxing statute to the parties by the taxing authority, and, thus, the only suitable remedy for such discrimination was to make whole the taxpayer who was overcharged through a refund of the overpaid taxes. Here, under the NLC, as severed, there was no overpayment of corporate income taxes by Nextel, as it owes exactly what the Revenue Department previously assessed.

Additionally, we reject Nextel's argument that failure to reward its challenge with a refund will somehow chill the bringing of future such actions to contest the constitutionality of taxing statutes. As our Court has noted previously, in dismissing a similar argument, "there is always an incentive, in the avoidance of liability for payment of taxes or fees in the future, to challenge the validity of a statute." *Oz Gas v. Warren Area School District*, 938 A.2d 275, 284 (Pa. 2007) (quoting *American Trucking Association v. McNulty*, 596 A.2d 784, 790 (Pa. 1991)). Because Nextel is not entitled to a refund under the NLC, as severed, we

reverse that portion of the Commonwealth Court order directing the Department to refund Nextel $3,938,220.

Order of the Commonwealth Court is affirmed in part and reversed in part. Jurisdiction is relinquished.

Chief Justice Saylor and Justices Donohue, Dougherty, Wecht and Mundy join the opinion.

Justice Baer files a concurring opinion in which Justices Donohue and Wecht join.

CONCURRING OPINION

JUSTICE BAER

I join the learned majority's holding that the "net loss carryover" provision of the Pennsylvania Revenue Code for tax year 2007 ("NLC")[1] violates the Uniformity Clause of the Pennsylvania Constitution[2] and that severance of the $3 million flat deduction remedies that violation. I write separately only to express my view on the nature of the constitutional challenge presented herein.

Throughout these proceedings, Nextel has steadfastly maintained that it is presenting an as-applied constitutional challenge to the NLC. In this regard, the majority observes that "Nextel has not previously argued, and does not presently allege, that the NLC is facially unconstitutional." Maj. Op. at 29 n.20. Taking Nextel at its word, the majority tailors its holding to align with Nextel's characterization of its claim, concluding that the NLC is unconstitutional as applied to Nextel. *Id.* at 29 (holding that "[w]e, therefore, affirm the Commonwealth Court's decision that the NLC is

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[1] Act of March 4, 1971, P.L. 6, as amended, 72 P.S. § 7401(3)4.(c)(1)(A)(II).

[2] Pa. Const. art. VIII, § 1.

unconstitutional as applied to Nextel"). In so doing, the majority further observes that the distinction between an as-applied challenge and a facial challenge is arguably meaningless in this case given the future effect of our decision. *Id.* at 29 n.20.

However, the question of whether a particular constitutional challenge is "facial" or "as applied" should not be dictated by the label a litigant attaches to it. *See Tooey v. AK Steel Corp.*, 81 A.3d 851, 877-78 (Pa. 2013) (Saylor, J., dissenting) (observing, in general reliance upon *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010), that a "court may declare a statute facially unconstitutional when adjudicating an as-applied challenge"); *Citizens United*, 558 U.S. at 331 (explaining that "the distinction between facial and as-applied challenges is not so well defined that it has some automatic effect or that it must always control the pleadings and disposition in every case involving a constitutional challenge"). Thus, a court should not be constrained in its holding simply by virtue of the manner in which a litigant has characterized its claim.

Here, the thrust of Nextel's uniformity challenge is that the NLC allows those corporations with $3 million or less in taxable income and carryover losses equaling or exceeding their taxable income to reduce their 2007 tax liability to zero, while requiring those corporations with over $3 million in taxable income to pay some income tax. As such, the NLC as written creates two classes of similarly situated taxpayers and treats them disparately solely on the basis of the value of the property involved (*i.e.*, taxable income), thereby violating the Uniformity Clause.

Consistent with the majority's astute analysis, I agree with Nextel's position. Nonetheless, while Nextel presents its claim as an as-applied challenge to the

NLC, its challenge necessarily implicates the facial validity of the NLC. Consequently, where the majority appears to attach no real significance to Nextel's characterization of its claim as an as-applied challenge to the NLC, the majority's holding could be interpreted as limited in accordance with Nextel's designation. I write separately to clarify that, in my view, our holding declares the NLC unconstitutional on its face.

Justices Donohue and Wecht join this concurring opinion.

APPENDIX B

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 98 F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Petitioner,
v.
COMMONWEALTH OF PENNSYLVANIA,
Respondent.

Argued: September 16, 2015

Filed: November 23, 2015

BEFORE:

HONORABLE DAN PELLEGRINI, President Judge
HONORABLE BERNARD L. McGINLEY, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Judge
HONORABLE RENEE COHN JUBELIRER, Judge
HONORABLE MARY HANNAH LEAVITT, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE ANNE E. COVEY, Judge

OPINION BY JUDGE BROBSON

In this appeal from the Board of Finance and Revenue (Board), Petitioner Nextel Communications of the Mid-Atlantic, Inc. (Nextel) challenges the Board's

denial of its petition for refund of corporate net income (CNI) tax paid to the Commonwealth of Pennsylvania for the tax year ending December 31, 2007 (2007 Tax Year). In pursuing its refund, Nextel contends that the net loss carryover deduction (NLC deduction) provision in Section 401(3)4.(c)(1)(A)(II) of the Tax Reform Code of 1971 (Tax Reform Code),[1] as applied to Nextel,[2] violates the uniformity requirement (Article VIII, Section 1) of the Pennsylvania Constitution (Uniformity Clause). For the reasons set forth below, we find in favor of Nextel, reverse the Board's Order, and grant relief to Nextel.

The NLC deduction provision of the Tax Reform Code allows a taxpayer to reduce its positive taxable income in a particular tax year by deducting prior year net losses *(i.e.,* where the taxpayer had negative taxable income in a prior year), thereby reducing the amount of CNI tax due and payable in that tax year. Net losses from prior tax years may be carried over to subsequent tax years and applied to reduce taxable income according to a schedule set forth in Section 401(3)4.(c)(2) of the Tax Reform Code, 72 P.S. § 7401(3)4.(c)(2). For example, a net loss in taxable years 1995 through 1997 may be carried over for ten taxable years. A net loss in taxable years 1998 and thereafter may be carried over for twenty taxable years. In addition to limiting how long a taxpayer may carry over its net losses, the Tax Reform Code also limits the amount of the NLC deduction that a taxpayer may take in any given tax year. For the 2007 Tax Year, the amount of the NLC deduction was

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[1] Act of March 4, 1971, P.L. 6, *as amended,* 72 P.S. § 7401(3)4.(c)(1)(A)(II).

[2] Nextel does not here press a facial constitutional challenge to the corporate net income tax or to the NLC deduction.

limited to *the greater of* 12.5% of the taxpayer's taxable income or $3 million. Section 401(3)4.(c)(1)(A)(II) of the Tax Reform Code.

Nextel is a telecommunications company that does business in multiple states, including Pennsylvania. Our inquiry is confined to Nextel's income and losses relating to its Pennsylvania business. According to the parties' Stipulation of Facts, Nextel carried over net losses of $150 million into the 2007 Tax Year.[3] Nextel earned $45 million of taxable income during the 2007 Tax Year. Accordingly, Nextel's available net loss carryover in 2007 well exceeded its 2007 taxable income. Consistent with the NLC deduction provision of the Tax Reform Code that limits the amount of the NLC deduction that a taxpayer may take in the 2007 Tax Year, Nextel reported for the 2007 Tax Year its full $45 million in taxable income to the Commonwealth, but it took only a $5.6 million NLC deduction (the greater of 12.5% of its taxable income or $3 million). As a result, Nextel reduced its taxable income for the 2007 Tax Year to $39.4 million and paid CNI tax of $4 million on that amount.[4]

Nextel filed a timely petition for refund of CNI tax paid in the 2007 Tax Year, in which it argued, *inter alia,* that the NLC deduction cap of the greater of 12.5% of taxable income or $3 million was unconstitutional. The Department of Revenue Board of Appeals (Revenue) and the Board held that they lacked the authority to consider and rule on Nextel's constitu-

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[3] The figures set forth herein are rounded in the interest of presentation. The actual figures are set forth in the parties' Stipulation of Facts.

[4] The statutory CNI tax annual rate is 9.99%. Section 402(b) of the Tax Reform Code, *as amended*, 72 P.S § 7402(b).

tional challenge. They both concluded that Nextel properly applied the NLC deduction provision as written when it filed its tax report and paid its taxes for the 2007 Tax Year. Accordingly, Revenue denied Nextel's request for a refund, and the Board affirmed.

The Uniformity Clause provides: "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax . . . ." Nextel contends that the limitations on the NLC deduction favor businesses with taxable income of $3 million or less. Assuming these taxpayers have a net loss carryover in excess of their taxable income in a particular year—*i.e.,* a positive net loss carryover position—these taxpayers can reduce their taxable income to $0. By contrast, any taxpayer that has taxable income in excess of $3 million in a tax year, who is also in a positive net loss carryover position, is precluded from reducing its taxable income to $0. That taxpayer will always have to pay CNI tax, even if its net loss carryover exceeds its taxable income that year.

According to Nextel and the parties' Stipulation of Facts,[5] this actually occurred in 2007. In the 2007 Tax Year, 19,537 taxpayers subject to the CNI tax were in a positive net loss carryover position—i.e., the amount of their net loss carryovers exceeded the amount of taxable income apportioned to Pennsylvania for the 2007 Tax Year. Of those 19,537 taxpayers, 19,303 (98.8%) were able to completely offset their taxable income through the NLC deduction provision. These particular taxpayers had taxable income at or below $3 million. Because the 2007 Tax Year NLC deduction was limited to *the greater of 12.5%* of taxable income

[5] Stipulation of Facts Ex. D.

or $3 million, these taxpayers, using the $3 million cap, were able to avoid paying any CNI tax for the 2007 Tax Year.

The other 1.2%, or 234 taxpayers, in a positive net loss carryover position in the 2007 Tax Year, paid some CM tax that tax year. They had taxable income in excess of $3 million. Indeed, the majority of the 234 taxpayers had taxable income in excess of $6 million. Because of the limitations placed on the NLC deduction that year, these taxpayers could not reduce their taxable income to $0. A taxpayer in a positive net loss carryover position in 2007 with $3,000,001 in taxable income in the 2007 Tax Year would have paid $0.10 in CNI tax. But a similarly-situated taxpayer in the 2007 Tax Year with one dollar less in taxable income would have owed no CM tax under the NLC deduction provision. For taxpayers with substantially more taxable income in the 2007 Tax Year, the tax consequences were more severe. Nextel was among twenty-six taxpayers whose taxable income in 2007 exceeded $24 million. At most, these taxpayers could only reduce their taxable income by 12.5% under the NLC deduction limitations.

Nextel maintains that this disparate treatment of taxpayers, based solely on the size of the business in terms of taxable income in the 2007 Tax Year, violates the Uniformity Clause. In Nextel's view, the NLC deduction limitations work in favor of small taxpayers in a positive net loss carryover position and against similarly-situated larger taxpayers. The larger the taxpayer *(i.e.,* the greater the income), the more disparate the impact. Accordingly, Nextel argues that the NLC deduction limitations create an unconstitutional progressive CM tax structure, where small taxpayers pay a lower effective tax rate than larger, similarly-

situated, taxpayers, even though the statutory rate is fixed at 9.99%.[6]

In response, the Commonwealth contends that there is no Uniformity Clause violation, because the same statutory rate of 9.99% is applied to the same base in every case (taxable income less NLC deduction). Similarly, because the same statutory rate is applied against the same tax base for every taxpayer, the Commonwealth argues that we must reject Nextel's characterization of the CM tax as unconstitutionally progressive. The Commonwealth also argues that we must reject Nextel's contention that the Uniformity Clause demands that all taxpayers pay the same effective tax rate, because Pennsylvania courts have consistently rejected such uniformity challenges to the CM tax.

The Commonwealth disputes Nextel's contention that larger taxpayers were somehow penalized in the 2007 Tax Year. In terms of effective tax rate, the Commonwealth notes that Nextel paid an effective CNI tax rate of 8.75%, less than the statutory rate. The Commonwealth also compares Nextel to a smaller taxpayer that was not in a positive net loss carryover position in 2007 and, therefore, may have paid a *higher* effective tax rate than Nextel did. Also, the Commonwealth emphasizes that even though Nextel's NLC deduction was limited to 12.5%, it was still able to reduce its taxable income by $5.6 million, which is well in excess of the $3 million cap. According to the Commonwealth: "The smaller businesses that are the focus of Nextel's argument never would have

[6] The Pennsylvania Business Council has filed an Amicus Brief in favor of Nextel's appeal.

been able to take such a large net loss deduction." (Commonwealth Br. at 21.)[7]

The Commonwealth contends that even if you accept Nextel's position that the NLC deduction cap creates some form of classification, the NLC deduction limitations satisfy the constitutional test of "rough" uniformity. The Commonwealth notes that the cap only affected 1.2% of CM taxpayers in the 2007 Tax Year. The 1.2%, however, like the other 98.8%, were still able to take a net loss deduction of 12.5% of taxable income or $3 million, whichever was greater, and still paid the statutory rate of 9.99%. So while they may have been negatively impacted, in the sense that they had to pay CNI tax, the disparity does not itself demonstrate unconstitutionality. The outcome, in the Commonwealth's view, is "nearly perfect" and thus satisfies the constitutional test of rough uniformity. (Commonwealth Br. at 27.)

The Commonwealth also argues that even if the NLC deduction limitations create classifications among taxpayers, the classification is reasonable in that it is rationally related to the legitimate state interest of sensible budgetary planning. The Commonwealth recounts the thirty-year history of the NLC deduction. Throughout this period, the Commonwealth contends that the General Assembly has struggled to balance the pro-growth benefits of the deduction with its negative impact on the Commonwealth's budget. This struggle, the Commonwealth maintains, led the General Assembly to enact legislation in 1991 that

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[7] We agree with the Commonwealth on this point, because, at most, those smaller corporations, which reported taxable income in the 2007 Tax Year of $3,000,000 or less, can only reduce their taxable income to $0.

suspended the NLC deduction for tax years beginning in 1991. *See Garofolo, Curtiss, Lambert & MacLean, Inc. v. Dep't of Rev.,* 648 A.2d 1329 (Pa. Cmwlth.) (holding that legislation suspending NLC deduction did not violate Uniformity Clause), *appeal dismissed,* 659 A.2d 561 (Pa. 1994). The Commonwealth notes that when the General Assembly reinstated the NLC deduction, it determined that the Commonwealth's budget could only handle a limited NLC deduction. For the 2007 Tax Year, the General Assembly set the limit at the higher of 12.5% of taxable income or $3 million. Although the General Assembly has increased the limitations over time,[8] it has not seen fit to remove the limitations. Because the General Assembly concluded that the Commonwealth could not afford an unlimited NLC deduction, the Commonwealth's position is that Nextel's desire for an unlimited deduction must give way to the General Assembly's wisdom with respect to sensible budgetary planning.

The Commonwealth also rejects Nextel's argument that the General Assembly lacks the authority to enact legislation that benefits small business. Indeed, the Commonwealth contends that the NLC deduction was intended to help small business. The favorable treatment afforded to small business by the NLC provision was an exercise of the General Assembly's wide discretion in matters of taxation. The Commonwealth also points out that not all businesses benefitted from the NLC provision. Of the 46,676 taxpayers that reported positive taxable income apportioned to Pennsylvania during the 2007 Tax Year, less than half availed

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[8] For tax years beginning after December 31, 2014, the NLC deduction is capped at the greater of 30% of taxable income or $5 million. Section 401(3)4.(c)(1)(A)(VI) of the Tax Reform Code, *as amended,* 72 P. S. § 7401(3)4. (c)(1)(A)(VI).

themselves of the NLC deduction. The Commonwealth also contends that Nextel's business model, which led to many unprofitable years, prevented Nextel from recouping fully its net loss deduction.

Finally, the Commonwealth argues that although the NLC deduction limitations prevented Nextel from fully offsetting its taxable income in the 2007 Tax Year by its net loss carryovers from prior years, the law permits carryover of net losses for twenty years. Any assertion by Nextel that its inability to offset its taxable income in 2007 fully by its net operating losses means that Nextel will forever lose the benefit of the NLC deduction is unfounded and speculative.

In reply, Nextel emphasizes its base premise—i.e., that under the NLC deduction provision, a taxpayer with a net loss carryover from Year 1 of $3 million and income of $3 million in Year 2 will pay $0 in CNI tax in Year 2, but a taxpayer with a net loss carryover from Year 1 of $30 million and income of $30 million in Year 2 will pay $2.6 million in CNI tax for Year 2. Because Nextel contends that Pennsylvania law prohibits tax classifications based on the size of business (as measured by income), the NLC deduction limitations violate the Uniformity Clause. With respect to its effective tax rate argument, Nextel concedes the Commonwealth's point that taxpayers may pay different effective rates based on the nature of their operations and their deductions. Nonetheless, different effective rates cannot be based on a deduction statute that has disparate impact on taxpayers *solely* on the basis of their income level and withstand a uniformity challenge.[9] Here, the effective tax rate rises not solely

[9] To illustrate Nextel's point, consider a NLC deduction that has no cap. Company A enters Tax Year 2 with a net loss carryover of $1 million and reports taxable income in Tax Year 2

because of each company's peculiar net loss and income position in a tax year, but also because the statutory scheme imposes a capped deduction that favors those taxpayers with taxable income of $3 million or less.

Nextel also disputes the Commonwealth's "rough" uniformity claim. Nextel argues that "rough" uniformity is not dependent on the number of taxpayers adversely affected, but the degree in difference between the amount of tax paid between taxpayers. Here, Nextel paid $3.9 million of tax while others that, like Nextel were in a positive net loss carryover position, paid $0. According to Nextel, that is not "rough" uniformity.

In terms of the legislative history, Nextel does not dispute the General Assembly's authority to eliminate the NLC deduction, as it did in 1991. If it allows the deduction, however, the General Assembly cannot limit the amount of the deduction based on taxpayer income. Nextel also argues that the General Assembly's policy reasons for establishing the NLC deduction

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of $3 million. After deducting in full the net loss carryover, Company A pays a CNI tax of $199,800 (9.99% x $2 million), for an effective tax rate on $3 million of income in Year 2 of 6.66%. Company B entered Tax Year 2 with a net loss carryover of $10 million and reports taxable income in Tax Year 2 of $50 million. After deducting in full the net loss carryover, Company B pays a CNI tax of $3,996,000 (9.99% x $40 million), for an effective tax rate on $50 million of income in Year 2 of 7.99%. Although Company B pays a higher effective tax rate under this example, Nextel's position is that the Uniformity Clause is not implicated because the effective rate was not influenced by a classification scheme in the tax law based on taxpayer income; rather, it is the result of the peculiar business operations of each company.

limitations are irrelevant. Even if the General Assembly's reasoning was sound and the limits reasonable, the scheme must still be uniform. Moreover, to the extent the Commonwealth's position is that the General Assembly purposefully favored small business over large business when it instituted the NLC deduction limitations, the argument further supports Nextel's uniformity challenge. Nextel notes that if the people of Pennsylvania wished to impose a greater tax burden on large businesses and provide relief to small businesses, they can amend the Constitution, as they have done in other contexts.[10]

In terms of whether Nextel has been disadvantaged, seeing as it may carry over net operating losses for a 20-year period, Nextel notes that under the statute, the 20 years is a rolling period, running from each year in which Nextel incurred a net operating loss. For example, a net operating loss incurred in 1998 can only be used to offset taxable income until 2018. If

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[10] Nextel cites Article VIII, § 2(b)(ii) of the Pennsylvania Constitution, which, following the section that includes the Uniformity Clause, provides:

> (b) The General Assembly may, by law:
>
> . . .
>
> (ii) Establish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity *or poverty* are determined to be in need of tax exemption or of special tax provisions, and for any such class or classes, uniform standards and qualifications. The Commonwealth, or any other taxing authority, may adopt or employ such class or classes and standards and qualifications, and except as herein provided may impose taxes, grant exemptions, or make special tax provisions in accordance therewith. . . .

(Emphasis added.)

unused by that time, it is lost, or, as Nextel claims, expired. According to the deposition testimony of Terrence D. Frederick, who works for Nextel's parent company, Sprint, and oversees state and local tax obligations for the parent and its subsidiaries, millions of dollars in net operating loss carryovers that could have been applied to reduce Nextel's taxable income in the 2007 Tax Year but for the statutory cap, have, in fact, expired.[11]

A taxpayer challenging the constitutionality of tax legislation bears a heavy burden. *Leonard v. Thornburgh,* 489 A.2d 1349, 1351 (Pa. 1985). First, the taxpayer must demonstrate that the provision results in some form of classification. Second, the taxpayer must demonstrate that the classification is "unreasonable and not rationally related to any legitimate state purpose." *Clifton v. Allegheny Cnty.,* 969 A.2d 1197, 1211 (Pa. 2009); *see Lebanon Valley Farmers Bank v. Commonwealth,* 83 A.3d 107, 113 (Pa. 2013). The legislature, however, has wide discretion in matters of taxation. *Leonard,* 489 A.2d at 1351. It is well-established that tax legislation is presumed to be constitutionally valid and will not be declared unconstitutional unless it "clearly, palpably and plainly violates the constitution." *Free Speech, LLC v. City of Phila.,* 884 A.2d 966, 971 (Pa. Cmwlth. 2005). Furthermore, "[a]ny doubts regarding the constitutionality of tax legislation should be resolved in favor of upholding its constitutionality." *Id.*

Although the Uniformity Clause does not require absolute equality and perfect uniformity in taxation, the legislature cannot treat similarly-situated taxpayers differently. *Leonard,* 489 A.2d at 1352. Where the

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[11] Stipulation of Facts, Ex. H (Frederick Dep. Tr. at 41:6-41:19).

validity of a tax classification is challenged, "the test is whether the classification is based upon some legitimate distinction between the classes that provides a non-arbitrary and 'reasonable and just' basis for the difference in treatment." *Id.* (quoting *Aldine Apartments, Inc., v. Commonwealth,* 426 A.2d 1118 (Pa. 1981)). In other words, "[w]hen there exists no legitimate distinction between the classes, and, thus, the tax scheme imposes substantially unequal tax burdens upon persons otherwise similarly situated, the tax is unconstitutional." *Id.*

The Commonwealth contends that because the CM statutory tax rate is the same for all taxpayers (9.99%), there can be no Uniformity Clause violation. This position does not comport with the law. Even where a tax law provides for a fixed statutory tax rate applicable to all taxpayers, the tax scheme may still yield unconstitutionally divergent tax burdens. The Pennsylvania Supreme Court has held: "While reasonable and practical classifications in tax legislation are justifiable and often permissible, *when a method or formula for computing a tax* will, in its operation or effect, produce arbitrary, unjust, or unreasonably discriminatory results, the uniformity requirement is violated." *Clifton,* 969 A.2d at 1211 (emphasis added). We must, therefore, consider whether the NLC deduction, in operation or effect for the 2007 Tax Year, which is part of the method or formula for computing the CNI tax, violated the Uniformity Clause.

Based on our review of the parties' Stipulation of Facts, Nextel has demonstrated that the NLC deduction provision in the Tax Reform Code creates classes of taxpayers according to their taxable income. As written, the NLC deduction provision can, and in the 2007 Tax Year did, allow some taxpayers to reduce

their taxable income to $0 and, as a result, pay no CNI tax. The same provision can, and in the 2007 Tax Year did, prevent other taxpayers from reducing their taxable income to $0 and, as a result, cause these affected taxpayers to pay at least some CNI tax. Both classes of taxpayers entered the 2007 Tax Year in a positive net operating loss carryover position—i.e., their net operating loss carryover exceeded their 2007 taxable income. The only factor that distinguishes between these two classes of taxpayers (those who paid no CM tax as a result of the NLC deduction provision and those that paid some CNI tax as a result of the NLC deduction provision) is the amount of taxable income in the 2007 Tax Year. Taxpayers with $3 million or less in taxable income in 2007 could offset up to 100% of their taxable income through the NLC deduction provision, because the statute allows a *greater of* 12.5% of taxable income or $3 million deduction. Taxpayers with more than $3 million in taxable income in 2007, however, under this scheme, could not offset up to 100% of their taxable income. In fact, the higher the taxable income of the taxpayer, the lower the percentage of taxable income the taxpayer could offset through the NLC deduction. Eventually, the amount of taxable income that may be offset bottoms out at the 12.5% statutory rate.[12]

Having concluded that the NLC deduction provision of the Tax Reform Code for the 2007 Tax Year treated taxpayers with taxable income in excess of $3 million

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[12] Based on the limitation in effect for the 2007 Tax Year, for taxpayers with taxable income of $24 million or less, the maximum NLC deduction was the statutory cap of $3 million. For taxpayers with taxable income in excess of $24 million, the statutory rate of 12.5% of taxable income yielded the greater net loss carryover deduction.

differently than taxpayers with $3 million or less in taxable income, we must now determine whether this classification is unreasonable and not rationally related to any legitimate state purpose. On this question, we agree with Nextel that a classification based solely on income amount cannot withstand scrutiny under the Uniformity Clause. In *In re Cope's Estate,* 43 A. 79 (Pa. 1899), the Pennsylvania Supreme Court considered a uniformity challenge to the Commonwealth's inheritance tax law,[13] which then exempted $5,000 worth of property from the tax calculation for all estates. Big or small, then, every estate could exclude $5,000 of assets from the calculation of the tax.

Referring generally to the scope and limitations of the General Assembly's power to tax under the Uniformity Clause, the Supreme Court opined that "[a] pretended classification, that is based solely on a difference in quantity of precisely the same kind of property, is necessarily unjust, arbitrary, and illegal." *Id.* at 81. The Court continued:

> These limitations on the power of the legislature mean something. They are plainly intended to secure, as far as possible, uniformity and relative equality of taxation, by prohibiting, generally, the exemption of a certain part of any recognized class of property, and subjecting the residue to a tax that should be borne uniformly by the entire class,

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[13] At the time of *Cope's Estate,* the Uniformity Clause was set forth in Article IX, Section 1 of the Pennsylvania Constitution. That section also vested in the General Assembly the power to exempt certain property from taxation. *Cope's Estate,* 43 A. at 81. In Pennsylvania's current Constitution, the General Assembly's authority to exempt certain property from taxation (Art. VIII, § 2) is set forth separately from the Uniformity Clause.

> and by guarding against any other device that necessarily or intentionally infringes on the established rule of uniformity and relative equality which, as we have seen, underlie every just system of taxation.

Id. With this in mind, the Supreme Court held that the inheritance tax scheme violated this constitutional mandate of uniformity and relative equality:

> In any view that can reasonably be taken of these limitations [in the Uniformity Clause], it must be manifest, to any reflecting mind, that the act in question offends against them by undertaking to wholly exempt from taxation the personal property of a very large percentage of decedents' estates, and impose increased and unequal burdens on the residue of the same class of property. If the authority to exempt, etc., which was assumed and exercised by the legislature in this case, is sanctioned by this court, the constitutional rule of uniformity virtually becomes a dead letter, and, in lieu of the will of the people plainly declared in the fundamental law of the state, the unrestrained will of the legislature becomes supreme law on that subject. If the legislature had authority, under the constitution, to do what was done in this case, they had like authority to reverse their order of taxation, etc., and thus impose the tax on personal property amounting in value to $5,000 and less, and exempt therefrom all property of same recognized class in excess of that sum; *and, consequently, they have like authority, in every case, to establish any other arbitrary ratio, between the amount in value*

> *of property to be taxed and that which shall be exempt therefrom, in any class of subjects.*

Id. (emphasis added).

The Supreme Court then returned to its earlier premise, which undergirded its entire reasoning: "The money value of any given kind of property . . . *can never* be made a legal basis of subdivision or classification for the purpose of imposing unequal burdens on either of such classes, or wholly exempting either of them from any burden." *Id.* at 82 (emphasis added). The Supreme Court estimated that approximately 90-95% of estates annually paid no inheritance tax as a result of the $5,000 exemption cap, leaving only 5 to 10% of estates subject to the 2% tax. *Cope's Estate,* 43 A. at 82. In this Supreme Court's words, this disparity "illustrates the injustice and inequality that must result from such special legislation." *Id.*

Cope's Estate has stood the test of time, perhaps because of its simple adherence to a straightforward reading of the Uniformity Clause. To the extent the General Assembly exercises its power to tax property, it cannot set a valuation threshold that, in effect, exempts some property owners from the tax entirely. The Commonwealth offers no reasoned or persuasive argument to eschew this precedent in this case. Here, the General Assembly has elected to tax property—*i.e.,* corporate net income. It has also allowed taxpayers to deduct from their taxable income carryover net losses from prior years. By capping that deduction at the greater of $3 million or 12.5% of taxable income, however, the General Assembly has favored taxpayers whose property *(i.e.,* taxable income) is valued at $3 million or less. To the extent these taxpayers are in a positive net loss carryover position, they pay no corporate net income tax—i.e., they have no tax

burden. A similarly-situated taxpayer with more than $3 million in taxable income, however, cannot avoid paying tax under the NLC deduction provision. The distinction is based solely on asset value, which is, under *Cope's Estate,* "unjust, arbitrary, and illegal." *Id.* at 81.[14] Moreover, the fact that the NLC deduction provision enabled 98.8% of taxpayers in a positive net loss carryover position to avoid paying any tax in 2007, leaving 1.2% of similarly-situated taxpayers to pay some tax, "illustrates the injustice and inequality that must result from such special legislation." *Id.* at 82.

We must also reject the Commonwealth's claim that the General Assembly had sound budgetary reasons for imposing the NLC deduction limitations. We do not question the General Assembly's ability to impose limitations on the NLC deduction, so long as those limitations do not impose unequal tax burdens on the taxpayers or exempt one class from paying the tax entirely. "[R]egardless of the extent to which the political branches are responsible for budgetary matters, they are not permitted to enact budget-related legislation that violates the constitutional rights of Pennsylvania citizens." *Hosp. & Healthsystem Ass'n of Pa. v. Commonwealth,* 77 A.3d 587, 598 (Pa. 2013). For the reasons set forth above, the limitations in the NLC deduction provision, particularly the operation and effect of the $3 million alternative cap, violate the Uniformity Clause.

---

[14] The arbitrariness of the $3 million limitation is evident in light of *Cope's Estate.* The Commonwealth argues that the General Assembly imposed the $3 million limitation in an effort to benefit "small business." If true, then the General Assembly can define "small business" in a fashion unrestrained by the text of the Uniformity Clause. The Supreme Court expressly rejected such unbridled legislative power in *Cope's Estate.*

Finally, that Nextel and other high-income taxpayers may, in future years, be able to apply unused net losses to reduce taxable income does not change the fact that some taxpayers paid no tax in Tax Year 2007 because of the NLC deduction provision, while Nextel and others did. A taxpayer should not have to wait twenty years to get the same deduction that another taxpayer, because of a legislatively-imposed cap based solely on the value of the property to be taxed, can take in Year 1.

This brings us to the question of remedy. The Commonwealth contends that if we hold the NLC deduction provision unconstitutional, we should strike the NLC deduction provision in its entirety. We disagree. We do not have before us a facial challenge to the NLC deduction provision and have not analyzed Nextel's claim under that rubric. *See Johnson v. Allegheny Intermediate Unit,* 59 A.3d 10, 16 (Pa. Cmwlth. 2012) (en banc). Instead, Nextel claims that the NLC deduction provision is unconstitutional as applied to Nextel for the 2007 Tax Year. Having resolved that limited question in Nextel's favor, any relief afforded in this case should be confined to remedying that alleged wrong.

"[A]nalysis under the Uniformity Clause of the Pennsylvania Constitution is generally the same as the analysis under the Equal Protection Clause of the United States Constitution." *Clifton,* 969 A.2d at 1211 n.20; *see Commonwealth v. Molycorp, Inc.,* 392 A.2d 321, 323 (Pa. 1978). In *Molycorp, as* a remedy to a Uniformity Clause violation, the Pennsylvania Supreme Court struck the additional tax paid by the taxpayer as a result of the violation. In so doing, our Supreme Court cited with approval the United States

Supreme Court's decision in *Iowa-Des Moines National Bank v. Bennet,* 284 U.S. 239 (1931).

In *Iowa-Des Moines National Bank,* the corporate taxpayer alleged that Polk County taxing officers taxed the taxpayer at rates in excess of those used to assess its competitors over a course of years under certain Iowa statutes. The taxpayer sought mandamus against the county taxing officers to compel them to refund the portion of the taxes that had been illegally exacted due to this disparate treatment. The Iowa Supreme Court held, however, that the objecting taxpayers were not entitled to relief. In the state court's view, the collection error meant only that "the competing domestic corporations remain, so far as it appears, liable for the balance of the assessments" that they underpaid. *Iowa-Des Moines Nat'l Bank,* 284 U.S. at 243. The Iowa Supreme Court held, then, that the only remedy to the harmed taxpayer was "to await action by the taxing authorities to collect the taxes remaining due from their competitors or to initiate proceedings themselves to compel such collection." *Id.* at 243-44. In other words, "the discrimination thus affected was remediable only by correcting the wrong under the state law in favor of the competitors and not 'by extending . . . the benefits as of a similar wrong' to the petitioners." *Id.* at 244.

The United States Supreme Court reversed the Iowa Supreme Court. It expressly rejected the state court's refusal to afford affirmative relief to the offended taxpayer in the face of discriminatory treatment under the notion that the state could, instead, equalize the tax burden by seeking to recoup the underpaid taxes from the favored taxpayers. The possibility of recoupment from the favored taxpayers was, in the Supreme Court's view, "not material":

> The petitioners' rights were violated, and the causes of action arose, when taxes at the lower rate were collected from their competitors. It may be assumed that all ground for a claim for refund would have fallen if the state, promptly upon discovery of the discrimination, had removed it by collecting the additional taxes from the favored competitors. By such collection the petitioners' grievances would have been redressed; for these are not primarily overassessment. The right invoked is that to equal treatment; and such treatment will be attained if either their competitors' taxes are increased or their own reduced. But it is well settled that a taxpayer who has been subjected to discriminatory taxation through the favoring of others in violation of federal law cannot be required himself to assume the burden of seeking an increase of the taxes which the others should have paid. Nor may he be remitted to the necessity of awaiting such action by the state officials upon their own initiative.

Id. at 247.

In *Tredyffrin-Easttown School District v. Valley Forge Music Fair, Inc.,* 627 A.2d 814 (Pa. Cmwlth.), *appeal denied,* 647 A.2d 513 (Pa. 1993), this Court, citing *Molycorp* and *Iowa-Des Moines National Bank,* affirmed a common pleas court's ruling that, as a result of its selective enforcement of a local amusement tax ordinance, the local taxing authority was required to refund amusement taxes remitted by the objecting taxpayer. The remedy endorsed by this Court was to place the discriminated taxpayer in the same position as the benefitted taxpayers. Because

of the unequal treatment the objecting taxpayer paid taxes *in excess of* the favored taxpayers. The remedy, therefore, was to refund the excess. *Tredyffrin-Easttown Sch. Dist.,* 627 A.2d at 822-23.

The discrimination in this case derives from the $3 million alternative limitation in the NLC deduction provision. Although we could strike that limitation for the 2007 Tax Year and the similar limitations for the tax years thereafter in an effort to make the statutory scheme uniform, such a statutory revision would not remedy the wrong suffered by Nextel in the 2007 Tax Year. Indeed, striking the $3 million cap, as the dissent proposes, would only serve to highlight the fact that while Nextel paid what it was supposed to pay, many corporate net income taxpayers in the 2007 Tax Year benefitted from the discriminatory cap and thus *underpaid* their corporate net income taxes—i.e., they benefitted from the unconstitutional provision. Without more, then, an order declaring the $3 million cap unconstitutional and striking it from the statute does not remedy the constitutional violation.

Under *Molycorp, Iowa-Des Moines National Bank,* and *Tredyffrin-Easttown School District,* the unequal treatment suffered by Nextel must be remedied, and it can only be remedied in one of two ways—the favored taxpayers pay more or Nextel pays less. The latter is the only practical solution. Nextel seeks a refund of corporate net income tax paid in 2007. This is an appropriate remedy. Like similarly-situated taxpayers with $3 million or less taxable income in the 2007 Tax Year, Nextel should be permitted under the NLC deduction provision to reduce its taxable income to $0 by virtue of its positive net operating loss position that tax year.

In response to the Commonwealth's concerns, we fully recognize that our decision in this case could be far-reaching. Nonetheless, our analysis and remedy is appropriately confined to the Commonwealth, Nextel, and the 2007 Tax Year. To the extent our decision in this as-applied challenge calls into question the validity of the NLC deduction provision in any other or even every other context, the General Assembly should be guided accordingly.

/s/ P. Kevin Brobson
P. KEVIN BROBSON, Judge

CONCURRING AND DISSENTING OPINION BY PRESIDENT JUDGE PELLEGRINI

I agree with the majority that the net loss carry-over deduction (NLC deduction) provision in Section 401(3)4.(c)(1)(A)(II) of the Tax Reform Code of 1971 (Tax Reform Code)[1] that allows a net loss deduction that is the greater of the flat percentage of net losses or of a flat capped amount violates the uniformity requirement (Article VIII, Section 1) of the Pennsylvania Constitution (Uniformity Clause). As the majority cogently explains:

> To the extent the General Assembly exercises its power to tax property, it cannot set a valuation threshold that, in effect, exempts some property owners from the tax entirely. The Commonwealth offers no reasoned or persuasive argument to eschew this precedent in this case. Here, the General Assembly has elected to tax property – i.e., corporate net income. It has also allowed taxpayers to

[1] Act of March 4, 1971, P.L. 6, *as amended,* 72 P.S. §7401(3)4.(c)(1)(A)(II).

> deduct from their taxable income carryover net losses from prior years. By capping that deduction at the greater of $3 million or 12.5% of taxable income, however, the General Assembly has favored taxpayers whose property (*i.e.,* taxable income) is valued at $3 million or less. To the extent these taxpayers are in a positive net loss carryover position, they pay no corporate net income tax – i.e., they have no tax burden. A similarly-situated taxpayer with more than $3 million in taxable income, however, cannot avoid paying tax under the NLC deduction provision. The distinction is based solely on asset value, which is, under *Cope's Estate,* "unjust, arbitrary, and illegal." *Id.* at 81. Moreover, the fact that the NLC deduction provision enabled 98.8% of taxpayers in a positive net loss carryover position to avoid paying any tax in 2007, leaving 1.2% of similarly-situated taxpayers to pay some tax, "illustrates the injustice and inequality that must result from such special legislation." *Id.* at 82. (footnote omitted).

Slip Opinion, p. 13.

The majority, however, pretends that because Nextel is purportedly not making a facial challenge, what is "only" to be declared unconstitutional is the NLC deduction provision as applied to Nextel for the 2007 Tax Year. Realizing the effect that its opinion would have, the majority opinion states that "[t]o the extent our decision in this as-applied challenge calls into question the validity of the NLC deduction provision in any other or even every other context, the General Assembly should be guided accordingly." Slip Opinion, p. 19. Unless our case law means nothing, no

matter whether you call it – an "as applied" challenge or a facial challenge – the net effect of our holding is that Section 401(3)4.(c)(1)(A)(II) can no longer cap the amount of NLC deductions for all taxpayers. As a result, we must go on to determine whether the flat capped NLC deduction should be stricken making that provision uniform or, as the majority does, eliminate all caps on NLC deductions.[2]

Section 1925 of the Statutory Construction Act, 1 Pa. C.S. §1925, provides, in relevant part:

> The provisions of every statute shall be severable. If any provision of any statute . . . is held invalid, the remainder of the statute . . . shall not be affected thereby, unless the court finds that the valid provisions of the statute are so essentially and inseparably connected with, and so depend upon, the void provision . . . that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one; or unless the court finds that the remaining valid provisions, standing alone, are incomplete and are incapable of being executed in accordance with the legislative intent.

---

[2] The majority relies on *Iowa-Des Moines Nat. Bank v. Bennett,* 52 S.Ct. 133 (1931) and *Tredyffirin-Easttown Sch. Dist. v. Valley Forge Music Fair, Inc.,* 627 A.2d 814, 821 (Pa. Cmwlth. 1993), but those cases have nothing to do with how a tax statute should be interpreted once a provision is found unconstitutional to give effect to the General Assembly's intention. They are not applicable because neither of those cases dealt with an unconstitutional tax statute, but with the unequal enforcement of a constitutional statute by administrative officials.

Under the provisions, the unconstitutional provisions should be severed from their constitutional counterparts unless the valid provisions are so essentially and inseparably connected with, and so dependent upon, the void provision or application so that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the voided one or that the remaining valid provisions, standing alone, are incomplete and incapable of being executed in accordance with the legislative intent. *Pennsylvanians Against Gambling Expansion Fund, Inc. v. Commonwealth,* 877 A.2d 383 (Pa. 2005).

The NLC deduction contained in Section 401(3)4.(c)(1)(A)(II) is part of the "Definition" section of the Tax Reform Code which provides, in relevant part:

> (A)(I) For taxable years beginning before January 1, 2007, two million dollars ($2,000,000);
>
> (II) For taxable years beginning after December 31, 2006, the greater of twelve and one-half per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);
>
> (III) For taxable years beginning after December 31, 2008, the greater of fifteen per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);
>
> (IV) For taxable years beginning after December 31, 2009, the greater of twenty per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or three million dollars ($3,000,000);

> (V) For taxable years beginning after December 31, 2013, the greater of twenty-five per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or four million dollars ($4,000,000);
>
> (VI) For taxable years beginning after December 31, 2014, the greater of thirty per cent of taxable income as determined under subclause 1 or, if applicable, subclause 2 or five million dollars ($5,000,000).

72 P.S. §7401(3)4.(c)(1)(A) (emphasis added).

It is clear that the General Assembly wanted to limit NLC deductions every tax year – with both a flat and percentage cap on deductions. The majority would strike all caps on deductions, which is directly against the legislative scheme of the placement of caps on NLC deductions. If the unconstitutional flat cap deduction is severed for each relevant year highlighted in bold, the uniform percentage deduction would remain, which would be available to all taxpayers. Severing the flat cap provisions would carry out the legislative intent to place a limitation on NLC deductions for each year.

Because the remaining valid provisions of Section 7401(3)4.(c)(1)(A) carry out the intent of the General Assembly, protect the public purse, and are complete and capable of being administered without the severed provisions, I dissent from that portion of the majority opinion that removes the cap on all NLC deductions.

/s/ Dan Pellegrini
DAN PELLEGRINI, President Judge

Judge Leadbetter joins in this concurring and dissenting opinion.

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 98 F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Petitioner

v.

COMMONWEALTH OF PENNSYLVANIA,

Respondent.

ORDER

AND NOW, this 23rd day of November, 2015, it is hereby ORDERED that the order of the Board of Finance and Revenue in the above-captioned matter is REVERSED, and the refund petition of Nextel Communications of the Mid-Atlantic, Inc. (Nextel) is GRANTED. The Department of Revenue is directed to refund Nextel $3,938,220 in corporate net income tax paid for the tax year ending December 31, 2007.

Unless exceptions are filed within 30 days pursuant to Pa. R.A.P. 1571(i), this order shall become final.

/s/ P. Kevin Brobson
P. KEVIN BROBSON, Judge

APPENDIX C

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 98 F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Petitioner,

v.

COMMONWEALTH OF PENNSYLVANIA,

Respondent.

ORDER

PER CURIAM

AND NOW, this 30th day of December, 2015, upon consideration of Respondent's Application to Waive Briefing and Argument on Exceptions, to which Petitioner does not object, the Application is GRANTED, and Respondent's Exceptions are OVERRULED.

Judgment is entered against Respondent and in favor of Petitioner, Nextel Communications of the Mid-Atlantic, Inc.

Certified from the Record

DEC 30, 2015

And Order Exit

APPENDIX D

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 EAP 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Appellee,

v.

COMMONWEALTH OF PENNSYLVANIA,
Appellant.

Appeal from the Judgment of Commonwealth Court entered on December 30, 2015 at No. 98 F.R. 2012

ARGUED: April 5, 2017

ORDER

PER CURIAM

AND NOW, this 4th day of January, 2018, Appellee's Application for Reargument with Application for Consolidation with *R.B. Alden Corp v. Commonwealth*, 60 MAP 2017 or with Application for Remand to Correct a Factual Error is DENIED. Also, the Application for Leave to Intervene by R.B. Alden Corp. is DENIED as moot.

A True Copy
As Of 1/4/2018
Attest: /s/ John W. Person
John W. Person Jr., Esquire
Deputy Prothonotary
Supreme Court of Pennsylvania

APPENDIX E

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Petitioner,

v.

COMMONWEALTH OF PENNSYLVANIA,

Respondent.

PETITION FOR REVIEW

To the Honorable Judges of the Commonwealth Court:

1. This Court has jurisdiction under 42 Pa. Cons. Stat. Ann. § 763(a) and Pa. R.A.P. 1571.

2. Petitioner is Nextel Communications of the Mid-Atlantic, Inc.

3. Respondent is the Commonwealth of Pennsylvania.

4. Petitioner timely reported and paid its Pennsylvania corporate net income tax (hereafter, "Tax") for the year ending December 31, 2007.

5. On April 15, 2011, Petitioner timely filed a Petition for Refund of Tax with the Board of Appeals.

6. On August 23, 2011, the Board of Appeals issued a Decision and Order denying Petitioner's Petition for Refund of Tax.

7. On October 21, 2011, Petitioner timely filed a Petition for Review of the Board of Appeals decision with the Board and Finance and Revenue (hereafter, "Board").

8. On January 24, 2012, the Board issued its order in which it sustained the Board of Appeals' decision and order. A copy of that order was mailed to Petitioner on January 27, 2012. The Board's docket number is 1107916.

9. Petitioner seeks review of that order. Petitioner objects to the Board's order because:

A. Issues involving the computation of Petitioner's tax, generally. Petitioner's Tax was not computed in accordance with the Tax Reform Code of 1971, 72 P.S. § 7401 *et seq.,* or the Fiscal Code, 72 P.S. § 1, *et seq*.

B. Issues involving the tax base. Petitioner is entitled to properly compute its taxable income. *See* 72 P.S. § 7401. Therefore, Petitioner's taxable income must be adjusted for the following, among other, reasons:

i. Petitioner participated in filing a consolidated federal income tax return. Petitioner's Pennsylvania taxable income should have been based on the federal taxable income that Petitioner would have been able to report if it had filed its own, separate income tax return with the federal government. *See* 72 P.S. § 7401(3)1.(a). As currently reported, Petitioner's Tax reflects computations of the consolidated group instead of the computations that Petitioner would have been able to make on a separate-company basis. Accordingly, Petitioner's taxable income, as reported, is overstated. Petitioner's Tax must, therefore, be

corrected. As an example, Petitioner is entitled to independently determine a method of depreciation.

ii. Petitioner is entitled to properly compute its Pennsylvania net loss deduction.

C. Issues involving apportionment. Petitioner is entitled to properly compute its apportionment fractions and thus its Pennsylvania taxable income. *See* 72 P.S. § 7401(3)2.(a)(9) through (18). Therefore, Petitioner's apportionment fractions must be adjusted for the following reasons (among others):

i. Petitioner is entitled to recompute its sales-factor numerator by excluding receipts that were not Pennsylvania receipts. *See* 72 P.S. § 7401(3)2.(a)(15)—(17). For example, Petitioner is entitled to exclude receipts from services where more income-producing activity was performed in a state other than Pennsylvania based on costs of performance. *See* 72 P.S. § 7401(3)2.(a)(17).

ii. Petitioner is entitled to recompute its apportionment factors to properly reflect the apportionment attributable to Petitioner's investments or interests in other entities. *See* 61 Pa. Code §153.29.

iii. Petitioner is entitled to special apportionment or separate accounting under 72 P.S. § 7401(3)2.(a)(18) because the method used to compute Petitioner's Tax does not fairly represent the extent of Petitioner's Pennsylvania business activity. *See Unisys Corp. v. Commonwealth,* 812 A.2d 448 (Pa. 2002).

D. Constitutional issues. The Tax imposed on Petitioner violates the state and federal constitutions and must be recomputed. For example:

i. The Tax imposed on Petitioner violates the Commerce Clause of the United States Constitution because it is imposed: (1) on activity without a substantial nexus to Pennsylvania; (2) in a manner that is not fairly apportioned; (3) in a manner that discriminates against interstate commerce; and (4) in a manner that is not fairly related to services provided by Pennsylvania. *See Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).

ii. The Tax imposed on Petitioner violates the Equal Protection and Due Process Clauses of the United States Constitution, and the Due Process and the Uniformity Clauses and the equal protection provisions of the Pennsylvania Constitution. For example:

(1) Because of the limitation on the deductibility of net operating loss carryovers under 72 P.S. § 7401(3)4.(c), Petitioner's Tax is imposed at a higher effective rate than other similarly situated taxpayers. This violates the Uniformity Clause of the Pennsylvania Constitution. *See Amidon v. Kane,* 279 A.2d 53 (Pa. 1971); Pa. Const. art. VIII, § 1. *(See* letter to Board of Appeals, included in the Board of Finance and Revenue petition filing.)

(2) Petitioner's taxable income is apportioned to Pennsylvania in a greater concentration than other similarly situated taxpayers.

WHEREFORE, Petitioner respectfully requests that this Honorable Court review the Board's order and grant Petitioner's requested Tax refund and grant such other relief as may be appropriate.

/s/ Kyle O. Sollie

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Nextel Communications of the Mid-Atlantic, Inc.

Dated: 2/21/12

APPENDIX F

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 98 F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Petitioner,

v.

COMMONWEALTH OF PENNSYLVANIA,

Respondent.

BRIEF FOR PETITIONER NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.

Appeal from an Order of the
Board of Finance and Revenue,
dated January 24, 2012, Docket Number 1107916

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* * *

Statement of the Case

This case involves a petition for refund of tax paid by Nextel. Nextel filed a petition for refund with the Department of Revenue's Board of Appeals, raising the net loss issue, which is the issue in this litigation.[11] That Board denied that petition.[12] Nextel timely appealed to the Board of Finance and Revenue,[13] again raising the issue; that Board also denied the petition.[14] Nextel has timely appealed to this Court.[15]

Nextel is a telecommunications company that does business in 12 states, including Pennsylvania.[16] In years before 2007, Nextel made large investments in its business.[17] Specifically, Nextel spent about $2 billion building out its wireless network, using a unique "iDEN" network technology developed by Motorola.[18] The expenses from those investments and other deductible expenses exceeded Nextel's gross income; as a result, Nextel incurred Pennsylvania net losses of over $150 million, which it carried into 2007.[19]

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[11] S/F ¶ 17.

[12] S/F ¶18.

[13] At the time of the Board's decision, the Board was composed of designees of the Secretary of Revenue, the Auditor General, the Treasurer, the Secretary of the Commonwealth, the Attorney General, and the General Counsel. The composition of the Board has since changed, *See* Act 52 of 2013.

[14] S/F 9 19, 20.

[15] S/F ¶ 21.

[16] S/F ¶¶ 3, 26, Ex, H, Deposition of Terrence Frederick, Tax Director at Nextel, 10:12-10:21.

[17] S/F ¶ 26, Ex. H, Frederick Dep. 11:6-11:24.

[18] S/F ¶ 26, Ex. H, Frederick Dep. 11:6-12:12.

[19] S/F ¶¶ 10, 26, Ex. H, Frederick Dep. 10:22-11:24.

In 2007, Nextel earned $45 million of income.[20] Pennsylvania law allows all corporate taxpayers, big and small, to carry forward prior-period losses into years in which they have income.[21] So Nextel carried losses into 2007 ($150 million) that vastly exceeded its 2007 income ($45 million).[22]

Although Nextel had net loss carryovers that exceeded its 2007 income, Nextel, and other larger Pennsylvania taxpayers, could not freely deduct their net losses. For large corporate taxpayers (i.e., those with taxable income above $3 million), the law limits the net loss deduction.[23] In 2007, a total of 314 larger taxpayers (like Nextel) had their net loss deductions limited.[24] Of those, 234 taxpayers were like Nextel: Those large taxpayers could have reduced their income to zero if the deduction was not limited.[25] As a result of the limitations imposed on large corporate taxpayers, Nextel only deducted $5.6 million of its $150 million net loss carryovers in 2007.[26] After deducting the $5.6 million net loss, Nextel had taxable income of $39.4

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[20] S/F ¶¶ 11, 26, Ex. H, Frederick Dep. 13:3-13:8.

[21] *See* 72 P.S. §7401(3)4. All citations to title 72 refer to the statute in effect in 2007.

[22] S/F ¶¶ 10, 11, 26, Ex. H, Frederick Dep. 13:3-13:14.

[23] 72 P.S. §7401(3)4.(c)(1)(A)(II).

[24] S/F ¶ 22, Ex. D (119+86+47+62 = 314 taxpayers had net loss deductions limited because their income exceeded $3 million).

[25] *Id.* (Of the taxpayers in footnote 24, 114+61+33+26 = 234 could have reduced their income to zero if they were allowed to freely deduct their net losses.)

[26] S/F ¶ 12.

million. So Nextel paid tax (at a 9.99% rate) of about $3.94 million.[27]

Meanwhile, in 2007, over 19,000 other corporate taxpayers also had net losses carried into 2007 that exceeded their 2007 income,[28] In that way, those taxpayers were like Nextel.[29] But unlike Nextel, those taxpayers' income was below the $3 million threshold. Since their income was below the $3 million threshold, the net loss limitations did not affect them. They were able to freely deduct their net losses and reduce their taxable income to zero.[30] Those taxpayers were able to do so because their income (before the net loss deduction) was less than $3 million.[31] Those taxpayers paid no tax.

If Nextel's business had been exactly the same—if it had been conducted on a 1150th scale—its loss carryovers would have been about $3 million (instead of $150 million) and its income would have been about $1 million (instead of $45 million). If its business had been conducted on this smaller scale, it would have paid no tax—even if everything else about its business was the same.[32] The issue in this case is whether the

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[27] S/F ¶ 13.

[28] S/F ¶ 22, Ex. D.

[29] S/F ¶¶ 11, 12, 22, Ex. D.

[30] S/F ¶ 25, Ex. G, McCaffery Report at ¶ 6; S/F ¶ 26; Ex. H, Frederick Dep. 16:2-16:24. Professor McCaffery has analyzed the facts of this case and offers his opinions concerning the practical and economic impacts of the net loss cap on Nextel and other corporate taxpayers in 2007. His Report is offered by Nextel as expert opinion on those topics only. McCaffery's Report is not offered as expert opinion regarding Pennsylvania law.

[31] S/F ¶ 22, Ex, D.

[32] S/F ¶ 26, Ex. H, Frederick Dep. 16:2-16:24.

net loss limitation—which affects only large taxpayers with income above $3 million—violates the Uniformity Clause of the Pennsylvania Constitution.[33]

Note, for simplicity Nextel will in this brief refer to a taxpayer's income before net loss deductions simply as "income." Nextel will refer to a taxpayer' s income after the net loss deductions as "taxable income."

* * *

B. Even if the Department of Revenue could, in theory, remedy a Uniformity Clause violation by assessing the 19,000+ taxpayers with income below $3 million that benefitted from a 100% net loss deduction, that option is unavailable because the statute of limitations has expired on assessing those taxpayers.

As described in section III.A of this brief, under Pennsylvania's Uniformity Clause case law, the only remedy to fix a uniformity violation is to grant relief to the taxpayer. Yet even if it were legally permissible, in theory, to solve a uniformity problem by assessing small taxpayers that benefitted from an unlimited net loss deduction, that remedy is not an option in this particular case. This case involves the 2007 corporate tax year. Tax returns for 2007 were due April 15, 2008.[123] Even if all taxpayers requested an extension of time to file a return, the latest a taxpayer could file a 2007 return was October 15, 2008.[124]

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[33] S/F ¶ 7.

[123] 72 P.S. § 7403(a) (tax returns are due by April 15 of each year).

[124] 72 P.S. § 7405 (return filing due date may be extended to no later than 30 days after a federal return is due). Under 26 U.S.C.

Under Pennsylvania law, if there is a corporate tax deficiency, the Department of Revenue must assess a taxpayer within three years of the date the return was filed.[125] So October 15, 2011 (three years from October 15, 2008) was the last date that the Department could have assessed smaller taxpayers to cure the uniformity problem. Thus, none of the 19,000+ smaller taxpayers, with income less than $3 million, that took a 100% net loss deduction for the 2007 year are still open for assessment. Indeed, the Department agrees that the 2007 year is closed for assessment for all taxpayers.[126] (Of course, the 2007 year is closed for assessment against Nextel too.) Therefore, the Department cannot issue timely assessments against the 19,000+ taxpayers to cure the uniformity violation in 2007. Therefore, the only way to remedy the uniformity violation in 2007 is to grant relief to Nextel by allowing Nextel to deduct its net loss without limitation.

IV. CONCLUSION

The legislature has singled out a minority of corporate taxpayers that conduct business on a large

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§ 6072(b), a federal tax return is due by March 15. Under 26 U.S.C. § 6081(a), that return due date may be extended by six months, to September 15. Since the Pennsylvania return is due within 30 days after that, the Pennsylvania return is due by October 15. So for the 2007 taxable year, all Pennsylvania corporate tax returns were due by October 15, 2008.

[125] 72 P.S. § 7407.3(a).

[126] S/F ¶ 24, Ex. F, Respondent's Response to Petitioner's Interrogatory No. 7 (no taxpayers have signed waivers extending the statute of limitations for the 2007 year) and No. 9 ("the Department of Revenue is not aware of any taxpayer [that took the net loss deduction for the 2007 year] which is still open for assessment.").

scale by limiting their net loss deductions. Indeed, this design of the net loss limitations (singling out a few large-scale taxpayers) is intentional: The legislature curries favor with a large number of smaller-scale corporations, while extracting revenue from the small number of large-scale corporations.[127] This is exactly the reason we have a Uniformity Clause. Therefore, this Court should order that the net loss limitations violate the Uniformity Clause. This Court should order the Department of Revenue to recompute Nextel's tax without the net loss limitations.

Respectfully submitted,

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[127] *See* footnote 51, *supra.*

APPENDIX G

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 98 F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Petitioner

v.

COMMONWEALTH OF PENNSYLVANIA,
Respondent

Appeal from an Order of the Board of Finance and Revenue Dated January 24, 2012, at Docket No. 1107916

BRIEF OF RESPONDENT

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DATED: May 18, 2015

* * *

ARGUMENT

I. THE CAP IMPOSED ON THE NET LOSS DEDUCTION RESULTS IN NO CLASSIFICATION AND ANY ARGUABLE CLASSIFICATION RESULTING FROM THE CAP SATISFIES THE CONSTITUTIONAL REQUIREMENT OF "ROUGH" UNIFORMITY AND SERVES THE LEGITIMATE STATE PURPOSE OF SENSIBLE BUDGETARY PLANNING.

This appeal concerns the constitutionality of the statutory provision within the Tax Reform Code permitting taxpayers subject to the Corporate Net Income Tax to deduct from positive taxable income a "net loss." 72 P.S. § 7401(3)4.(b).[3] A net loss is generated in a year of negative taxable income and may be carried forward to future tax years to offset positive taxable income. *See* 72 P.S. § 7401(3)4.(c)(2)(A). Net losses which are carried forward into future years will be referred to throughout this brief as "accrued net losses."

The net loss deduction provisions have gone through various statutory changes, and so the amount of the net loss deduction allowed and the number of years over which a net loss can be carried forward has varied. During the Tax Year, the net loss deduction was limited to the greater of $3,000,000 or 12.5% of taxable income, 72 P.S. § 7401(3)4.(c)(1)(A), and could be carried forward up to 20 years, 72 P.S. § 7401(3)4.(c)(2)(A). The extent to which a net loss is

[3] See 72 P.S. § 7401(1) for the definition of "corporation." All taxpayers subject to the Corporate Net Income Tax will be referred to throughout this brief as "corporations."

taken is dependent upon (1) earning positive taxable income by the end of the year and (2) having sufficient accrued net losses carried into the tax year to support the deduction taken. *See* 72 P.S. § 7401(3)4.(b).

Nextel challenges[4] that the statutory cap imposed on the net loss deduction, as applied, violates the Uniformity Clause of the Pennsylvania Constitution. (S/F 7). Nextel concedes- that the net loss deduction cap is not facially unconstitutional[5] and, instead, argues that the cap is unconstitutional due to the particular circumstances of those taxpayers having sufficient accrued net losses to reduce their taxable income to zero but could not do so because of the net loss cap.

The Uniformity Clause of the Pennsylvania Constitution provides:

> All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws.

Pa. Const. art. VIII, § 1.

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[4] Although Nextel is the only taxpayer represented in the current appeal, an Amicus Brief filed on behalf of the Pennsylvania Business Counsel in favor of Nextel was filed with the Commonwealth Court on April 14, 2015. The Commonwealth contends that the Amicus Brief does not raise any arguments in addition to the arguments presented by Nextel. Accordingly, all arguments set forth in this brief similarly respond to the points raised in the Amicus Brief.

[5] Brief of Nextel, p. 31. *See Clifton v. Allegheny County,* 969 A.2d 1197, 1222 (Pa. 2009) ("A statute is facially unconstitutional only where no set of circumstances exists under which the statute would be valid.").

Any challenge to the constitutionality of a statute must overcome the hurdle that all statutes are presumed to be constitutional. *See* 1 Pa.C.S. § 1922(3). More specifically, a taxpayer seeking to invalidate a tax statute as violating the Uniformity Clause must demonstrate that (1) the enactment results in some form of classification, and (2) the classification is unreasonable, in that the statute is not rationally related to any legitimate state purpose. *Lebanon Valley Farmers Bank v. Commonwealth,* 83 A.3d 107, 113 (Pa. 2013) (citing *Clifton v. Allegheny County,* 969 A.2d 1197, 1211 (Pa. 2009) (citations omitted)). A tax statute will not be declared unconstitutional unless the taxpayer can successfully establish that the statute "'clearly, palpably, and plainly violates the Constitution.'" *Lebanon Valley Farmers Bank,* 83 A.3d at 113 (quoting *Clifton,* 969 A.2d at 1211 (quoting *Wilson Partners, L.P. v. Commonwealth,* 737 A.2d 1215, 1220 (Pa. 1999))).

A. The net loss cap does not result in an unconstitutional classification because every taxpayer reporting a Corporate Net Income Tax liability remains taxed at the statutory rate of 9.99% and any alleged classification satisfies the requirement of "rough" uniformity.

The burden is on Nextel to first demonstrate that the net loss deduction cap results in some form of classification. There is no facial challenge here because every taxpayer reporting a Corporate Net Income Tax liability – regardless of size, industry, or any other characteristic – was subject to the same net loss cap. As applied, the net loss deduction cap does not result in any classification.

1. The standard for uniform tax rates applies to the statutory tax rate and the net loss deduction cap does not change the fact that every taxpayer subject to the Corporate Net Income Tax is taxed at the identical statutory rate.

The Pennsylvania courts have repeatedly held that there is no Uniformity Clause violation where the same statutory rate is applied to the same tax base. *Commonwealth v. Budd Co.,* 108 A.2d 563, 569 (Pa. 1954); *Commonwealth v. Warner Bros. Theatres,* 27 A.2d 62, 64 (Pa. 1942); *Turco Paint & Varnish Co. v. Kalodner,* 184 A. 37, 40 (Pa. 1936); *Garofolo, Curtiss, Lambert & MacLean, Inc. v. Commonwealth,* 648 A.2d 1329, 1332 (Pa. Cmwlth. 1994), *reargument denied,* 659 A.2d 561 (Pa. 1994) (citing *Commonwealth v. Rohm and Haas Co.,* 368 A.2d 909, 912-13 (Pa. Cmwlth. 1977), *aff'd,* 386 A.2d 491 (Pa. 1978), *appeal dismissed,* 99 S.Ct. 61 (1978)). When the Supreme Court of Pennsylvania upheld the constitutionality of the Corporate Net Income Tax in *Turco Paint,* it reasoned:

> Plaintiff has not pointed to a single provision in the act which would demonstrate a legislative intent to impose a graded income tax. The rate used, 6 per cent., is the same for all corporations. The tax base to which this rate is to be applied is also identical. It is the net income attributable to this state ... Where different rates are *legislatively imposed on varying amounts or quantities of the same tax base,* then you have a graded tax that lacks uniformity under our Constitution. *To create a graded tax it is generally necessary that the rate itself be a variable factor ....*

Turco Paint, 184 A. at 40 (emphasis added) (citation omitted).

Nextel mistakenly relies on the decisions of *In Re Cope's Estate,* 43 A. 79 (Pa. 1899), and *Kelley v. Kalodner,* 181 A. 598 (Pa. 1935), for the idea that progressive tax rates are impermissible in Pennsylvania.[6] The obvious flaw in relying upon these cases is that the present appeal does not involve a progressive statutory tax rate, as was the issue in both *Cope's Estate* and *Kelley*. In *Cope's Estate,* the Pennsylvania Supreme Court found unconstitutional the inheritance tax statute which exempted from taxation estates valued under $5,000, reasoning that statutory rates which increased depending upon quantity or value violated uniformity. *Cope's Estate,* 43 A. at 81. Similarly, in *Kelley,* the Pennsylvania Supreme Court held that the Personal Income Tax statute was unconstitutional because the statutory tax rate increased in direct correlation with the amount of income received. *Kelley,* 181 A. at 602.

However, unlike the statutes at issue in *Cope's Estate* and *Kelley,* the cap imposed on the net loss deduction in no way impacted the fact that – as the parties have stipulated – during the Tax Year every single taxpayer (including Nextel) that was subject to the Corporate Net Income Tax remained taxed at the identical statutory rate (9.99%) which was imposed on the same adjusted tax base (taxable income apportioned to Pennsylvania after accounting for the net loss deduction). (S/F ¶¶ 14-15). The net loss cap clearly satisfies the requirement for uniformity because Nextel, similar to the taxpayer in *Turco Paint,* cannot point to a single section of the net loss deduction

[6] *See* Brief of Nextel, p. 18-21.

provision that would impose a graduated statutory tax rate.

2. The result of varying "effective" tax rates does not demonstrate a Uniformity Clause violation.

Nextel argues that the net loss cap, as applied, results in an unconstitutional classification because it produces varying "effective" tax rates for the group of taxpayers that carried into the Tax Year sufficient net losses to reduce their tax liability to zero but could not do so because of the cap.[7] This includes taxpayers with taxable income apportioned to Pennsylvania of over $3,000,000 before accounting for the net loss deduction and having sufficient accrued net losses to reduce taxable income to zero but could not do so because of the cap.[8]

Notably, neither the Pennsylvania Uniformity Clause nor the Tax Reform Code mentions the term "effective tax rate." Nextel's proffered expert defines it as "total tax paid divided by the total tax base" (S/F Ex. G, p. 5, ¶ 6),[9] and Nextel asks this Court to adopt

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[7] Brief of Nextel, pp. 24-8.

[8] Brief of Nextel, p. 27.

[9] Professor McCaffery's report was obtained by Nextel in preparation for this litigation. (S/F ¶ 25(a), Ex. G). Professor McCaffery is not licensed to practice law in Pennsylvania and has never been licensed to practice law in Pennsylvania. (S/F ¶ 25(e)). Without diminishing or otherwise questioning the academic accolades of Professor McCaffery, the Commonwealth finds it at least questionable as to whether Professor McCaffery is qualified to address the constitutionality of a Pennsylvania statute. Accordingly, the Commonwealth did not stipulate to Professor McCaffery being considered an expert for purposes of this appeal, to any statements contained in Professor McCaffery's report, or to any legal conclusions contained in the report. (S/F ¶¶ 25(b)-

the requirement of uniform effective tax rates despite the fact that the General Assembly has not done so.

The concept of "effective" tax rates can be explained with the following example: Taxpayer A has income of $10,000. If taxed at the statutory rate of 9.99%, Taxpayer A's tax liability would be $999. However, Taxing Jurisdiction X does not impose a tax on gross income and instead allows various deductions and imposes a tax on net income, equal to gross income minus deductions. After accounting for various tax deductions, Taxpayer A's tax liability is $200. In effect, Taxpayer A is taxed at a rate of 2% (i.e., an effective tax rate of 2%), equal to the actual tax liability of $200 divided by the tax base of $10,000. As this example illustrates, all tax deductions by their very nature generate varying effective tax rates; some taxpayers can take advantage of certain deductions and some cannot, and the extent to which taxpayers may utilize deductions will differ, further resulting in varying effective tax rates.

In asserting that effective tax rates must be uniform, Nextel is revisiting an argument that has already been repeatedly rejected by the Pennsylvania courts. In *Garofolo,* the Commonwealth Court of Pennsylvania upheld as constitutional the General Assembly's decision to suspend the net loss deduction entirely. *Garofolo,* 648 A.2d at 1335. The Court dismissed the taxpayer's uniformity argument which relied upon the fact that the taxpayer could no longer use its remaining unused net losses to offset its 1991 taxable income but other companies with larger profits in 1990

(d)). Before this Court is a pure question of law and the Commonwealth maintains that the only experts who are able to decide this issue are the Honorable Judges of this Court.

(the last year taxpayers could take the net loss deduction before the suspension) could have used more of their accrued net losses, thus resulting in varying effective tax rates. *Id.* at 1333.

The Court in *Garofolo* referenced the extensive history of Pennsylvania cases endorsing the use of federal net income as the starting point for calculating Pennsylvania Corporate Net Income Tax liability. *See Garofolo,* 648 A.2d at 1331-33. Federal net income incorporates various deductions from gross income that vary among taxpayers and invariably produces different effective tax rates, but the Pennsylvania courts have consistently upheld the use of federal net income because ultimately the same statutory rate was being applied to the same tax base. *Id.* at 1331-33. For this reason, the Pennsylvania courts have repeatedly rejected constitutional arguments focusing on varying effective tax rates for Corporate Net Income Tax purposes because the allowance of any deductions from gross income will produce varying effective tax rates. *Id.* at 1333.

The Pennsylvania net loss cap is analogous to the federal capital loss limitation of $2,000 which was at issue in the *Warner Bros. Theatres* decision. *Warner Bros. Theatres,* 27 A.2d at 63. Similar to Nextel, which carried into the tax year accrued net losses in excess of the net loss deduction cap, the taxpayer in *Warner Bros. Theatres* wished to deduct the entire $84,000 that it had incurred as capital losses. *Id.* However, because Pennsylvania adopted the federal calculation of net income as the tax base, the taxpayer's capital losses were subject to-the same limitation for state tax purposes and only $2,000 could be deducted. *Id.* Ultimately, the Supreme Court of Pennsylvania

upheld Pennsylvania's adoption of the federal definition of net income, thus denying the request to deduct all capital losses, and held that there was no lack of uniformity because all taxpayers were subject to the identical statutory tax rate as applied to the same tax base. *Id.* at 64. Noteworthy is that the Court found the tax statute to be constitutional despite the fact that the taxpayer could have deducted more of its capital losses, just as Nextel now argues that it could have utilized more of its accrued net losses but could not do so because of the net loss deduction cap.

Adopting the federal calculation of net income was subsequently upheld by the Pennsylvania Supreme Court in *Commonwealth v. Budd Co.,* 108 A.2d at 566, and by the Commonwealth Court of Pennsylvania in *Commonwealth v. Rohm and Haas,* 368 A.2d at 913. The Court in *Rohm and Haas* held that a corporation which had elected to take foreign taxes paid as a credit against federal income tax liability (rather than as a deduction from gross income) could not subsequently deduct foreign taxes paid in reducing the corporation's state tax liability because, as a general principle, taxpayers are bound by their federal elections. *Rohm and Haas,* 368 A.2d at 912-913; *see also Commonwealth v. Westinghouse Electric Corp.,* 386 A.2d 491 (Pa. 1978), *appeal dismissed,* 99 S.Ct 61 (1978). In *Garofolo,* when the Commonwealth Court rejected the effective tax rate argument for Corporate Net Income Tax purposes, the Court cited to the *Rohm and Haas* decision and explained that there was no uniformity violation despite the fact that some corporations were unable to take a foreign tax deduction to reduce their state tax liabilities, thus resulting in higher effective tax rates in comparison to the corporations that could have utilized the deduction.

Garofolo, 648 A.2d at 1333 (citing *Rohm and Haas,* 368 A.2d at 912-13).

This history of cases demonstrates that Pennsylvania courts have continually rejected uniformity challenges despite the outcome of varying effective tax rates in the Corporate Net Income Tax context.

Another important consideration is that Nextel, while arguing that it was subjected to an unfavorable effective tax rate and going so far as to say that it was "penalized" (S/F Ex. H, p. 16, lines 18-20), overlooks the fact that the alleged effective tax rate of 8.75%[10]

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[10] Brief of Nextel, p. 25. The effective tax rate of 8.75% was calculated by dividing Nextel's tax liability ($3,938,220) by Nextel's net income before the net loss deduction ($45,053,282). Brief of Nextel, p. 25, n.86. Nextel's use of net income before the net loss deduction as the tax base is unsupported by all caselaw and Nextel's own witness, Professor McCaffery.

The cases upholding the use of federal net income as the starting point for calculating Corporate Net Income Tax liability consistently referred to federal net income as the "tax base." *See, e.g., Budd,* 108 A.2d at 565; *Warner Bros,* 27 A.2d at 63. Here, Nextel's tax base using federal net income would be $242,837,736, (S/F Ex. A, p. 3, Line 1), in which case the effective tax rate would be 1.62% ($3,938,220 / $242,837,736).

In calculating tax liability, Professor McCaffery provides the following formula: tax = tax base (x) the tax rate. (S/F Ex. G, p. 4, ¶ 5). The Pennsylvania Supreme Court explained in *Turco Paint* that "the tax base ... is the net income attributable to this state." *Turco Paint,* 184 A. at 40. The net income attributable to Pennsylvania (as Professor McCaffery's formula confirms) is net income after accounting for the net loss deduction which Nextel reported as $39,421,622. (S/F ¶ 13, Ex. A, p. 3, line 12). Seen mathematically:

> Tax ($3,938,220) = tax base ($39,421,622) x statutory rate (0.0999).

If net income after accounting for the net loss deduction is the tax base – or rather, the adjusted tax base – then every single

was less than the statutory rate of 9.99%. In fact, in years of profitability, Nextel's effective tax rate was always less than the statutory tax rate. (S/F Ex. H, p. 29, lines 20-24).

Even more surprising, although Nextel argues that small businesses benefitted more from the net loss deduction to the detriment of larger companies, arguably the opposite may have been true. A smaller business without any accrued net losses or accrued net losses which were insufficient to take the full net loss deduction would have had a greater portion of its gross income taxed, resulting in a higher effective tax rate than that of Nextel. Also, nominally speaking, Nextel benefitted from a net loss deduction which was larger than the deduction any small business could have possibly taken. For the Tax Year, Nextel subtracted from taxable income a net loss of $5,631,660 – the greater of 12.5% of taxable income apportioned to Pennsylvania or $3,000,000 (S/F ¶ 12) – which well-exceeded the $3,000,000 dollar cap. The smaller businesses that are the focus of Nextel's argument never would have been able to take such a large net loss deduction. And so, companies as large as Nextel arguably were advantaged from the net loss deduction during the Tax Year in comparison to smaller businesses subject to the same cap.

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corporation (including Nextel) would have an effective tax rate equal to the statutory rate. Seen mathematically:

> Tax ($3,938,220) / tax base ($39,421,663) = effective rate (0.0999).

Accordingly, Nextel's assertion that the tax base is net income before accounting for the net loss deduction is unsupported by caselaw and Professor McCaffery's report.

a. Nextel misapplies Personal Income Tax caselaw to a Corporate Net Income Tax issue.

In asserting its effective tax rate argument, Nextel ignores relevant Pennsylvania caselaw repeatedly rejecting this argument for purposes of the Corporate Net Income Tax and Nextel instead relies upon the decision in *Amidon v. Kane,* 279 A.2d 53 (Pa. 1971).[11] At issue in *Amidon* was the legality of the Pennsylvania Personal Income Tax statute which adopted the definition of federal net income. *Amidon,* 279 A.2d at 55. Ultimately, the Pennsylvania Supreme Court struck down the statute as unconstitutional because federal net income incorporated various exemptions and deductions which were not available to all taxpayers, thus resulting in varying effective tax rates imposed upon the same levels of income. *Id* at 62.

While relying upon the holding from *Amidon* for the effective tax rate argument, Nextel simultaneously ignores the Pennsylvania Supreme Court's reasoning from that very decision. In rejecting the use of federal net income for Personal Income Tax purposes, the Court had to distinguish the Personal Income Tax from the Corporate Net Income Tax, which carried an extensive history of adopting the federal definition of net income. *Amidon,* 279 A.2d at 63. The Personal Income Tax is purely a tax on income, whereas the Corporate Net Income Tax is an excise tax for the privilege of conducting business in Pennsylvania which is designed to account for the cost of producing income. *Id* (citing *Warner Bros. Theatres,* 27 A.2d at 63).

The Court in *Amidon* recognized that the obvious differences between natural persons and corporations

[11] *See* Brief of Nextel, pp. 22-4.

justifies taxing them differently. The Court explained that "[c]orporations are artificial legal entities created with the permission of the state for the purpose of maximizing profits for shareholders, and the Corporate Net Income Tax is imposed upon a tax base which is the net income attributable to this state." *Amidon,* 279 A.2d at 63 (citing *Turco Paint,* 184 A. at 40). Natural persons, unlike corporations, spend their resources for a variety of reasons unrelated to maximization of profits, and so it would be illogical for the Personal Income Tax to emulate the Corporate Net Income Tax, which accounts for the cost of producing income. *Amidon,* 279 A.2d at 63. As a result, the Supreme Court of Pennsylvania flatly rejected any attempted analogy between the Personal Income Tax and Corporate Net Income Tax. *Id.* This distinction between corporations and natural persons was subsequently recognized in *Garofolo* when the Commonwealth Court rejected the taxpayer's effective tax rate argument in the context of the Corporate Net Income Tax. *Garofolo,* 648 A.2d at 1333.

The Commonwealth does not dispute that the Uniformity Clause applies to all types of taxes, but the holdings of *Amidon* and *Garofolo* demonstrate that uniformity analysis may differ depending on the type of tax at issue because the taxpayers themselves and the purpose behind their respective taxes varies. This idea was explicitly expressed in Justice Bell's concurring opinion in *Amidon* when he explained, "[t]his ... clearly indicates that there may [c]onstitutionally be different tests, standard and exemptions for individuals which are totally inapplicable to corporations, and consequently decisions with respect to and governing taxes for corporations are not controlling on Uniformity requirements for individuals." *Amidon,* 279 A.2d at 66-7 (Bell, J., concurring).

Despite this guidance, Nextel urges this Court to ignore prior caselaw and find that the Personal Income Tax decision of *Amidon* should dictate the Corporate Net Income Tax issue presently before this Court. Nextel's entire argument also ignores the fact that the Court in *Amidon* would not have reached the effective tax rate result without first distinguishing natural persons from corporations.[12] Uniformity for Personal Income Tax purposes may require an analysis of effective tax rates, but the Pennsylvania Courts have repeatedly rejected this analysis for purposes of the Corporate Net Income Tax and Nextel's argument should likewise be rejected here. Accepting Nextel's argument that *Amidon* should be followed for Corporate Net Income Tax purposes would overturn nearly a century of caselaw adopting the federal definition of net income (which invariably produces varying effective tax rates) and call into question whether gross federal income should be used as the tax base for Corporate Net Income Tax purposes.[13]

Nextel's attempt to analogize the present facts to *Amidon* is further misguided because that case concerned varying effective tax rates for taxpayers with the same levels of income. As the Court in that decision explained:

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[12] The two dissenting Justices in *Amidon* make room for the argument that it may have a different outcome if heard today. *See Amidon,* 279 A.2d at 69-73 (Eagen & Jones, JJ, dissenting).

[13] Nextel wishes to present that the adoption of federal net income should not be impacted here. (Brief of Nextel, p. 15, n.53). However, it must be questioned if Nextel's effective tax rate argument is accepted because federal net income incorporates numerous deductions which will inevitably produce varying effective tax rates.

> ... the most significant feature of the above tables is the fact that each taxpayer in Tables II and III respectively enjoy the privilege ... of 'receiving, earning, or otherwise acquiring' the *[sJame dollar amount* of annual income ... [y]et no two taxpayers are ... required to pay the same [e]ffective percentage rate of taxation ....

Garofolo, 648 A.2d at 62 (emphasis added).[14]

The basis of Nextel's entire argument is that effective tax rates varied depending upon the level of income. *Amidon* does not support this position. Therefore, looking beyond the questionable applicability of a Personal Income Tax decision to a Corporate Net Income Tax issue, Nextel's analogy is further dissipated because the present facts differ from the facts in *Amidon.*

Therefore, the net loss deduction cap did not result in any form of classification because every taxpayer remained taxed at identical statutory rates. Nextel's classification argument relies upon varying effective tax rates. The only authority for this argument is *Amidon,* a decision which held that the uniformity analysis for corporations and natural persons must differ. This distinction was subsequently upheld in

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[14] The chart on p. 23 of Nextel's Brief misrepresents the facts in *Amidon.* The first two columns at p. 23 of Nextel's Brief are from Table II (taxpayers with $10,000 of income) in *Amidon* and the third column is pulled from Chart III (taxpayers with $20,000 of income) in *Amidon. See Amidon,* 279 A.2d at 61-2. Ultimately, the Court took issue with the fact that natural persons subject to the Personal Income Tax who received the same amount of income were subject to varying effective tax rates. That is not the issue presently before this Court.

Garofolo and should similarly be recognized in upholding the constitutionality of the net loss deduction cap.

3. The alleged classification resulting from the net loss deduction cap satisfies the constitutional requirement of "rough" uniformity.

Assuming for the sake of argument that the net loss cap results in some form of classification, that classification does not rise to the unconstitutional standard of "substantially unequal tax burdens." *See Lebanon Valley Farmers Bank,* 83 A.3d at 113. A total of 19,537 corporations carried into the Tax Year sufficient accrued net losses to reduce taxable income to zero. (S/F Ex. D). Of this total, Nextel claims that 234 corporations were impacted by the net loss cap.[15] This represents the number of taxpayers with taxable income (before accounting for the net loss deduction) exceeding $3,000,000 in the Tax Year and having sufficient accrued net losses to reduce taxable income to zero but could not do so because of the cap. (S/F Ex. D).

Despite the exaggerated warning from Professor McCaffery that the net loss cap results in "class warfare" (S/F Ex. G, p. 14, ¶ 20), the reality is that the cap only impacted 1.2% (234 / 19,537) of the entire group of taxpayers having sufficient accrued net losses to reduce taxable income to zero.[16] All of the allegedly aggrieved taxpayers were still able to take a net loss deduction equal to the greater of 12.5% of taxable

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[15] Brief of Nextel, p. 6.

[16] Note, this is not 1.2% of all corporations subject to the Corporate Net Income Tax. Nor is this 1.2% of the total 46,676 corporations reporting positive taxable income apportioned to Pennsylvania during the Tax Year. *See* S/F Ex. E, p. 19.

income apportioned to Pennsylvania or $3,000,000 and were all subject to an effective tax rate that was less than the statutory rate.

Even if 1.2% of taxpayers in this group were negatively impacted, perfect uniformity is not – nor has it ever been – the standard for determining whether a tax provision is constitutional. The fact that a tax law, as applied, may result in some disparity does not necessarily demonstrate unconstitutionality. *Cope's Estate,* 43 A. at 81. The Pennsylvania Supreme Court has acknowledged that "[t]axation ... is not a matter of exact science; hence[,] absolute equality and perfect uniformity are not required to satisfy the constitutional uniformity requirement." *Lebanon Valley Farmers Bank,* 83 A.3d at 113 (quoting *Clifton,* 969 A.2d at 1210 (citing *Leonard v. Thornburgh,* 489 A.2d 1349, 1352 (Pa. 1985))). Rather, when it comes to matters of taxation, only "rough uniformity" is required and a taxing scheme should withstand constitutional scrutiny so long as it does not result in "substantially unequal tax burdens." *Lebanon Valley Farmers Bank,* 83 A.3d at 113 (quoting *Clifton,* 969 A.2d at 1210-11). The outcome here approximates a level of uniformity that is nearly perfect and clearly satisfies the constitutional standard of "rough" uniformity.

B. Any alleged disparity resulting from the net loss deduction cap serves the legitimate state interest of sensible budgetary planning.

Even if this Court were to overturn prior caselaw dismissing the effective tax rate argument in the Corporate Net Income Tax context and agree with Nextel that the net loss deduction cap results in some form of classification, Nextel fails to address – let

alone satisfy – its heavy burden of establishing that the classification is unreasonable, meaning that it is not rationally related to any legitimate state interest. *Lebanon Valley Famers Bank,* 83 A.3d at 113.

This present appeal is on point with the *Garofolo* decision where this very Court held that taxpayers do not have a constitutional right to a net loss deduction and, because the deduction is a matter of legislative grace, it is subject to repeal, suspension or reinstatement by the legislature. *Garofolo,* 648 A.2d at 1334. If it is constitutional to suspend or repeal the deduction entirely, surely it is constitutional to impose a cap on the deduction. With this understanding in mind, it is difficult to grasp how Nextel could possibly argue that it was "penalized" here. (S/F Ex. H, p. 16, lines 18-20). Nextel – a company with federal net income of $242,837,736 (S/F Ex. A, p. 3, Line 1) and income apportioned to Pennsylvania of $45,053,282 (S/F ¶ 11, Ex. A, p. 3, Line 10) – by legislative grace was able to take advantage of a net loss deduction in the Tax Year which reduced its taxable income by $5,631,660.

Reviewing the legislative history supporting a statutory enactment is one method for ascertaining the intent of the General Assembly. 1 Pa.C.S. § 1921(c)(7). It can be gleaned from the legislative history that the net loss cap serves the legitimate state purpose of encouraging the investment and growth of businesses without having too much of a negative impact on Pennsylvania's budget. In permitting this deduction, the General Assembly's concern as to the deduction's budgetary impact has remained unchanged since the modern-day net loss deduction was introduced over

thirty years ago.[17] This concern is demonstrated by the General Assembly's decision in 1991 to disallow the net loss deduction entirely.[18] For the Tax Year, the General Assembly in its wisdom determined that the budget could only handle a deduction limited to the greater of $3,000,000 or 12.5% of taxable income. As of 2015, the net loss deduction remains capped which further indicates that the budget still cannot sustain an unlimited deduction. *See* 72 P. S. § 7401(3)4. (c)(1)(A).

The importance of protecting the budgetary and fiscal affairs of the Commonwealth is self-evident. *See, e.g., Reese's Pizzas & More v. Dep't of Labor & Indus., Office of Unemployment Comp. Tax Servs.,* 93 A.3d 914, 918 (Pa. Cmwlth. 2014) ("Where an important government interest such as collecting revenue exists, private property rights must yield to governmental need.") (quoting *Dep't of Revenue, Bureau of Corp. Taxes v. Marros,* 431 A.2d 392, 393 (Pa. Cmwlth. 1981) (citations omitted)). The United States Supreme Court has acknowledged that taxes are "the life-blood of government, and their prompt and certain availability an imperious need." *Bull v. United States,* 55 S.Ct. 695, 699 (1935). And so, while the General Assembly

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[17] A copy of the House remarks from November 18, 1980 is attached at Appendix C. Refer to p. 2576 for the repeated questions and apparent concern as to the estimated revenue loss resulting from the allowance of a net loss deduction. Legislative Journal – House, Remarks on H.B. 1252, at 2576 (Nov. 18, 1980).

[18] A copy of the Senate remarks from June 14, 1994 is attached at Appendix D. Refer to p. 2318 for the explanation that the net loss provision had to be eliminated in 1991 because of the downturn in the economy and Pennsylvania's budget could not support any net loss deduction at that time. Legislative Journal – Senate, Remarks on H.B. 868, at 2318 (June 14, 1994).

was by no means required to permit a net loss deduction at all, it did so in a manner which allowed companies such as Nextel to partially offset future year profits with prior year losses. Nextel is now asking this Court to allow for full recovery of all losses. Simply put, the Commonwealth could not afford an unlimited net loss deduction and allowing this outcome as requested by Nextel would have crushing budgetary consequences and directly contradict the wisdom of the General Assembly in even allowing the deduction. Thus, in the interest of sensible budgetary planning, the net loss deduction cap serves a legitimate state interest.

Further, if there is some additional benefit afforded to small businesses by way of the net loss deduction, this outcome appears consistent with the General Assembly's original intention in granting the deduction. In 1980 when the General Assembly was considering the allowance of the net loss deduction, a major emphasis for passing the legislation was to encourage the growth of small businesses in Pennsylvania that may never be able to recover from initial start-up losses.[19] More specifically, the net loss deduction was intended to also assist the construction industry, which was significantly impacted by the

[19] *See* pp. 2579-80 of the 1980 House remarks, attached at Appendix C. Legislative Journal – House, Remarks on H.B. 1252, at 2579-80 (Nov. 18, 1980). *See also* p. 2318 of the 1994 Senate remarks at Appendix D. Legislative Journal – Senate, Remarks on H.B. 868, at 2318 (June 14, 1994) (stating that the net loss deduction was "very, very important to small businesses in Pennsylvania.").

recession at the time, and farmers experiencing losses from the drought.[20]

The alleged favorable treatment towards small businesses ignores the principle that the General Assembly is equipped with wide discretion when it comes to matters of taxation. *Lebanon Valley Farmers Bank,* 83 A.3d at 113 (citing *Wilson Partners,* 737 A.2d at 1220); *see also Commonwealth v. Life Assurance Company of Pennsylvania,* 214 A.2d 209, 214 (Pa. 1965) ("By necessity a wide discretion must be conceded to the Legislature in the classification of various businesses or occupations for purposes of taxation."). Nextel's argument that quantitative classifications are impermissible[21] mistakenly applies caselaw where the statutory rate varied among taxpayers; again, that is not the issue presently before this Court because the net loss deduction cap did not change the fact that every corporation remained subject to the identical statutory tax rate of 9.99%. Further, Nextel inaccurately presents that the net loss deduction cap is similar to the statute at issue in *Cope's Estate* which exempted from inheritance tax estates valued under $5,000. Unlike the statute in that case, the net loss deduction does not exempt from taxation all small businesses. This is demonstrated by the fact that a total of 46,676 corporations reported positive taxable income apportioned to Pennsylvania during the Tax Year (S/F Ex. E, p. 19) and only 19,872 of those corporations utilized a net loss deduction (S/F Ex. D). Based on the Department's reports, thousands of small businesses still incurred a Corporate Net Income Tax

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[20] *See* p. 2579 of the 1980 House remarks, attached at Appendix C. Legislative Journal – House, Remarks on H.B. 1252, at 2579 (Nov. 18, 1980).

[21] Brief of Nextel, pp. 29-30.

liability during the Tax Year even after accounting for the net loss deduction. *See* S/F Ex. E, p. 19.

Moreover, for purposes of the Corporate Net Income Tax, the Pennsylvania Supreme Court has recognized the opposite of Nextel's quantitative argument and has explained that "'the legislature can ... classify corporations for purposes of taxation; *may sever a small class from a larger one; might subject one class to taxation, and leave others untaxed.*'" *Turco Paint,* 184 A. at 43 (quoting *Commonwealth v. Sharon Coal Co.,* 30 A. 127 (Pa. 1894)) (emphasis added). If, as Nextel presents, the General Assembly lacks the discretion to provide assistance to small businesses, then all small business incentives must also be reevaluated.[22]

The legislative history also indicates that one motivation in allowing the net loss deduction was to encourage investment in new enterprises and promote invention and innovation for companies like Nextel that could offset future year profits with start-up year losses by way of the net loss deduction.[23] Thus, the deduction essentially functioned as an investment loan from which Nextel received a significant benefit.

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[22] Consider, for example, the Pennsylvania Research and Development Tax Credit. *See* 72 P.S. § 8702-B. Under this provision, a qualified taxpayer may receive a research and development tax credit equal to 10% of qualified research and development expenses which is applied against the Corporate Net Income Tax liability. 72 P.S. § 8703-B(b)(1); 61 Pa. Code § 9.17(a). A qualified small business, however, may receive a research and development tax credit equal to 20% of qualified research and development expenses. 72 P.S. § 8703-B(b)(2).

[23] *See* p. 2579 of the 1980 House remarks, attached at Appendix C. Legislative Journal – House, Remarks on H.B. 1252, at 2579 (Nov. 18, 1980).

By admission, Nextel incurred significant expenses during the initial years of operations and fully anticipated that it would become profitable and, therefore, recover its initial investments by taking advantage of the net loss deduction. (S/F Ex. H, p. 12, lines 13-20). Unfortunately for Nextel, its business model simply was not as innovative and profitable as originally anticipated. (S/F Ex. H, p. 14, lines 5-16). Initially, Nextel was able to offset early years of profitability with accrued net losses and reduce its Pennsylvania Corporate Net Income Tax liability. (S/F Ex H, p. 26, lines 6-10). However, as a result of ongoing years of unprofitability, Nextel was unable to reap the full benefit of the net loss deduction and is now asking the Commonwealth and businesses that were profitable to pick up the tab. This outcome was not the original intention in allowing the deduction.

Nextel's argument that it is "permanently disadvantaged" as a result of not being able to use its net losses in future years[24] further obscures the issue here and should be disregarded. Since Nextel began operating in Pennsylvania in 1995 (S/F ¶ 3), there has always been a cap on the net loss deduction, and so any expectation held by Nextel that the deduction would be unlimited is completely unfounded. *See* 72 P.S. § 7401(3)4.(c)(1)(A). Further, Nextel's assertion that its remaining net losses will be unused is entirely speculative and ignores the 20-year carryover period for net losses incurred after 1998. 72 P.S. § 7401(3)4.(c)(2)(A). Whether Nextel will be profitable in future years is not certain. Nextel relies on the testimony of Mr. Terrence Frederick, Sprint's State and Local Tax Director, whom the parties deposed on February 19, 2014. (S/F ¶ 26, Ex. H). Despite the

[24] Brief of Nextel, p. 32.

projections of Nextel's future unprofitability, Mr. Frederick testified that Sprint is still a profitable company (S/F Ex. H, p. 30, lines 20-22). Sprint, as the parent company of Nextel (S/F ¶ 2), could implement a profitable business operation through Nextel (S/F Ex. H, p. 38, lines 9-11) in which case unexpired net losses would still be utilized. Nextel would also use unexpired net losses if, for example, it merged with another profitable entity. (S/F Ex. H, p. 39, lines 16-24, p. 40, lines 1-8). These future operational decisions would ultimately be made by Sprint's Board of Directors, not Mr. Frederick whose duties are limited to filing tax returns which, by their very nature, reflect activities that have already occurred. (S/F Ex. H, p. 21, lines 2-9). Despite these considerations, this Court has already determined that taxpayers do not have a vested right in offsetting future profits with prior year losses. *Garofolo,* 648 A.2d at 1333-4.

Therefore, the net loss deduction cap does not result in any classification and any arguable classification serves the legitimate state interest of providing a tax benefit to all taxpayers without a crippling impact on Pennsylvania's budget. Any arguable additional benefit experienced by small businesses as a result of the cap should actually be encouraged so that these businesses have a chance of survival. For these reasons, Nextel is unable to satisfy its burden of proving that the net loss deduction cap clearly, palpably, and plainly violates the Pennsylvania Constitution.

II. THE OUTCOME OF THIS CASE WILL IMPACT EVERY TAXPAYER SUBJECT TO THE CORPORATE NET INCOME TAX AND THE DEDUCTION SHOULD BE DISALLOWED ENTIRELY IF THE CAP IS FOUND TO BE UNCONSTITUTIONAL.

A. The decision in the appeal will impact every taxpayer that is subject to the Corporate Net Income Tax.

Nextel erroneously presents that the remedy here will only impact Nextel and only for this Tax Year.[25] To the contrary, this decision will necessarily have ramifications for every taxpayer subject to the Corporate Net Income Tax for future tax years because the net loss deduction cap – although the percentage of income and dollar amount options have varied – has been present in every subsequent tax year and a cap still exists. *See* 72 P.S. § 7401(3)4.(c)(1)(A).[26] Thus, in the interest of judicial efficiency, this Court should consider the implications for future tax years.

Nextel's suggestion of a remedy with limited application overlooks the statutory changes that have followed judicial determinations of uniformity violations. For example, after the Personal Income Tax graduated tax rate statute was struck down in *Kelley* as violating the Uniformity Clause, the General Assembly enacted a statute imposing a flat tax rate on all taxpayers subject to that tax. *See* 72 P.S. § 7302. After the Pennsylvania Supreme Court in *Amidon* struck down the use of federal net income for Personal Income Tax

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[25] *See* Brief of Nextel, pp. 31-2.

[26] The implications that this decision will have on other taxpayers and for other tax years is further supported by the Joint Application for Argument *En Banc* filed by Nextel and the Commonwealth on May 8, 2015 where the parties stated, "There are dozens of cases at Commonwealth Court and at the administrative board level involving the very same legal issue present in this case. Many of the cases at Commonwealth Court have been held pending the outcome of this case." A copy of this Application is attached at Appendix E, ¶ 3.

purposes as violating uniformity, the General Assembly enacted a new methodology for taxing the various classes of income which impacted all taxpayers subject to the tax. *See* 72 P.S. § 7303.

Likewise, the Court's decision here will necessarily affect more than just Nextel because either a piece of or the entire net loss deduction statutory provision will be struck down if the cap is found to be unconstitutional.

B. The net loss deduction should be disallowed entirely if the cap is unconstitutional.

The parties in this appeal were unable to reach a stipulation as to the appropriate remedy if this Court finds that the net loss deduction cap is unconstitutional. The Commonwealth primarily asks that this Court uphold the net loss deduction cap as constitutional, thus allowing taxpayers to continue to take advantage of the deduction to the extent permitted by statute. However, if the net loss deduction cap violates uniformity, this Court must find an appropriate remedy that removes the unconstitutional disparity.

Whenever a provision is severed from a statute, it must be done in a manner which effectuates legislative intent. 1 Pa.C.S. § 1925; *see PPG Industries, Inc. v. Commonwealth,* 790 A.2d 261, 268 (Pa. 2001). In *PPG,* the Supreme Court of Pennsylvania severed the manufacturing exemption from the Capital Stock Tax statute because the exemption was held to be unconstitutional. *PPG,* 790 A.2d at 269. Relying on the rules of statutory construction, the Court reasoned, "'[c]learly, [1 Pa.C.S. §] 1925 funnels our inquiry to examining what the enacting legislature would have done had it known that the exemption ... was unconstitutional.'" *Id.* at 269 (quoting *Annenberg v. Commonwealth,* 757

A.2d 338, 347 (Pa. 2000)). The General Assembly had repealed the manufacturing exemption in the past, and so, consequently, it was conceivable that the General Assembly would strike the exemption again if it were found to be unconstitutional. *PPG,* 790 A.2d at 269.

If this Court finds the net loss cap to be unconstitutional, the Commonwealth presents that the only remedy is to strike the net loss deduction entirely. The only argument of inequality stems from Nextel's effective tax rate argument. If the Court adopts this theory, the Commonwealth submits that the only way to remedy the problem is to take away the deduction entirely because taxpayers will have varying effective tax rates so long as the net loss deduction is permitted. This result would then call into question whether any deductions should be allowed and whether the Corporate Net Income Tax should instead be imposed on gross income.

The first option presented by Nextel to cure the alleged inequality is to remove the dollar cap so that every corporation would remain subject to the same percentage of income cap. [27] However, this Court should bear in mind that such a result could negatively impact small businesses – the businesses that the net loss deduction was originally intended to benefit – that relied upon the $3,000,000 cap.

Nextel then urges that the only remedy here is to remove the cap and allow an unlimited net loss deduction.[28] In evaluating this argument, it is important for this Court to consider that the General Assembly carries wide discretion when it comes to matters of

[27] Brief of Nextel, p. 32.

[28] Brief of Nextel, p. 33.

taxation, *Lebanon Valley Farmers Bank,* 83 A.3d at 113, and that the net loss deduction is a matter of legislative grace which is subject to suspension or repeal, *Garofolo,* 648 A.2d at 1334. The General Assembly previously suspended the net loss deduction – which this Court upheld as constitutional in *Garofolo* – and, therefore, applying the reasoning from *PPG,* it is conceivable that the General Assembly would suspend or repeal the deduction again. In allowing the net loss deduction, the General Assembly has always remained cognizant of the budgetary consequences and determined that the budget could not support an unlimited deduction for the Tax Year. The General Assembly certainly would not have allowed the net loss deduction at all if the only option were to allow an unlimited deduction because such a result would have had a crippling impact on the budget. If this Court finds that the net loss deduction cap violated the Uniformity Clause and does not strike the deduction entirely, the General Assembly surely will. This outcome would be an unfortunate result for the small businesses, new ventures, and large companies such as Nextel which have been taking advantage of the net loss deduction for so many years, but such an outcome may be the only remedy where there is a "constitutional 'attack [on] the goose that has been laying golden eggs ....'" *PPG Industries, Inc. v. Commonwealth,* 790 A.2d 252, 260, n.10 (Pa. 1999) (quoting Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business,* 110 HARV. L. REV. 337, 411 (1996)).

CONCLUSION

The Commonwealth respectfully requests that this Honorable Court uphold the constitutionality of the net loss deduction cap and affirm the Order of the

Board of Finance and Revenue entered on January 24, 2012, BF&R Docket No. 1107916, thus denying Nextel's request for relief with respect to its 2007 Corporate Net Income Tax liability.

Respectfully submitted,

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APPENDIX H

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 98 F.R. 2012

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Petitioner

v.

COMMONWEALTH OF PENNSYLVANIA,
Respondent

Appeal from an Order of the Board of Finance
and Revenue, dated January 24, 2012,
Docket Number 1107916

REPLY BRIEF FOR PETITIONER NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.

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* * *

VI. The only remedy permitted in this case is to grant relief to Nextel for 2007.

As a threshold matter, the parties have stipulated that the issue in this case is "whether the net loss cap provided under 72 P.S. § 7401(3)4.(c)(1) violates the Uniformity Clause of the Pennsylvania Constitution."[64] Thus, the Commonwealth has misstated the issue in this case in its brief when it writes that this "appeal concerns the constitutionality of the statutory provision ... permitting taxpayers ... to deduct from positive taxable income a 'net loss'."[65] The issue is not the constitutionality of the deduction; the issue, as stipulated by the parties, is the constitutionality of the net loss limitation.

A. The Commonwealth does not address the authorities that hold that the only remedy for a uniformity violation is to grant relief to the complaining taxpayer.

Instead of addressing Nextel's argument that the only remedy in a uniformity case is to grant relief to the complaining taxpayer,[66] the Commonwealth asserts that Nextel and all other taxpayers should have the net loss taken away from them entirely because, if the General Assembly would have known that the net loss limitations were unconstitutional, the "General Assembly *certainly* would not have allowed the net loss deduction at all...."[67] Certainly? Not only is this assertion an exercise in divination that is

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[64] S/F ¶ 7 (emphasis added).

[65] Respondent's Brief at 10.

[66] Petitioner's Brief at 31-39.

[67] Respondent's Brief at 40 (emphasis added).

beyond the powers of the Deputy Attorney General, this assertion directly conflicts with the discussion, on page 33 of its brief, of the benefits the General Assembly intended to bestow on smaller taxpayers. If the General Assembly intended to bestow those benefits, why is the Deputy Attorney General "certain" that the General Assembly would not have provided them to all taxpayers?

On the basis of the Commonwealth's assertion about what the General Assembly would have done, the Commonwealth argues that this Court must order an assessment of all taxpayers who took the net loss deduction in 2007 forward.

For the reasons that follow, that approach does not work.

B. Procedurally, the only remedy for 2007 is to grant a refund to Nextel and other taxpayers like Nextel that have refund claims pending on this issue. For all other taxpayers, 2007 is closed.

The record shows that 19,537 taxpayers had net loss carryovers in excess of their income in 2007—just like Nextel. The record also shows that 19,303 of those taxpayers had income of $3 million or less, and thus were able to reduce their taxable income—and tax—to zero.[68] To cure the uniformity problem in this case, Nextel argued that it and a handful of other taxpayers whose income exceeded $3 million, who have preserved their rights through refund claims for 2007, should be allowed to compute their net loss deductions without regard to the loss limitations. In that way, Nextel and others like Nextel will be treated substan-

[68] S/F ¶ 22, Ex. D.

tially the same as the taxpayers who benefitted from the full net loss deduction.

Procedurally, this is the only option available for the 2007 tax year because any other alternative requires assessing all 19,000+ taxpayers that benefitted from the full net loss deduction. That option is not available since the statute of limitations is closed for each of those taxpayers—including Nexte1.[69]

Despite that, the Commonwealth argues that the net loss deduction should be taken away from all 19,000+ taxpayers that benefitted from it in 2007. That would require all of those taxpayers be assessed. But the record is clear: Every taxpayer's 2007 tax year is closed for assessment. The Commonwealth has offered no argument to explain how the net loss deduction will be taken away from those taxpayers for 2007 to equalize the tax treatment in that year.

C. This Court should not decide the uniformity issue for other years.

The Commonwealth asks this Court "in the interest of judicial efficiency" to order a "remedy" for a uniformity violation for years after 2007. For a variety of reasons, this Court should not do that.

First, the Attorney General, as the chief law officer of the Commonwealth,[70] would be expected to argue to narrow any holding that the application of a statute is

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[69] S/F ¶ 24, Ex. F, Respondent's Response to Petitioner's Interrogatory Nos. 7 and 9. *See* Petitioner's Brief at 37-38.

[70] Pa. Const. art. IV, § 4 (the Attorney General "shall be the chief law officer of the Commonwealth and shall ... perform such duties as may be imposed by law."); 71 P.S. § 732-204(a)(3) ("It shall be the duty of the Attorney General to uphold and defend the constitutionality of all statutes ... in the absence of a controlling decision by a court of competent jurisdiction").

unconstitutional. It is unclear why, in this case, the Attorney General is advocating for a broad finding of unconstitutionality to multiple years that are not before this Court.

Second, this Court should not anticipate that other taxpayers will be able to make the same factual showing for years after 2007 that Nextel was able to make for 2007. After all, the statutory net loss limitations have changed from year to year, and it has not yet been established whether the differences in tax treatment among various corporations in other years meets the standards for "rough uniformity" described above. Therefore, this Court should exercise restraint and wait for a taxpayer to build a record and show substantial tax differences for years after 2007.[71]

Third, even if this Court were inclined to rule on years after 2007 with no factual showing in those years, the same procedural barrier that exists for 2007 also exists for the 2008-2011 years. Recall that, in each year, the tax return is due by April 15 of the following year. The statute of limitations for assessments runs three years after the return is filed. Thus, the 2008-2011 years for most taxpayers are closed—for refund or assessment.[72] The Commonwealth does not present any mechanism by which the benefit of the net loss deduction can be taken away from smaller taxpayers whose tax years are closed for 2008-2011.

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[71] *See, e.g., Wash. State Grange v. Wash State Rep. Party,* 552 U.S. 442, 450 (2008) (courts should exercise restraint in constitutional matters and should not anticipate a question of constitutional law in advance of the necessity of deciding it).

[72] For example, for the most recent of these years, 2011, the tax return was due April 15, 2012. 72 P.S. § 7403. So for most taxpayers, the three-year statute of limitations for assessment expired after April 15, 2015. 72 P.S. § 7407.3.

Finally, with respect to more recent years, the General Assembly may act. Indeed, the Deputy Attorney General predicts that the General Assembly "surely will" act.[73] The General Assembly has the policy tools to implement any prospective change to the net loss statute. And the General Assembly, in addition to a prospective remedy, may decide to make retrospective changes, which it is free to do subject to due process limitations.[74] This Court cannot, and should not, predict what the General Assembly will decide to do.

Instead, this case only requires a remedy for Nextel for the 2007 tax year—there is nothing in the record regarding other tax years. The General Assembly's task will be to determine what do for more recent tax years. And since the 2007 tax year is closed for assessment to all taxpayers, including Nextel, the only remedy is a refund to Nextel.

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[73] Respondent's Brief at 40.

[74] *Budd Co.,* 108 A.2d at 569 ("[A] tax may not be retroactively applied beyond the year of the general legislative session immediately preceding that of its enactment; to provide otherwise constitutes a denial of due process.").

APPENDIX I

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 EAP 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Appellee,

v.

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF REVENUE,
Appellant.

BRIEF FOR APPELLANT

APPEAL FROM THE ORDER OF THE COMMONWEALTH COURT ENTERED ON DECEMBER 30, 2015 AT NO. 98 F.R. 2012

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* * *

STATEMENT OF THE QUESTIONS PRESENTED

1. Whether the cap imposed on the net loss deduction violates the Uniformity Clause of the Pennsylvania Constitution?

Answered in the affirmative by the Commonwealth Court.

Suggested answer: No.

2. Whether the appropriate remedy to cure the constitutional disparity was to sever the net loss deduction dollar cap leaving an unlimited deduction for all taxpayers, rather than to sever the dollar cap while leaving in place a percentage cap?

Answered in the affirmative by the Commonwealth Court.

Suggested answer: No.

* * *

SUMMARY OF THE ARGUMENT

This action concerns the cap on the net loss deduction of the Corporate Net Income Tax. Nextel challenged the cap based solely on the assertion that it creates varying effective tax rates. The Commonwealth Court found a violation of the Uniformity Clause on that basis. This was error.

This Court has repeatedly held that in the context of the Corporate Net Income Tax that there is no Uniformity Clause violation when the same statutory rate is applied to the same tax base. This Court has held in that context that varying effective tax rates does not implicate the Uniformity Clause. It has also explained why.

Because of the way corporations operate, the initial step of the Corporate Net Income Tax is designed to take into account the cost of producing income. It is only after this determination is made that the uniformity analysis begins. If the tax is imposed at a fixed statutory rate, the analysis is over. With individuals there is no initial step outside uniformity to isolate the cost of producing income. Accordingly, any consideration of factors such as deductions or exemptions is not to determine what is subject tax but to determine the tax itself. Thus the uniformity analysis is fundamentally different in the context of the Corporate Net Income Tax. The Commonwealth Court failed to apply the property uniformity analysis and failed to reach the right conclusion.

Absolute equality is not required to satisfy constitutional uniformity. Here the cap only impacted 1.2 percent of the taxpayers at issue. Given the instrumentalities involved and the subject upon which the tax law operates this constitutes rough uniformity. Therefore, there is no Uniformity Clause violation.

Where a constitutional disparity has been determined, as to remedy, it is axiomatic that when faced with the severing of unconstitutional provisions, the focus is on determining legislative intent; that is whether the General Assembly would have enacted the remaining valid provisions without the void one. The Commonwealth Court majority on this issue did not undertake that analysis. The majority concluded that while it could strike the cap at issue here satisfying uniformity, it would not do so because it was faced with an as-applied challenge.

The Commonwealth Court dissent, on this issue correctly criticized this analysis. First the dissent pointed out that the effect of the Commonwealth

Court's holding is that the dollar limitation would no longer cap the net loss deduction for all taxpayers. The dissent then went on to review the statutory language at issue and the General Assembly's legislative intent. Finally the dissent correctly determined that the proper remedy here, assuming a uniformity violation, is to sever the dollar cap leaving in place the percentage cap on the net loss deduction.

ARGUMENT

I. THE COMMONWEALTH COURT INCORRECTLY DETERMINED THAT THE CAP ON THE NET LOSS DEDUCTION VIOLATES THE UNIFORMITY CLAUSE.

A. The Commonwealth Court incorrectly determined that the cap on the net loss deduction creates a classification that violates uniformity.

This action concerns the proper interpretation and application of the Tax Reform Code of 1971, Act of March 4, 1971, P.L. 6 as amended, 72 Pa.C.S. § 7201, *et seq*. (the Code). Specifically this appeal concerns the statutory provisions within the Code permitting taxpayers, subject to the Corporate Net Income Tax to deduct from positive taxable income a "net loss" 72 P.S. § 7401(3)4.(b). A net loss is generated in a year of negative taxable income and may be carried forward to future tax years to offset positive taxable income. 72 P.S. § 7401(3)4.(c)(2)(A).

The net loss deduction provisions have gone through various statutory changes. During 2007, the net loss deduction was limited to the greater of $3 million or 12.5 percent of taxable income, 72 P.S. § 7401(3)4.(c)(1)(A), and could be carried for up to 20 years, 72 P.S. § 7401(3)4.(c)(2)(A). The extent to which the net loss is

taken is dependent on (1) earning positive taxable income by the end of the year and (2) having sufficient crude net loss carried into the Tax Year to support the deduction taken. 72 P.S. § 7401(3)4.(b).

Nextel challenged the statutory cap on the net loss deduction as applied, asserting that it violated the Uniformity Clause.

As to the Code, the cardinal rule of statutory construction applies; to carry out the intent of the General Assembly. To determine that intent, statutory language is not to be read in isolation; it must be read with reference to the context in which it appears. *O'Rourke v. Commonwealth*, 778 A.2d 1194, 1201 (Pa. 2001). *See also*, 1 Pa.C.S. § 1921(a). *Food and Drug Administration v. Brown and Williamson Tobacco Corp.,* 529 U.S. 120, 132-133 (2000). This context includes *inter alia* placing a statute in its proper historical context, as well as construing the language at issue in harmony with existing law as part of a general system of juris prudence. *PECO Energy v. Pennsylvania Public Utilities Commission*, 791 A.2d 1155, 1160 (Pa. 2002); *Casey v. Penn State University*, 345 A.2d 695, 700 (Pa. 1975); *Olson v. Kucenic*, 133 A.2d 596, 598 (Pa. 1957).

In determining legislative intent it is presumed that when the General Assembly enacts a statute it does so with full knowledge of existing statutes. *Fonner v. Shandon, Inc.,* 724 A.2d 903, 906 (Pa. 1999); *Policemen's Pension Fund Board of City of Pittsburgh v. Fray*, 113 A.2d 232 (Pa. 1955). This Court has long held that the contemporaneous construction of the statute by those charged with its execution and application, especially when it has long prevailed, is entitled to great weight and should not be disregarded or overturned except for cogent reasons only if it is

clear that such construction is erroneous. *Alpha Auto Sales, Inc. v. Department of State*, 644 A.2d 153, 155 (Pa. 1994). Finally, administrative interpretations, not disturbed by the General Assembly, are appropriate guides to legislative intent. *Hospital Association of Pennsylvania v. Macelod MD, et al.,* 410 A.2d 731, 735 n. 10 (Pa. 1980).

As to the Uniformity Clause of the Pennsylvania Constitution,[2] allegations of its violations and violations of the Equal Protection Clause of the United States Constitution must be analyzed in the same manner. The principles which govern this analysis are equally well established. The legislature possesses wide discretion in matters of taxation. In contrast, a taxpayer challenging the constitutionality of state taxation has a heavy burden. Tax legislation will not be declared unconstitutional unless it *clearly, palpably and plainly* violates the Constitution. *Parsowith v. Commonwealth*, 723 A.2d 659, 663 (Pa. 1999), *Leonard v. Thornburgh*, 489 A.2d 1349, 1351 (Pa. 1985) (emphasis supplied by this Court). A taxpayer to meet its heavy burden, as to the Uniformity Clause, must demonstrate that (1) the enactment results in some form of classification, and (2) the classification is unreasonable in that the statute is not rationally related to a legitimate state purpose. *Lebanon Valley Farmers' Bank v. Commonwealth*, 83 A.3d 107, 113 (Pa. 2013).

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[2] The Uniformity Clause of the Pennsylvania Constitution provides that, "[a]ll taxes shall be uniform, upon the same class of subjects, within the territorial limit of the authority levying the tax shall be levied and collected under the general laws." Pa.Const. Art. VIII, § 1.

Under the Uniformity Clause, absolute equality and perfect uniformity in taxation is not required. The test is whether the classification is based upon some legitimate distinction between the classes that provides a nonarbitrary basis for the different treatment. The focus of judicial review is upon whether there can be discerned concrete justification for treating the relevant group of taxpayers as members of distinguishable classes subject to different tax burdens. *Leonard, supra.* at 1352. A classification, for tax purposes, is valid when it is based upon some legitimate distinction between the classes that provides a reasonable basis for different treatment "so long as the classification imposed is based upon some standard capable or reasonable comprehension, . . . equal protection of the law has been afforded." *Tool Sales and Services Co., Inc. v. Commonwealth*, 637 A.2d 607, 614 (Pa. 1994). The Uniformity Clause requires that a classification be applied with uniformity upon similar kinds of business and with substantial equality of the tax burden. *Amidon v. Kane*, 279 A.2d 53, 59 (Pa. 1971).

Though the Commonwealth Court made reference to certain of these principles, their misapplication here caused that court to conclude that the cap on the net loss deduction violates the Uniformity Clause. This was error. The crux of the Commonwealth Court's analysis, and the crux of its error, was to measure the uniformity of the corporate excise tax at issue here not by the statutory rate imposed but by the effective tax rate. Opinion 5, 9.[3] This is directly contrary to decades of this Court's case law. We begin with that case law.

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[3] The Commonwealth Court's majority and dissenting opinions appended to this brief will be referred to by their original pagination. The Commonwealth Court's decision is published at

This Court has repeatedly held that in the context of a corporate excise tax there is no Uniformity Clause violation when the same statutory rate is applied to the same tax base. In *Turco Paint and Varnish Co. v. Kalodner*, 184 A. 37 (Pa. 1936), this Court was faced, as here, with corporate net income tax which applied a statutory fixed rate of tax on federally determined net income. Though the calculation of corporate net income had all sorts of exemptions built into it, the Court specifically held that those exemptions did not create a lack of uniformity. This Court, in making that determination, focused on the statutorily fixed tax rate:

> The rate used, 6 percent, is the same for all corporations. The tax base to which this rate is to be applied is also identical. It is the net income attributable to this state. It certainly should be axiomatic that the same impost, when applied to the same subject matter, does not make the tax graded simply because of the fact that one association, owning more of a particular taxable subject matter than another, pays on this account a greater sum total of tax. Where different legislative rates are legislatively imposed on varying amounts or quantities of the same tax base, then you have a graded tax that lacks uniformity under our Constitution. To create [such] a graded tax, it is generally necessary that the rate itself be a variable factor, even though the base may remain constant or it may be that in particular cases such a tax may result because of intangible differentiations, in

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129 A.3d 1 (Pa. Cmwlth. 2016). The Opinion is also included in the Reproduced Record at R.R. 232a.

> subject matter with the imposition of a different rate upon each of them.

Id. at 40. (internal citations omitted)

This method of determining uniformity has remained consistent through the decades. In *Commonwealth v. Warner Brothers Theaters, Inc.* 27 A.2d 62 (Pa. 1942), this Court was again presented with a uniformity challenge to the corporate net income tax. In that action, this Court was again faced with a calculation of net income that had variable factors as to what could be included and as to what might be deducted therefrom; guaranteeing differing effective tax rates. Despite this, this Court concluded that the Uniformity Clause was not implicated. In reaching that conclusion, this Court emphasized that:

> We are not considering an income tax, but an excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the federal government.

Because of this "Net income as ascertained is the base upon which the tax is measured, not the tax itself". Accordingly, "[t]he rate of the income tax may vary, or *the method of its computation*, but as a base, it is unvaried." *Id*. at 63 (emphasis added).

Similarly, in *Commonwealth v. Rohm and Haas, Co.*, 368 A. 2d 909 (Pa. Cmwlth. 1977), *aff'd. sub nom Commonwealth v. Westinghouse Electric Corp.,* 386 A.2d 491 (Pa. 1978) this Court and the Commonwealth Court were again presented with uniformity challenges to the corporate net income tax. In that action corporations, which had taken foreign taxes paid as a credit against federal income tax liability rather than as a deduction from gross income, claimed a constitutional right to deduct the foreign taxes paid to reduce

their liability for state net income taxes. Both the Commonwealth Court in *Rohm* and this Court in *Westinghouse* rejected this assertion. Holding that there was no uniformity violation despite the fact that some corporations were unable to take a foreign tax deduction to reduce their state tax liability, thus resulting in higher effective tax rates in comparison to the corporations that could take the deduction. This Court reiterated that:

> The state tax is not violative of the Uniformity Clause if the tax 'applies to all corporations with which the Commonwealth has power constitutionally to deal . . . where the (state tax) base is the same and the rate unvarying there is no lack of uniformity.'

Westinghouse Electric Corp, supra. at 169 (*quoting Commonwealth v. Warner Brothers* at 64).

This Court has not only repeatedly emphasized, that in the context of the corporate net income tax, varying effective tax rates does not implicate the Uniformity Clause, it has also explained why. In *Amidon v. King*, 279 A.2d 53 (Pa. 1971), this Court was presented with a uniformity challenge, not to corporate net income tax but personal income tax. In that action, the tax statute at issue imposed a flat tax on taxable income but the calculation of that income incorporated various exemptions and deductions which were not available to all taxpayers, thus resulting in varying effective tax rates imposed upon the same level of income. In that context, this Court did hold that this violated the Uniformity Clause. *Id.* at 63. In *Amidon* this Court was reminded that, as detailed above, it had repeatedly held that exemptions or deductions that may or may not be available to corporations in calculating the corporate net income tax did not implicate the

Uniformity Clause and that therefore such factors should not implicate the Uniformity Clause in the context of personal income tax. *Id.* Rejecting any analogy between corporate and personal taxes, this Court began by pointing out that "[i]n passing upon the validity of the corporate net income tax, this Court emphasized that it was not considering an income tax but an excise tax for the privilege of doing business in the Commonwealth. Any attempted analogy between the instant tax and the corporate net income tax is unpersuasive." *Id.* at 63. (*citing Warner Brothers, supra.* at 63).

In addition, this Court rejected any analogy between corporate and personal taxes based upon the inherent differences in the nature of the entities:

> Corporations are artificial legal entities created with the permission of the state for the purpose of maximizing profits for shareholders and the corporate net income tax is imposed upon a tax base which is the net income attributable to this state.
>
> Natural persons on the other hand cannot be likened to profit maximizing entities. Individuals spend their resources for an infinite variety of reasons unrelated to the making of a profit. Thus unlike the corporate context it would be seemingly difficult, if not impossible to create a personal income tax designed to take into account the 'cost' of producing individual income.

Id. at 63. It was on this basis that this Court explained the fundamental difference in the uniformity analysis with respect to corporate net income taxes.

Nextel sought below to apply personal and property tax case law to this corporate net income tax case. Challenging that approach, each of these cases was brought to the attention of the Commonwealth Court. That court referred to none of them. Instead, if referred not to case law concerning the corporate net income tax but to case law concerning property taxes. We address that next.

The Commonwealth Court began with this Court's decision in *Clifton v. Allegheny County*, 569 A.2d 1197 (Pa. 2009), pointing out that in that case the method for determining the tax led to a uniformity violation. Opinion 12.

In *Clifton*, the taxpayers filed suit against Allegheny County challenging, on uniformity grounds, its continued use of an older tax year to calculate property tax assessments. In making this determination, this Court focused on the uniqueness of "property taxation. With property taxation, real property is the classification. Although there is no express constitutional requirement that real property be treated as a single class this Court has consistently interpreted the uniformity requirement of the Pennsylvania Constitution as requiring all real estate to be treated as a single class entitled to uniform treatment." *Id*. at 1212 (internal citations omitted). This Court determined that Allegheny County's indefinite use of an outdated base year to establish property tax liability did violate the Uniformity Clause. *Id*. at 1229.

The Department does not dispute that the Uniformity Clause applies to all types of taxes, but the holdings of the cases discussed above demonstrate that the uniformity analysis differs depending on the type of tax at issue. This was recognized in Chief Justice Bell's concurring opinion in *Amidon* when he

explained "this . . . clearly indicates that there may constitutionally be different tests, standards and exemptions for individuals which are totally inapplicable to corporations and consequently decisions with respect to governing taxes for corporations are not controlling on uniformity requirements for individuals". *Amidon*, 279 A.2d at 66, 67 (Bell, C.J. concurring). That is precisely how the law has developed.

Because of the way that corporations operate, the initial step of the corporate net income tax is designed to take into account the cost of producing income. It is only after that determination is made, that the uniformity analysis begins. If the tax is imposed at a fixed statutory rate, the analysis is over.

Because of the way individuals behave, there is no initial step outside uniformity to isolate the cost of producing income. Accordingly, any consideration of factors such as deductions or exemptions is not to determine what is subject to tax but to determine the tax itself. That was the case in *Clifton*. It is not the case in the corporate context.

Next the Commonwealth Court cites, and quotes at length, from *In re: Cope's Estate*, 43 A. 79 (Pa. 1899). In *Cope's Estate,* as in *Clifton,* a uniformity violation was found. The Commonwealth Court noted *inter alia* that pursuant to that case money values could not be used as a device to exempt taxpayers from any burden. Opinion 16.

Cope's Estate, like *Clifton*, is a personal property tax case; specifically involving estate taxes. In *Cope's Estate*, this Court found unconstitutional an inheritance tax statute which exempted from taxation estates valued under $5,000. This Court held that statutory rates which increased depending on value

violated uniformity. *Id.* at 81. This Court gave the following example of just such a violation:

> a division of personal property into three classes with the view of imposing a different tax rate on each – Class 1 consisting of personal property exceeding in value of the sum of $100,000, Class 2 consisting of personal property exceeding in value of $20,000 and not exceeding $100,000 and Class 3 consisting of personal property not exceeding in value $20,000 . . .

Id. at 81; a classically graduated tax. Nothing like that is at issue here. As the parties have stipulated during 2007, every single taxpayer (including Nextel) is subject to the corporate net income tax remain taxed at the identical statutory rate (9.99%) R.R. __, S/F, ¶¶ 14-15. Moreover, as detailed above, this Court has already determined, in the corporate net income tax context, that such a tax is not "graded simply because of the fact that one association owning more of the particular taxable subject matter than another, pays on this account the greater sum total tax." *Turco Paint, supra*. at 40.

As detailed throughout, the uniformity analysis is fundamentally different in the context of the corporate net income tax than outside of it. This Court has continually rejected uniformity challenges based upon varying effective tax rates in that context. Though presented with this case law below, the Commonwealth Court never referred to it let alone addressed it. This was error. In failing to apply the proper uniformity analysis to this corporate net income tax case, the Commonwealth Court failed to reach the correct conclusion.

Another point requires brief emphasis. We began our argument by pointing out that one of the principals of statutory construction is that the statute at issue be construed in harmony with existing law as part of a general system of juris prudence *see PECO Energy, supra.* at 1160. If the Commonwealth Court's decision is allowed to stand, adopting effective tax rates as a measure of uniformity for corporate net income tax purposes, it would overturn nearly a century of case law adopting the federal definition of net income (which invariably produces varying effective tax rates and call into question whether gross federal income should be used as the tax base for corporate net income tax purposes). Adoption of such an approach would also call into question the continuing validity of other excise taxes such as occupation taxes. As detailed throughout, there is no legal basis for such a revolution in tax juris prudence. We respectfully request that the Commonwealth Court be reversed.

B. Even if the net loss deduction cap implicated uniformity, the Commonwealth Court incorrectly failed to determine that the cap satisfies the constitutional requirement of rough uniformity.

It is axiomatic that "absolute equality and perfect uniformity are not required to satisfy the constitutional uniformity requirement" *Lebanon Valley Farmers' Bank v. Commonwealth*, 83 A.2d 107, 113 (Pa. 2013). The Uniformity Clause requires only substantial uniformity "which means as nearly uniform as practicable in view of the instrumentalities with which and the subject upon which tax laws operate." *Id. quoting L.& W.R. Co.'s Tax Assessment*, 73 A. 429, 430 (Pa. 1909).

Here a total of 19,537 corporations carried into 2007 sufficient accrued net loss to reduce taxable income to zero (R.R. 87a). Of this total Nextel claims the 234 corporations were impacted by the net loss cap. This represents the number of taxpayers with taxable income (before accounting for the net loss deduction) exceeding $3 million in 2007 and having sufficient accrued net loss so as to reduce taxable income to zero but could not do so because of the cap. *Id.* Moreover, all of these allegedly aggrieved taxpayers were still able to take a net loss deduction equal to the greater of 12.5 percent of the taxable income apportioned to Pennsylvania or $3 million and were all subject to an effected tax rate that was less than the statutory rate. The outcome here, given the instrumentalities involved and the subject upon which the tax law operates is as nearly uniform as practicable; thus satisfying the constitutional standard of rough uniformity.

Though presented with this information below, the Commonwealth Court, accept for acknowledging that the cap only impacted 1.2 percent of the taxpayers at issue, undertook no analysis of the cap satisfying the rough uniformity requirements of the Constitution. This was error. The cap does satisfy those requirements. Therefore, there is no Uniformity Clause violation.

II. THE COMMONWEALTH COURT INCORRECTLY DETERMINED THAT THE APPROPRIATE REMEDY FOR THE CONSTITUTIONAL DISPARITY WAS TO SEVER THE NET LOSS DEDUCTION DOLLAR LIMITATION FOR ALL TAXPAYERS RATHER THAN TO SEVER THE DOLLAR

CAP AND LEAVE IN PLACE A PERCENTAGE CAP.

A taxpayer has no vested right to a deduction or exemption in determining the income subject to tax. Such allowances are a matter of legislative grace and may be taken away at any time. *Commonwealth v. Buddco*, 108 A.2d 563, 573 (Pa. 1954); *see also Garofilo, Curtiss, Lambert & McClean, Inc. v. Commonwealth Department of Revenue*, 648 A.2d 1329, 1334 (Pa. Cmwlth. 1994). Reviewing the legislative history concerning the deduction at issue here, it is clear that the net loss cap was to balance the General Assembly's interest in encouraging the investment and growth of businesses against the negative impact on Pennsylvania's budget.[4] One motivation in allowing the net loss deduction was to encourage investment in new enterprises and promote invention and innovation so that companies like Nextel could offset future year profits with start-up year losses.[5] However, the countervailing budgetary concerns were demonstrated by the General Assembly's decision, in 1991, to disallow the net loss deduction entirely.[6] In 2007, the

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[4] A copy of the House remarks from November 18, 1980 is at R.R. 273a Appendix A. Refer to p. 2576 for the repeated questions and apparent concern as to the estimated revenue loss resulting from the allowance of a net loss deduction. Legislative Journal – House, Remarks on H.B. 1252, at 2576 (Nov. 18, 1980).

[5] *See* p. 2579 of the 1980 House remarks, R.R. 273a at Appendix A. Legislative Journal – House, Remarks on H.B. 1252, at 2579 (Nov. 18, 1980).

[6] A copy of the Senate remarks from June 14, 1994 is at R.R. 279a Appendix B. Refer to p. 2318 for the explanation that the net loss provision had to be eliminated in 1991 because of the downturn in the economy and Pennsylvania's budget could not support any net low deduction at that time, Legislative Journal – Senate, Remarks on H.B. 868, at 2318 (June 14, 1994).

General Assembly determined that the budget could only handle a deduction limited to the greater of $3 million or 12.5 percent of taxable income. As of 2015, the net loss deduction remained capped indicating that the budget still could not sustain an unlimited deduction. *See* 72 P.S. § 7401(3)4.(c)(1)(A).

It was against this background that the Commonwealth Court, having made its uniformity determination next addressed the question of remedy. It is axiomatic that whenever an unconstitutional provision is severed from the rest of the statute it must be done in a manner which effectuates legislative intent *PPG Industries, Inc. v. Commonwealth*, 790 A.2d 261, 268 (Pa. 2001); *see also* 1 Pa.C.S. § 1925.

When constitutional provisions are severed from their constitutional counterparts the remainder of the statute is generally not affected unless the valid provisions are "so essentially and inseparably connected with and so dependent upon, the void provision or application, that it cannot be presumed that the General Assembly would have enacted the remaining valid provision without the void one." *See e.g. Page Fund Inc. v. Commonwealth*, 877 A.2d 383, 403 (Pa. 2005) (*citing* 1 Pa. C.S. § 1925). The focus of this inquiry is legislative intent. Choosing between severing the dollar cap alone and leaving the net loss deduction to stand without one (the remedy the Commonwealth Court majority ultimately selected) or severing the dollar cap and leaving in place the percentage cap (the option the Commonwealth Court dissent on this issue selected) the majority did not reference legislative intent nor obviously did it apply such intent to its analysis.

Instead the majority determined that because Nextel made an applied rather than facial challenge

limited to 2007, any relief afforded in this action should be confined to remedying this alleged wrong. Opinion 18. In doing so, the majority looked not to cases that dealt with the appropriate remedy when a portion of a statute has been declared unconstitutional, but rather to cases that dealt with the unequal enforcement of a constitutional statute by administrative officials. *See Iowa-Des Moines National Bank v. Bennett*, 284 U.S. 239 (1931) (where the Court expressly rejected the state court's refusal to afford affirmative relief to an offended taxpayer); *Tredyffrin Easton School District v. Valley Forge Music Fair, Inc.,* 627 A.2d 814 (Pa. Cmwlth.) *appeal denied* 647 A.3d 513 (Pa. 1993) (concerning selective enforcement of the local amusement tax ordinance.)

The Commonwealth Court concluded that "[a]lthough we could strike [the dollar limitation] for the 2007 Tax Year and similar limitations for the tax years thereafter, in an effort to make the statutory scheme uniform, such a statutory revision would not remedy the wrong suffered by Nextel in the 2007 Tax Year." Opinion, pg. 19, 20.

Judge Pellegrini, in his dissent, correctly criticized this analysis, first as to the factual predicate upon which it was based and then as to the law.

> The majority . . . pretends that because Nextel is purportedly not making a facial challenge, what is "only" to be declared unconstitutional is the NLC deduction provision as applied to Nextel for the 2007 Tax Year. Realizing the effect that his opinion would have, the majority opinion states that 'to the extent our decision is in this as applied challenge calls into question the validity of the NLC deduction provision and any other or even every

> other context, the General Assembly should be guided accordingly'

DRP-2.

Judge Pellegrini was quite correct as to the effect the Commonwealth Court's decision will have beyond Nextel. After the Pennsylvania Supreme Court's decision in *Amidon* struck down the use of federal net income for Personal Income Tax purposes as violating uniformity the General Assembly enacted a new methodology for taxing the various classes of income which impacted all taxpayers subject to the tax. *See* 72 P.S. § 7303. Moreover, numerous cases have already been held pending the resolution of this action. Accordingly, Judge Pellegrini went on to correctly state:

> Unless our case law means nothing, no matter whether you call it – an "as applied" challenge or a facial challenge -- the net effect of our holding is that § 401(3)4.(c)(1)(A)(II) can no longer cap the amount of NLC deductions for all taxpayers. As a result we must go on to determine whether the flat capped NLC deduction can be stricken making that provision uniform or as the majority does, eliminate all caps on the NLC deductions.
>
> DRP-2-3.

Judge Pellegrini then goes on to review the statutory language and the General Assembly's legislative intent to determine what to sever from the offending statute in the service of that intent.

> It is clear that the General Assembly wanted to limit NLC deductions every tax year – with both a flat and percentage cap on deductions.

> The majority would strike all caps on deductions, which is directly against the legislative scheme of the placement of caps on the NLC deductions. If the unconstitutional flat [dollar] cap deduction is severed for each relevant year, . . . the uniform percentage deduction would remain which would be available to all taxpayers. Severing the flat [dollar] cap provisions would carry out the legislative intent to place a limitation on the NLC deductions for each year.

DRP-5.

Thought presented with this Court's case law concerning severability below, the Commonwealth Court majority neither referred to nor applied it below. This was error. In failing to apply the proper severability analysis, the Commonwealth Court failed to reach the correct conclusion concerning the appropriate remedy. The Commonwealth Court dissent, on this issue, undertook that analysis, and reached the correct conclusion as to remedy. If this Court determines that the dollar cap on the net loss deduction violates uniformity, we respectfully request that it adopt the dissent analysis as to remedy.

CONCLUSION

The Court should reverse the judgment of the Commonwealth Court. In the alternative, the remedy for any constitutional disparity should be the severing of the dollar cap on the net loss deduction leaving the percentage cap in place.

Respectfully submitted,

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DATE: May 26, 2016

APPENDIX J

IN THE SUPREME COURT OF PENNSYLVANIA

No. 6 E.A.P. 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Appellee,

v.

COMMONWEALTH OF PENNSYLVANIA,

Appellant.

BRIEF FOR APPELLEE
NEXTEL COMMUNICATIONS OF THE
MID-ATLANTIC, INC.

Appeal from an Order of the Commonwealth Court,
dated December 30, 2015,
Docket Number 98 F.R. 2012

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* * *

III. THE REMEDY FOR NEXTEL FOR 2007: COMPUTE THE NET LOSS DEDUCTION WITHOUT THE LIMITATION.

The Commonwealth Court, recognizing that the limitation on Nextel's net loss deduction violated the Uniformity Clause, ordered a refund of tax for Nextel for 2007 because that was the only remedy that would equalize the tax treatment of Nextel and the 19,303 other corporations that paid no tax in 2007. This Court should sustain the remedy ordered by the Commonwealth Court.[89]

A. Procedurally, the only remedy to fix Nextel's problem is to grant relief to Nextel.

Theoretically, to treat Nextel and other taxpayers equally with respect to the 2007 tax year, there are two options:

- Apply the 121/2% net loss limitation to all taxpayers in 2007. This would require the Department of Revenue to assess all 19,303 taxpayers who took a deduction in excess of 121/2% of their income. (Recall, these taxpayers in 2007 who took a net loss deduction took a deduction equal to 100% of their income.) Nextel would receive no refund, but the tax for all taxpayers for 2007 would be equalized.

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[89] Recently, in *RB Alden Corp. v. Commonwealth,* 73 F.R. 2011 (Pa. Cmwlth. 2016), the Commonwealth Court considered the constitutionality of the net loss limitation as applied to RB Alden's fiscal year 2006. The three judge panel unanimously held that the net loss limitation violates the Uniformity Clause, and that the tax must be calculated without the limitation.

- Remove the net loss limitation for Nextel for 2007. This would reduce Nextel's income to zero for 2007, and put Nextel in the same position as the 19,303 taxpayers whose income fell below the $3 million threshold.

The Commonwealth Court ordered the second option. Indeed, procedurally, on the facts before this Court, only second option is available. That is because the first option is now unavailable because the statute of limitations has expired on assessing the taxpayers who deducted their net losses in full.

The Deputy Attorney General argues that a possible "remedy" in this case would be to strike the flat dollar $3 million threshold and instead impose the 12[1]/2% limitation on all taxpayers.[90] Under this approach, the record shows that there are 19,303 taxpayers whose income in 2007 was less than $3 million. That means each of them took a net loss deduction for 100% of their income in 2007. Thus, if the $3 million threshold was stricken, leaving the 12 1/2% limitation, each of those taxpayers would have 87 1/2% of their net loss deductions disallowed so that only a 12 1/2% deduction remained.

The Deputy Attorney General, therefore, advocates for this: Following our example from page 20, if a taxpayer had a $3 million loss in Year One and $3 million income in Year Two, the taxpayer would have, on its original tax return, paid zero tax under the statute because it could carry over its loss from Year One and deduct it in full in Year Two. The Deputy Attorney General argues that the $3 million threshold should be stricken and that the deduction in Year Two should be limited to 12 1/2% of the taxpayer's income.

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[90] *Commonwealth's Brief* at 25-30.

Thus, the loss deduction would be limited to $375,000. This would result in taxable income of $2,625,000 in Year Two ($3 million less $375,000 net loss deduction). Thus, the Deputy Attorney General is advocating that tax of $262,237 ($2,625,000 taxable income x 9.9% statutory rate) must be assessed so that this taxpayer is treated the same as Nextel.

To accomplish this, therefore, and to make the tax uniform for the 2007 tax year, the Deputy Attorney General advocates assessing 19,303 of those taxpayers (see table on page 20) so that they are allowed only a 12 1/2% deduction—just like Nextel. Yet even if it were legally permissible to solve this uniformity problem by assessing taxpayers who followed the statute,[91] that remedy is simply not an option under the record in this particular case. This case involves the 2007 tax year. Tax returns for these taxpayers for 2007 were due April 15, 2008.[92] Even if all taxpayers requested an extension of time to file a return, the latest a taxpayer could file a 2007 return was October 15, 2008.[93]

Under Pennsylvania law, the Department of Revenue must assess a taxpayer within three years of the date

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[91] We will argue in section III.B on page 33 that this remedy is not appropriate in a uniformity case in any event.

[92] 72 P.S. § 7403(a) (tax returns are due by April 15 of each year).

[93] 72 P.S. § 7405 (return due date may be extended up to 30 days after federal return is due). Under 26 U.S.C. § 6072(b), federal return is due by March 15. Under 26 U.S.C. § 6081(a), that due date may be extended by six months, to September 15. Since Pennsylvania return is due within 30 days, Pennsylvania return is due by October 15. So for 2007 taxable year, all Pennsylvania corporate tax returns were due by October 15, 2008.

the return was filed.[94] So October 15, 2011 (three years from October 15, 2008) was the last date that the Department could have assessed smaller taxpayers to cure the uniformity problem. Thus, the record shows that none of the 19,303 smaller taxpayers, with income less than $3 million, that took a 100% net loss deduction for the 2007 year are still open for assessment. Indeed, the record shows that the Department agrees that the 2007 year is closed for assessment for all taxpayers.[95] Therefore, the Department cannot issue timely assessments against the 19,303 taxpayers to disallow the 87 1/2% of the net loss deduction for 2007 to cure the uniformity violation in 2007. That is why the Commonwealth Court majority recognized that "[W]ithout more, an order declaring the $3 million cap unconstitutional and striking it from the statute does not remedy the constitutional violation."[96]

B. To achieve uniformity, grant relief to the disfavored taxpayer.

Aside from the insurmountable procedural hurtle of assessing 19,303 taxpayers who took a full 100% deduction in 2007, the law in Pennsylvania is clear that the only remedy in a uniformity case is to grant relief to the disfavored taxpayer. The Deputy Attorney General, in advocating for mass assessment of small

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[94] 72 P.S. § 7407.3(a).

[95] R.R. 19a, S/F ¶ 24, Ex. F, Commonwealth's Response to Petitioner's Interrogatory No. 7 (no taxpayers have signed waivers extending the statute of limitations for the 2007 year) and No. 9 ("the Department of Revenue is not aware of any taxpayer [that took the net loss deduction for the 2007 year] which is still open for assessment.").

[96] *Nextel,* 129 A.3d at 20.

businesses, cites a Commerce Clause case.[97] The Commerce Clause, however, is designed to "protect[] markets . . . not taxpayers as such."[98] Thus, the Commerce Clause provides the wrong framework for analysis because, in those cases, the court is remedying flaws in the market.[99]

1. The uniformity case law.

The Uniformity Clause, by contrast, is designed to ensure the "substantial equality of the tax burden to all members of the same class . . . ."[100] No one would defend their rights under the Uniformity Clause if, as a result, they would merely increase the tax on others.[101] So unlike the Commerce Clause situation, the only remedy to a uniformity violation is to grant relief to the disfavored taxpayer. Any other remedy would have a chilling effect on any taxpayer exercising its rights under the Uniformity Clause.

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[97] *See Commonwealth's Brief* at 26, *citing PPG Industries, Inc. v. Commw.,* 790 A.2d 261, 268 (Pa. 2001).

[98] *General Motors Corp. v. Tracy,* 519 U.S. 278, 300 (1997).

[99] To fix Commerce Clause violations, the remedy may include taking away a benefit enjoyed by in-state commerce. *Annenberg v. Commw.,* 757 A.2d 333 (Pa. 1998) (Commerce Clause discrimination may be cured by assessing favored taxpayer). *See also McKesson v. Div. of Alcoholic Beverages and Tobacco,* 496 U.S. 18 (1990) and *PPG Industries, Inc.,* 790 A.2d at 269-70 (Pa. 2001) (same, each involving Commerce Clause).

[100] *Amidon v. Kane,* 279 A.2d 53, 59 (Pa. 1971).

[101] *Allegheny Pittsburgh Coal v. Webster County,* 488 U.S. 336, 346 (1989) (constitution not satisfied if state "imposes on him against whom the discrimination has been directed the burden of seeking an upward revision of the taxes" of the others).

In *Commonwealth v. Molycorp, Inc.,*[102] this Court found a uniformity violation. This Court concluded that the remedy for prior periods was to grant relief to Molycorp. Specifically, this Court cited *Iowa-Des Moines National Bank v. Bennett,*[103] which held that "it is well settled that a taxpayer . . . cannot be required . . . to assume the burden of seeking. an increase of the taxes which the others should have paid."[104] Instead, taxpayers are "entitled to obtain in these suits refund of the excess of taxes exacted from them."[105]

More recently, in *Tredyffirin-Easttown Sch. Dist. v. Valley Forge Music Fair, Inc.,*[106] the Commonwealth Court found that "when rights to equal treatment are violated, the party is entitled to obtain a refund of the excess of taxes exacted from them."[107]

Following that authority, the Commonwealth Court in this case correctly held that the appropriate remedy is to compute Nextel's tax by allowing Nextel to deduct its net losses fully—without regard to the net loss

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[102] 392 A.2d 321 (Pa. 1978) (taxpayers are "entitled to obtain in these suits refunds of the excess of taxes exacted from them") (citing *Iowa-Des Moines Nat'l Bank v. Bennett,* 284 U.S. 239, 247 (1931); *Tredyffrin-Easttown Sch. Dist. v. Valley Forge Music Fari, Inc.,* 627 A.2d 814, 823 (Pa. Commw. 1993); *see also Nextel,* 129 A.2d at 18.

[103] 284 U.S. 239 (1931).

[104] *lowa-Des Moines National Bank,* 284 U.S. at 247. *See also Nextel,* 129 A.3d at 18-19.

[105] *Id.*

[106] 627 A.2d 814 (Pa. Commw. 1993). *See Nextel,* 129 A.3d at 20.

[107] *Id.* at 823 *(citing Iowa-Des Moines Bank,* 284 U.S. 239).

limitation.[108] In that way, Nextel will be treated the same as the 19,303 taxpayers who got the benefit of a full net loss deduction.

2. The fact that the uniformity cases involved unequal "enforcement" does not affect their authority here.

The Deputy Attorney General in its brief noted that the cases discussed above related to "unequal enforcement" of a constitutional statute.[109] Instead, the Deputy argues, Nextel's case must be analyzed differently—as if the "provision is found unconstitutional" in all of its applications.[110] As will be discussed in this section, the statute here has not been "found unconstitutional" in any application other than as applied to Nextel for 2007. Thus, the Deputy Attorney General's distinction is based on an erroneous premise. Regardless, even if the net loss cap provision were "found unconstitutional," the case law cited by Nextel supports granting a refund to Nextel—even though some of those cases related to unequal enforcement. Nextel's uniformity claim is an as-applied challenge that relies on facts in a detailed record established for a single year-2007.

Nextel is not making a facial challenge to the constitutionality of the net loss limitation. The Commonwealth Court majority recognized this,[111] and

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[108] *Nextel,* 129 A.2d at 13.

[109] *Nextel,* 129 A.2d at 14 n.2 (Pelligrini, J. concurring and dissenting). *See also Commonwealth's Brief at* 27-28.

[110] *Nextel,* 129 A.2d at 14 n.2 (Pelligrini, J. concurring and dissenting).

[111] *Nextel,* 129 A.3d at 11 ("We do not have before us a facial challenge to the [net loss cap] provision. . . ."); *Johnson v. Am. Standard,* 607 Pa. 492, 520 (2010) (Saylor, concurring) ("facial constitutional challenges . . . are disfavored . . . ."); *see also Wash.*

concluded that Nextel has established, through a detailed record concerning a single tax year, that, as applied to Nextel only, it suffered from a material uniformity violation and that the only remedy for that violation for that year was to grant a refund to Nextel.[112]

Indeed, there is little in the record regarding other taxpayers, and nothing in the record regarding other tax years. Although other taxpayers may be able to follow Nextel's lead and prove a uniformity violation as applied to them for 2007 or for another year, those taxpayers would need to develop a record to do so. Consider the following elements of the record of this case:

- The Commonwealth may be able to make out a "rough uniformity" defense for other taxpayers for 2007 and for other years. Nextel has proven that for the 2007 year Nextel's income (at $45 million) was over 10 times the $3 million threshold. Thus, there is no "rough uniformity" for Nextel in 2007. Any other taxpayer for 2007 or any other year would have to prove that the tax was not "roughly uniform" as applied to them.

State Grange v. Wash. State Rep. Party, 552 U.S. 442, 450 (2008) ("Facial challenges . . . run contrary to. . . principle . . . that courts should neither anticipate a question of constitutional law in advance . . . nor formulate a rule of constitutional law broader than is required by the precise facts. . . .") (internal quotations omitted).

[112] *Nextel,* 129 A.3d at 11 (Commonwealth Court "resolved that limited question" of the application of the net loss cap to Nextel in the 2007 year in Nextel's favor).

- Other years are different—both factually and legally. The Commonwealth in its brief suggests that this Court should develop a remedy for tax years other than the year at issue in Nextel.[113] There is nothing in the record, however, showing that any taxpayer was discriminated against for any year other than 2007—and certainly no showing of material discrimination. Further, the net loss cap statute has changed in years after 2007, so it is unclear whether this Court should, in interpreting the 2007 statute, pass upon the constitutionality of the statute as amended for other years.[114]

- For other years, the statute of limitations for assessing tax may be open, which means that the remedy dynamics are different. As discussed in section III.A of this brief, the Court cannot, in any event, equalize the playing field for Nextel for the 2007 year by striking the $3 million threshold because 19,303 other taxpayers relied on that $3 million threshold to compute their tax. The record in this case shows that the statute of limitations to assess those taxpayers has expired. Thus the only remedy that would equalize the tax treatment for Nextel for 2007 is to grant Nextel a refund.

There is nothing in the record, however, regarding whether the statute of limitations is, or is not, open for other years. For example, the Department has the statutory authority to agree with the taxpayer

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[113] *Commonwealth's Brief at* 27.

[114] Indeed, in years before and after 2007, the limitations increase significantly. *See* Act 48 of 2009 § 7 and Act 52 of 2013 § 19 (each increasing the limitations).

to extend the statute of limitations.[115] Although the record in this case shows that the Department has not used that authority for 2007,[116] there is nothing in the record about other years.

Thus, the Courts are "not required to, and should not, anticipate factual situations to which a challenged law might be made applicable."[117] Following that authority, the Commonwealth Court majority's "relief [was] confined to remedying that alleged wrong"—that is, the uniformity violation against Nextel for the 2007 year only.[118]

C. The evidence suggests that the General Assembly would have adopted the net loss without any limitation.

Even if this Court determines that the net loss limitation is unconstitutional on its face, and even if this Court determines that a uniformity violation does not automatically result in relief to the complaining taxpayer, it must still answer the following question: What would the General Assembly have adopted if the

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[115] 72 § 7407.4.

[116] R.R. 19a, S/F ¶ 24, Ex. F, Commonwealth's Response to Petitioner's Interrogatory No. 7 (no taxpayers have signed waivers extending the statute of limitations for the 2007 year) and No. 9 ("the Department of Revenue is not aware of any taxpayer [that took the net loss deduction for the 2007 year] which is still open for assessment.").

[117] *Commonwealth v. Flickinger,* 67 A.2d 779, 781 (Pa. Super. 1949).

[118] *Turco Paint & Varnish Co. v. Kalodner,* 184 A. 37, 42 ("the party who alleges unconstitutionality must show the facts which renders its application unconstitutional").

General Assembly had known that the limitation were unconstitutional?[119]

If the General Assembly had known that the 12 1/2% limitation with a $3 million threshold was unconstitutional, it would have had two choices:

- Adopt the net loss deduction without any limitation, thereby allowing all businesses, large and small, a net loss deduction. This would have accomplished the stated legislative goal of helping small business, encouraging investment, and keeping Pennsylvania competitive. After all, Pennsylvania would otherwise be the only state in the union that limited the deduction.
- Adopt the net loss deduction, but limit the net loss for all taxpayers at 12 1/2% of income. In this way, the General Assembly would deny 19,303 taxpayers 87 1/2% of their net loss deduction.

Between these two, nothing in the record suggests that the General Assembly would have chosen the second approach. Although the second approach would result in more short-term revenue for the Commonwealth, the second approach would deny over 19,000 small businesses an important deduction, resulting in a significant burden on them. Indeed, remember that a net loss deduction simply allows a corporation that earned no income, on average, to pay no income tax.

Indeed, *the General Assembly has never adopted a net percentage-based cap without allowing small*

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[119] 1 Pa. C.S. § 1925 (if statute found unconstitutional, statute must be carried out "in accordance with legislative intent.").

corporations to deduct their losses in full.[120] By contrast, the General Assembly has, in the past, adopted an unlimited net loss deduction for all corporations.[121] This Court has held that, if it is required to hypothesize the General Assembly's actions in the face of an unconstitutional statute, that hypothesis may be guided by determining what the General Assembly has or has not done in the past.[122] Of the two choices above, the only choice the General Assembly has ever made is to adopt the net loss deduction without any limitation.

Thus the General Assembly would have adopted an uncapped net loss deduction, just like all other states in 2007, and just like it had done in the past.[123] Since in a tax case, doubts should be resolved in favor of the taxpayer,[124] and since any other holding would

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[120] The first institution of a percentage based cap was in tax years beginning after December 31, 2006. The percentage cap was coupled with the $3 million flat deduction, which invariably benefits smaller businesses with net losses of $3 million or less. *See* Act No. 2006-116, H.B. No. 859 (instituting the flat dollar cap with the percentage based limitation).

[121] For example, the General Assembly permitted an unlimited net loss deduction from 1981 through 1990. This was true until the law was changed in 1991. *See* Act No. 1980-195, H.B. No. 1252.

[122] *See, e.g., PPG Industries, Inc. v. Commonwealth,* 790 A.2d 261, 269 (Pa. 2001).

[123] In 2007, only New Hampshire had any restriction on net losses, but that limitation was strictly limited to the carryover of the loss, not the deductibility of the loss. *See* N.H. Rev. Stat. Ann. § 77—A:4, XIII

[124] See, *e.g., Commonwealth v. High Wielding Co.,* 239 A.2d 377 (Pa. 1968); *Lynnebrook and Woodbrook Associates et. al. v. Borough of Millersville,* 963 A.2d 1261 (Pa. 2008); *Skepton v. Borough of Wilson,* 755 A.2d 1267 (Pa. 2000).

discourage a taxpayer from bringing a uniformity case,[125] if this Court finds the net loss limitation to be unconstitutional, this Court should order that the net loss be computed without the limitation.

Moreover, since the intent to carry out legislative intent is important, this Court should ignore the invitation by the dissenting opinion and the Deputy Attorney General for this Court to develop a "remedy" for a uniformity violation for years after 2007. After all, with respect to more recent years, the General Assembly has the policy tools to implement any prospective change to the net loss statute. And the General Assembly, in addition to a prospective remedy, may decide to make retrospective changes, which it is free to do subject to due process limitations.[126] This Court should not predict what the General Assembly will decide to do for other years.

Instead, this case only requires a remedy for Nextel for the 2007 tax year—there is nothing in the record regarding other tax years. The General Assembly's task will be to determine what do for more recent tax years. And since the 2007 tax year is closed for assessment to all taxpayers, including Nextel, the only remedy is a refund to Nextel.

IV. CONCLUSION

Nextel earned no overall income because its losses of $150 million exceeded its income of $45 million.

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[125] *Allegheny Pittsburgh Coal v. Webster County,* 488 U.S. 336, 346 (1989) (constitution is not satisfied if state "imposes on him against whom the discrimination has been directed the burden of seeking an upward revision of the taxes" of the others).

[126] *Budd Co.,* 108 A.2d at 569 ("[A] tax may not be retroactively applied beyond the year of the general legislative session immediately preceding that of its enactment . . . .").

Nextel has established that, in 2007, over 19,000 other taxpayers were similarly situated—they had no overall income because their losses exceeded their income. Despite having no overall income, Nextel paid tax of $3.9 million because its income in 2007 exceeded the $3 million threshold and thus its loss deduction was limited. Yet the 19,000 other taxpayers with no economic income over the same time frame paid zero tax. Our Uniformity Clause prohibits thresholds on deductions from tax because they discriminate against taxpayers with income in excess of those thresholds. Nextel has established that the limitations violate this principle because they apply only to taxpayers with income greater than $3 million. Nextel is, therefore, entitled to a refund of its tax paid for 2007 so that it is treated the same as other taxpayers for that period.

Respectfully submitted,

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Dated: 6/24/16

APPENDIX K

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 EAP 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Appellee

v.

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF REVENUE,
Appellant

APPEAL FROM THE ORDER OF THE COMMONWEALTH COURT ENTERED ON DECEMBER 30, 2015 AT NO. 98 F.R. 2012

REPLY BRIEF FOR APPELLANT

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* * *

ARGUMENT

I. THE COMMONWEALTH COURT INCORRECTLY DETERMINED THAT THE CAP ON THE NET LOSS DEDUCTION VIOLATES THE UNIFORMITY CLAUSE. THAT COURT'S ERROR STEMMED FROM ITS USE OF EFFECTIVE TAX RATES AS A MEASURE OF UNIFORMITY. NEXTEL INVITES THIS COURT TO MAKE THE SAME ERROR.

In our initial brief, the Department asserted that the Commonwealth Court incorrectly determined that the cap on the net loss deduction violates the Uniformity Clause. The Commonwealth Court was in error; the error stemmed from measuring the uniformity of the corporate excise tax at issue here not by the statutory rate imposed but by the effective tax rate. Initial Brief, 15. Nextel now invites this Court to make the same error. That invitation should be declined.

Nextel begins its challenge to our initial brief by mischaracterizing our position concerning the proper uniformity analysis. Specifically Nextel asserts that, though there is no dispute that the Uniformity Clause applies to all types of taxes, the Department "vaguely suggests" that the uniformity analysis in the context of a corporate excise tax is somehow different. Nextel Brief, 8. There is nothing vague in our position or the case law upon which it is based. As we clearly detailed in the specific context of the corporate excise tax, there is no Uniformity Clause violation when the same statutory rate is applied to the same tax base. *Turco Paint and Varnish, Co. v. Kalodner*, 184 A.37, 40 (Pa. 1936). While Nextel acknowledges that this "is the

rule", it asserts that the rule is not applicable here because the tax base is not the same. Nextel Brief, 14. This is simply wrong. As we detailed in our initial brief in dealing with an excise tax for the privilege of doing business in the Commonwealth "net income as ascertained [by the computation of exemptions and deductions] is the base upon which the tax is measured, not the tax itself". Accordingly, while "[t]he rate of the income tax may vary, or the method of its computation, but as a base it is unvaried." *Commonwealth v. Warner Brothers Theaters, Inc.*, 27 A.2d 62, 63 (Pa. 1942). Because of the way corporations operate, the initial step of the corporate net income tax is designed to take into account the cost of producing income in determining the tax base. It is only after that determination is made, that the uniformity analysis begins. If the tax is imposed at a fixed statutory rate, the analysis is over. This is a key difference in the uniformity analysis concerning corporations.

Nextel seeks to escape this different uniformity analysis by suggesting that this Court's case law outlining it is somehow distinguishable from the present action. It is not. In making this suggestion Nextel refers to this Court's case law in series. We will do the same.

Nextel asserts, for example, that this Court's decision in *Turco Paint and Varnish Co. v. Kalodner*, 185 A. 37 (Pa. 1936), is somehow irrelevant here because it involved *inter alia* apportionment of income among various states. Nextel Brief, 14. This is accurate but does not alter the fact that this Court in *Turco* also addressed uniformity generally. In doing so this Court specifically held that there is no uniformity violation

"simply because of the fact that one association, owning more of a particular taxable subject matter than another, pays, on this account, the greater sum total of tax." *Turco Paint and Varnish Co. v. Kalodner, et al.*, 184 A.37, 40 (Pa. 1936). That is this case – the only disparity that Nextel can point to is that it had more taxable income after accounting for all deductions, which, in itself, is not a uniformity violation. As this Court instructed, "[w]here different rates are legislatively imposed on varying amounts of quantities of the same tax base, then you have a graded tax that lacks uniformity . . . [t]o create a graded tax it is generally necessary that the rate itself be a variable factor." *Turco Paint,* 184 A. at 40. Here, as was the case in *Turco Paint*, every corporation was subject to the identical statutory tax rate, and, therefore, there was no uniformity violation.

Nextel's similar claim that this Court's decision in *Commonwealth v. Warner Brothers Theater, Inc.*, 27 A.2d 62 (Pa. 1942) is also irrelevant here is similarly meritless. In *Warner Brothers*, this Court was presented with the issue of the proper delegation of legislative authority. In that action, this Court was again faced with a calculation of net income that had variable factors as to what could be included and as to what might be deducted therefrom guaranteeing differing effective tax rates. These factors were adopted by Pennsylvania from the federal calculation of net income. This Court was correctly dismissive in rejecting a delegation challenge; "the Act does not delegate the power to tax to the Federal Tribunal, it only takes the net income affixed by it, as the base for the excise privilege tax levied by the Commonwealth." *Id.* at 63. However, what Nextel overlooks, and now asks this Court to overlook, is that *Warner Brothers* also presented a straight uniformity challenge.

In *Warner Brothers*, in determining what is net income, the statute permitted only $2,000 of capital losses to be deducted. Warner Brothers sought to deduct the entire $84,000 of capital losses for the year at issue. Warner Brothers argued that the deductions allowed in different years may vary and that this variability was inconsistent with the Pennsylvania Constitution. *Id*. In rejecting that assertion, this Court emphasized that:

> Net income is ascertained as the base upon which the tax is measured not the tax itself. How it was fixed by the Federal authorities is of no concern to the taxing officers of the Commonwealth nor to its statute. The rate of income may vary, or the method of its computation, but as a base it is unvarying.
>
> *Warner Bros. Theatres,* 27 A.2d at 63.

Thus this Court upheld the use of a federal net income despite the fact that Warner Brothers sought to deduct more of its capital losses, just as Nextel now seeks to utilize more of its accrued net losses. It was on this basis, that this Court found that "the act before us does not violate the Uniformity Provision of the Constitution" *Id*. at 64 (citing *Turco Paint and Varnish Co. v. Kalodner*).

Nextel's efforts at discounting and dismissing this Court's decision in *Commonwealth v. Westinghouse Electric Corp.*, 386 A.2d 491 (Pa. 1978), are also unavailing. Specifically Nextel asserts that *Westinghouse* is yet again not relevant here because determining whether to take foreign taxes as a credit rather than as a deduction on its federal tax return was voluntary. Nextel Brief, 15. While this Court did make that point in *Westinghouse Electric Corporation, supra.* at 493,

this Court's rejection of the uniformity challenge in that action was not dependent on that point. Indeed, this Court makes clear that the basis of Westinghouse's uniformity challenge in that action arose from "not being permitted to deduct foreign taxes from its state tax returns" and as a result being "taxed at a higher rate than those corporations which were *allowed* to deduct foreign taxes from their state tax returns." *Id*. at 493. Once again this Court determined that variable effective tax rates resulting from limitations on what corporations were *allowed* to deduct simply did not implicate the Uniformity Clause. *Id.* at 493. (citing *Warner Brothers*).

Despite Nextel's assertions to the contrary, these cases concern the proper application of the Uniformity Clause to excise taxes on corporate net income. These cases are not only relevant to this action but address the specific issue presented here resolving it. Instead of applying that case law here, Nextel invites this Court to make precisely the same error made by the Commonwealth Court, and ignore that case law completely. Nextel also invites this Court to repeat another error made below by relying upon case law concerning personal taxes as guidance for the proper uniformity analysis here. We address that next.

A. This Court has repeatedly and consistently held that the uniformity analysis in the corporate context is different from personal and property taxes.

As we detailed in our initial brief, Nextel sought below, as it seeks here, to apply personal and property tax case law to this corporate net income tax case.

Nextel principally[1] cites to *In re: Cope's Estate*, 43 A. 79 (Pa. 1899) and *Amidon v. Kane*, 279 A.2d 53 (Pa. 1971). First as to *In re: Cope's Estate,* that case involved an estate taxing statute which exempted from taxation estates valued under $5,000. This Court determined that because the $5,000 exemption applied to all estates it had the effect of a graduated tax. *In re: Cope's Estate*, 43 A. 79, 81 (Pa. 1899). Nextel challenges this characterization; but, the estate tax exemption is a universal bracket, a threshold, which all estates must clear before any tax is due. As this Court emphasized, "the act in question offends . . . [uniformity] . . . by undertaking to *wholly* exempt from taxation the personal property of a very large percentage of decedents' estates, . . ." *Id.* at 81 (emphasis added). Nothing like that is at issue in this action. The corporate net income tax does not wholly exempt from taxation a certain class of taxpayers. Here, every single taxpayer (including Nextel) is subject to the corporate net income tax at an identical statutory rate. R.R. 17a SF ¶¶ 14-15. In the context of an excise tax on corporate net income, that is all that uniformity requires.

Finally, Nextel repeatedly refers to *Amidon v. Kane*, 279 A.2d 53 (Pa. 1971), a personal income tax case. In that action a flat tax rate was imposed on taxable income and the calculation of that income incorporated various exemptions and deductions which were not available to all taxpayers, thus resulting in varying effective tax rates imposed upon the same level of income. In the personal income tax context, this Court did hold that this violated the Uniformity Clause. *Id.* at 63. However, even Nextel acknowledges

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[1] Nextel also cites to *Kelley v. Kalodner*, 181 A. 598 (Pa. 1935). This is simply another action involving property taxes.

that this Court in *Amidon*, recognized a fundamental difference between individual and corporate taxation; that "using federal taxable income as the starting point for corporations is permissible because they are 'created . . . for the purpose of maximizing profits' and, therefore, the deductions allowed in computing a corporation's federal taxable income are directly related to the generation of those profits." Nextel Brief, p. 22 (quoting *Amidon*). Nextel further acknowledged that this Court in *Amidon* "differentiated between corporations and individuals because, for individuals the deductions allowed in computing the individual's federal taxable income were not related to the way the individual earns income." *Id.* It is because of this fundamental difference in the way that corporations operate that the initial step of the corporate net income tax calculation is designed to take into account the cost of producing income in determine the tax base.[2] It is after that determination is made that the

[2] Nextel suggests that the tax base is gross income less all state and federal deductions, except for the net loss deduction. Nextel Brief, 18 n. 52. This suggestion is unsupported by case law and Nextel's own witness, Professor McCaffery. As detailed throughout, this Court has specifically held that net taxable income – after accounting for apportionment and all deductions – is the base upon which the tax is measured. *Warner Brothers, supra.* at 63; *Turco Paint,* 184 A. at 40. The tax base accounts for all costs of producing income. The net loss deduction, like all other state and federal deductions, is a cost of producing income. Calculating tax liability, Nextel's own expert, Professor McCaffery, provided the following formula: tax = tax base x the tax rate. (R.R. 135a, S/F Exhibit G, pg. 4, ¶5). Pursuant to this formula, the net income attributable to Pennsylvania is net income after accounting for the net loss deduction which Nextel reported as $39,421,622 R.R. 24a (S/F ¶13, Exhibit A, pg. 3, line 12. Seen mathematically: tax ($3,938,222) = tax base ($39,421,622) x statutory rate (0.0999).

uniformity analysis begins. If the tax is imposed at a fixed statutory rate, the analysis is over.

One further point as to uniformity, in our initial brief we pointed out that adopting effective tax rates as a measure of uniformity for corporate net income tax purposes would *inter alia* call into question the continuing validity of other excise taxes such as occupation taxes. Nextel suggest that the impact of such a drastic change in tax jurisprudence is limited because the various federal deductions incorporated by reference into Pennsylvania law are permissible because the federal deductions allowed to corporations are relevant to computing its economic income. Nextel Brief, pg. 25. But the net loss deduction serves precisely the same function. And as detailed above, this Court in *Warner Brothers* made clear that though the federal deductions incorporated by reference into Pennsylvania law were capped by a specific dollar amount, this did not implicate Pennsylvania's Uniformity Clause. *Warner Brothers*, *supra.* at 63 ("the Act does not delegate the power to tax to the Federal Tribunal, it only takes the net income fixed by it as the base for the excise privilege tax levied by the Commonwealth.") Despite Nextel's assertions to the contrary such deductions as the net loss deduction, whether it has its genesis in federal or state law, leads to varying effective tax rates. Such varying effective tax rates, in a corporate context, have not, until the Commonwealth Court's decision, been held to violate the Uniformity Clause. Thus, adopting effective tax rates as a measure of uniformity for corporate net

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Where, as here, net income after accounting for the net loss deduction is the tax base, every single corporation (including Nextel) would have an effective tax rate equal to the statutory rate.

income tax purposes would have a profound and far-reaching impact on tax jurisprudence.

Despite Nextel's own acknowledgement of the difference in uniformity analysis between an excise tax on corporate net income and personal taxes Nextel spends a large portion of its brief asking this Court to do as the Commonwealth Court did and apply the wrong uniformity analysis to this action. As we detailed in our initial brief, this was the crux of the Commonwealth Court's error below. It should not be repeated here.[3]

II. THE COMMONWEALTH COURT INCORRECTLY DETERMINED THAT THE APPROPRIATE REMEDY WAS TO SEVER THE NET LOSS DEDUCTION DOLLAR LIMITATION FOR ALL TAXPAYERS RATHER THAN TO SEVER THE DOLLAR CAP AND LEAVE IN PLACE A PERCENTAGE CAP.

In our initial brief we detailed the axiomatic principle that whenever an unconstitutional provision is severed from the rest of a statute, it must be done in a manner which effectuates legislative intent. *PPG Industries Inc. v. Commonwealth*, 790 A.2d 260, 268 (Pa. 2001); see also 1 Pa.C.S. § 1925. We also asserted that because the Commonwealth Court majority failed to apply this severability analysis, the majority failed to make the correct decision as to remedy.

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[3] Nextel also cites to *American Stores Co. v. Boardman,* 6 A.2d 826 (Pa. 1939). But as detailed above there is a fundamental difference between the statutorily set tax rate and an effective tax rate. The tax at issue in *American Stores* was no different than a statutorily graduated tax.

Nextel, in defending the Commonwealth Court's failure to apply the established severability analysis makes *inter alia*[4] several arguments. First, Nextel argues that the severability analysis is not applicable when the constitutional provision at issue concerns uniformity. Second, Nextel cites to a whole series of case law that has nothing to do with how a tax statute should be interpreted once a provision is found unconstitutional but rather case law concerning enforcement. Nextel suggests that this case law somehow forecloses application of the severability analysis here. Nextel also asserts that because the Commonwealth Court's decision below concerned only an as-applied challenge to a specific tax year the severability analysis is not applicable. Finally, Nextel argues that if the Commonwealth Court majority had in fact undertaken a severability analysis, the result would have been the same. We address each in turn.

It is axiomatic that, whenever an unconstitutional provision is severed from the rest of the statute it must be done in a manner which effectuates legislative intent. Initial Brief, 26. This principle has been recognized both in case law and statutes. *Id.* (citing *PPG*

[4] Nextel also argues that proper application of the severability analysis is somehow procedurally foreclosed because of the three year statute of limitations to assess tax liability. The Department acknowledges that limitation on assessment. In advocating for the proper interpretation of the statute with the unconstitutional provision removed, we are not advocating for the assessment and recalculation of taxes for taxpayers beyond the assessment window.

Industries, Inc. v. Commonwealth, 790 A.2d 261, 268 (Pa. 2001); and 1 Pa.C.S. § 1925)[5].

> Section 1925 of the Statutory Construction Act states in pertinent part:
>
> The provisions of every statute shall be severable. If any provision of any statute . . . is held invalid, the remainder of the statute . . . shall not be affected thereby, unless the Court finds that the valid provisions of the statute are so essentially and inseparably connected with, and so depend upon the void provision . . . that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one; or unless the court finds that the remaining valid provisions, standing alone, are incomplete and are incapable of being executed in accordance with the legislative intent.

Nextel seeks to escape this fundamental principle of statutory construction, and defend the Commonwealth Court majority's failure to apply that principle here, by seeing, as significant, that we cited to the principle in *PPG Industries, Inc., supra.*, a Commerce Clause case. Nextel argues that the principle is not applicable in a uniformity challenge. This argument is baseless as a matter of law. Indeed, this Court has specifically held to the contrary. In *Saulsbury, et al. v. Bethlehem Steel Co.,* 196 A.2d 664 (Pa. 1964), this Court was faced, as here, with a tax statute that was challenged based on uniformity. *Id.* at 666. In that specific context, this Court held that, in determining severability,

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[5] In addition to case law, the principles of statutory construction are codified in the Statutory Construction Act 1 Pa.C.S. §§ 1501-1991.

"the legislative intent is of primary significance . . . the legislating body must have intended that the act or ordinance be separable and the statute or ordinance must be capable of separation in fact". Applying this analysis to that action this Court determined that the statute at issue was not severable but indivisible. *Id.* at 667.

Similarly baseless is Nextel's persistent reference to a series of cases that have nothing to do with how a tax statute should be interpreted once a provision is found unconstitutional, but rather with the enforcement of the statute by administrative officials. Specifically Nextel cites to *inter alia*: *Commonwealth v. Molly Corp., Inc.*, 392 A.2d 321 (Pa. 1978); *Allegheny Pittsburgh Coal Company v. County Commission of Webster County, West Virginia*, 488 U.S. 336 (1989); *Hillsborough Township v. Cromwell*, 326 U.S. 620 (1946); and *Iowa-Des Moines National Bank v. Bennett,* 284 U.S. 239 (1931). However these cases addressed enforcement mechanisms that imposed upon the individual taxpayer the burden of seeking an increase of the taxes others should have paid. *Allegheny Pittsburgh Coal Company, supra.* at 346; *Iowa-Des Moines National Bank, supra.* at 46. Nothing like that has occurred here. Moreover, these same cases also make clear that while such an individual burden may not be placed on a taxpayer, the taxpayer "may not complain if equality is achieved by increasing the same taxes on other members of the class to the level of his own". *Hillsborough Township, supra.* at 623. Nothing in this case law precludes the proper application of the severability analysis to determine how a tax statute should be interpreted to give effect to the General Assembly's intent.

Nextel also asserts that because the Commonwealth Court's decision below concerned an as-applied challenge to a specific tax year the severability analysis is not applicable. In our initial brief we detailed how the Commonwealth Court's dissent, on this issue, was quite skeptical as to the supposedly limited effect of the Commonwealth Court's decision. Initial Brief, 28 (citing dissent at DRP 2). Subsequent events have established that that skepticism was prescient.

In *R.B. Alden Corp. v. Commonwealth*, ___A.3d ___, 2016 W.L. 3266111 (Pa. Cmwlth. 2016) the Commonwealth Court was faced with another uniformity challenge to the net loss deduction though for a different taxpayer, in a different year. Nevertheless the Commonwealth Court, citing to Nextel, held that the net loss deduction cap was unconstitutional. The Commonwealth Court went on to render the same remedy. *Id.* at *14. Thus, just as the dissent predicted, the "effect of [Nextel] is that Section 401 (3)4.(c)(1)(A)(II) can no longer cap the amount of the NLC deduction for all taxpayers. As a result, we must go on to determine whether the flat capped NLC deduction should be stricken making that provision uniform or, as the majority does, eliminate all caps on the NLC deductions." DRP 3. That is the analysis the Commonwealth Court majority never undertook. That is the fundamental error the Commonwealth Court majority made as to remedy.

Finally Nextel defends the Commonwealth Court majority's failure to undertake a proper severability analysis by suggesting that even if the majority had done so, it would have reached the same conclusion as to remedy.

In support of this suggestion, Nextel, rather emphatically, and incorrectly, asserts that "nothing in the

record suggests that the General Assembly would have chosen the second approach, [limiting the net loss for all taxpayers to 12.5 percent of income]". Nextel Brief, 40. Nextel overlooks,[6] and now asks this Court to overlook that, as detailed in our initial brief the General Assembly took the deduction away entirely from 1991 to 1994. Thereafter the deduction has been capped and has remained capped since 1995. As the dissent below correctly determined, based on its own review of that legislative history, "it is clear that the General Assembly wanted to limit NLC deductions every tax year – with both a flat and percentage cap on deductions the majority would strike all caps on deductions, which is directly against the legislative scheme of the placement of caps on NLC deductions. If

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[6] Nextel also makes a series of public policy arguments as to what the General Assembly would or would not choose to do, as opposed to applying principles of statutory construction. In this, Nextel is not alone. A number of amici have submitted briefs to this Court making similar public policy arguments. We would simply note here that speculation about the proper balancing of capital investments and research and development as against budgetary constraints are not the concern of this Court. Moreover, both Nextel and amici when they engage in this speculation ignore the fact that the General Assembly has allowed for a 20-year carryover period to recover net losses. 72 P.S. § 7401(3)4.(c)(2)(A). The entire goal of that carryover period is to encourage business investment and grant corporations the ability to recover investment costs for up to twenty years after making the investment. Nextel notes that the General Assembly previously adopted an unlimited net loss deduction for all corporations. Nextel Brief, p. 41. However, Nextel fails to mention that the net loss carryover period ranged from only one to three years during the 1981 through 1990 tax years when the General Assembly adopted an unlimited net loss deduction, after which any remaining net losses would have expired. 72 P.S. § 7401(3)4.(c)(2)(A). In the modern era of the 20-year net loss carryover period, the net loss deduction has always been capped.

the unconstitutional flat cap deduction is severed . . . , the uniform percentage deduction would remain which would be available to all taxpayers. Severing the flat cap provision would carry out the legislative intent to place limitations on the NLC deductions for each year." DRP 5. Because the dissent, unlike the majority, undertook the proper severability analysis and reviewed the legislative history to determine intent, the dissent reached the correct conclusion as to remedy. If this Court determines that the dollar cap on the net loss deduction violates uniformity, we respectfully request that it adopt the dissent's analysis as to remedy.

CONCLUSION

The Court should reverse the judgment of the Commonwealth Court. In the alternative, the remedy for any constitutional disparity should be the severing of the dollar cap on the net loss deduction leaving the percentage cap in place.

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APPENDIX L

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 EAP 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Appellee

v.

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF REVENUE,

Appellant

APPEAL FROM THE ORDER OF THE COMMONWEALTH COURT ENTERED ON DECEMBER 30, 2015 AT NO. 98 F.R. 2012

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* * *

SUMMARY OF ARGUMENT

1. The issue in this appeal is fundamentally different from the question presented in *Mt. Airy*. The Court acknowledged that the uniformity claim in *Mt. Airy* pertained to the statutory tax rates and not the calculation of the tax base. Nextel, however, is not challenging the statutory tax rate and is instead challenging the calculation of the tax base. Unlike the statute at issue in *Mt. Airy*, or the case law upon which that decision was based, the statute in this appeal imposes the same statutory tax rate on every corporation, regardless of the tax base value. The Commonwealth continues to rely upon the Court's precedent that there is no uniformity violation where the same statutory tax rate is applied to the same statutory tax base.

2. If the Court affirms the Commonwealth Court's decision that the net loss deduction cap violates the Uniformity Clause and grants the unlimited net loss deduction permitted by the Commonwealth Court majority, then such relief should be prospective only. Accepting Nextel's argument would establish a new principle of law and be a significant divergence from the Court's long-established precedent. Further, prospective-only relief would avoid devastating budgetary repercussions of having to refund millions of dollars that have already been budgeted for, collected by the Department of Revenue in good faith, and spent.

ARGUMENT

I. THE COURT'S DECISION IN *MT. AIRY* DID NOT ADDRESS AND CERTAINLY DID NOT RESOLVE THE ISSUES PRESENTED IN THIS ACTION.

Mt. Airy does not control this case because *Mt. Airy* presented, and the Court decided, a fundamentally different question. In this case, Nextel challenges the use of a specific deduction in calculating the tax base. That, however, was not the issue in *Mt. Airy*, as the Court specifically noted ("Mt. Airy does not take issue with ... the formula for determining each casino's tax base"). *Id.*, slip op. at 12, 2016 WL 6210519 at *6. To the contrary, *Mt. Airy* involved a challenge to the application of statutory tax rates *after* the tax base had been determined.

This distinction matters because the tax at issue here is a tax on *net* income; that is, the tax is designed to take into account a corporation's cost of producing income. It does this by allowing for a variety of deductions from gross income. These deductions are equally available to all corporations as a matter of law; but their practical *effect* will, in the nature of things, vary from one taxpayer to another, depending on the nature of its business, its gross income and a host of other factors. This results in variations in net income—the tax base—and this in turn will inevitably result in different amounts of tax due. Thus, every statutory deduction could be characterized as resulting in varying *effective* tax rates; and that is precisely the argument on which Nextel and Commonwealth Court rely.

But the Court has consistently rejected this approach to Uniformity Clause analysis. In *Turco Paint and*

Varnish Co. v. Kalodner, 184 A. 37 (Pa. 1936), the taxpayer, like Nextel, argued that "the graduation of the tax results from the process by which net income is determined," resulting in different results "when applied to corporations differently situated" with respect to the factors that determined net income. *Id.*, at 40. The Court, however, rejected this argument: a tax does not violate the Uniformity Clause "simply because of the fact that one association, owning more of the particular taxable subject-matter than another, pays, on this account, a greater sum total of tax." *Ibid.*

Rather, the Court has consistently held that the Uniformity Clause is satisfied where, as here, the same statutory tax rate is applied to the same statutory tax base. *See, e.g.*, *Turco Paint*, 184 A. at 40 (Pa. 1936); *Commonwealth v. Warner Brothers Theaters, Inc.*, 27 A.2d 62, 63 (Pa. 1942); *Commonwealth v. Westinghouse Electric Corp.*, 386 A.2d 491 (Pa. 1978).

Nothing in *Mt. Airy* changed this well-settled approach to corporate tax analysis. *Mt. Airy* and the case law on which the Court relied – *Cope's Estate*, 37 A. 79 (Pa. 1899) and *Kelley v. Kalodner*, 181 A. 598 (Pa. 1935) – all involved statutes that imposed varying statutory tax rates, which is entirely different from Nextel's challenge to the calculation of the tax base. As we noted above, the Court in *Mt. Airy* did not address, and had no occasion to address, any issue involving the calculation of the tax base; and the Court specifically avoided opining on whether a uniformity violation could arise out of "disparate *effective* tax rates". *Mt. Airy*, Slip Op. at 3, 2016 WL 6210519 at *1.(emphasis added).

Nextel relies upon a personal income tax case in arguing that the net loss deduction cap results in disparate effective tax rates, but the Court has already

explained that the uniformity analysis is quite different for personal and corporate taxes. In *Amidon v. Kane*, 279 A.2d 53 (Pa. 1971), the Court was presented with a *personal* income tax rather than a *corporate* net income tax. The Court was reminded that it had repeatedly held that exemptions or deductions that may or may not be available to corporations in calculating the corporate net income tax did not implicate the Uniformity Clause and that, therefore, such factors should not implicate the Uniformity Clause in the context of the personal income tax. However, the Court specifically rejected any analogy between corporate and personal taxes based upon the inherent differences in the nature of the entities. *Amidon*, 279 A.2d at 63. Corporations are artificial legal entities created for the purpose of maximizing profits, and the corporate net income tax is imposed upon *net* income. *Ibid.*

Natural persons, on the other hand, cannot be likened to profit maximizing entities. *Ibid.* Thus, unlike corporations, it is not possible to create a personal income tax designed to take into account the cost of producing individual income. *Ibid*. It is because of this fundamental difference in the way corporations operate that the initial step of the corporate net income tax calculation is designed to take into account the cost of producing income to determine the tax base. It is after that determination is made that the uniformity analysis begins. If the tax is imposed at a fixed statutory rate, then the analysis is over and there is no uniformity violation.

Thus, citing to *Turco Paint* and *Amidon*, the Court in *Mt. Airy* continued to recognize that "our Uniformity Clause jurisprudence affords the General Assembly a bit more flexibility in the context of

corporate taxation." *Mt. Airy*, Slip Op. at 12, 2016 WL 6210519 at *6. In the context of *Mt. Airy*, this distinction had no bearing, precisely *because* "Mount Airy does not take issue with the Gaming Act's formula for determining each casino's taxable base." *Ibid.* By contrast, the calculation of the tax base is precisely the issue that Nextel raises here.

Essentially, then, Nextel is asking the Court to import a Uniformity Clause analysis designed for personal taxes into the very different context of corporate taxes. Not only is this contrary to the long-standing case law described above, but it would lead to the absurd result that no deductions at all from corporate gross income could be permitted.

In *Mt. Airy,* the Court carefully did not address the effective tax rate uniformity argument that Nextel now presents here. The Court did reiterate the decades of case law recognizing the fundamental difference in uniformity analysis between corporate and personal taxes. Thus, in *Mt. Airy,* the Court far from rejected arguments that were in any way similar to the Department's arguments here, but its analysis supports the position of the Department here.

II. *MT. AIRY* CORRECTLY APPLIED THE PRINCIPLE THAT DECISIONS CONSTITUTIONALLY INVALIDATING A TAX STATUTE TAKE EFFECT AS OF THE DATE OF THE DECISION AND ARE NOT APPLIED RETROACTIVELY. THAT PRINCIPLE IS ALSO APPLICABLE IN THIS ACTION.

In *Mt. Airy*, the Court reiterated the principle that "a decision of this Court invalidating a tax statute takes effect as of the date of the decision and is not to be applied retroactively." *Mt. Airy,* Slip Op. at 18 n.11,

2016 WL 6210519 at *8 (citing *Oz Gas Ltd. v. Warren Area School District*, 938 A.2d 274, 285 (Pa. 2007)); *see also American Trucking Association, Inc., et al. v. McNulty,* 596 A.2d 784, 790 (Pa. 1991). In making that determination, the Court cited to, *inter alia, Oz Gas*. If the Court affirms the Commonwealth Court's decision that the net loss deduction cap violates the Uniformity Clause and grants an unlimited net loss deduction as permitted by the Commonwealth Court majority, then, in accordance with the principles that were applied in *Oz Gas,* such relief should be prospective only.

The Commonwealth anticipates that Nextel will seek to escape purely prospective application of any decision invalidating the tax statute at issue here by asserting that such a remedy has been waived because it was not presented in briefing. This assertion ignores that the determination of whether or not a decision should be applied retroactively or purely prospectively is a matter of judicial discretion, and, as we will detail below, determined by the Court based on a variety of factors, including equitable principles. The Department here specifically will brief these equitable principles, referencing the budgetary and revenue concerns that gave rise to the General Assembly's enactment of the various iterations of the statute at issue. *See* Initial Brief, pp. 25, 26 and n.5. Finally, and most fundamentally, in *Mt. Airy,* the Court determined that a prospective application of its decision was appropriate without the issue being briefed by any of the parties. Without such briefing, the Court correctly exercised its own discretion in correctly determining that prospective relief was all that was legally available in that action. As we now detail, that is also the case here.

In *Oz Gas,* the Court looked to the three-prong test enunciated in *Chevron Oil v. Hudson,* 404 U.S. 97, 106-107 (1971) (plurality), as to whether relief should apply retroactively. Those three prongs examine (1) whether the decision establishes a new principle law; (2) whether retroactive application of the decision would forward the operation of the decision; and (3) whether the relevant equities dictate prospective application because the General Assembly did not believe the taxes to be unconstitutional, the taxing authorities collected taxes that the authorities reasonably believed were valid, and refunding the taxes could deplete the state treasury. *Oz Gas, supra,* at 282.

The Commonwealth anticipates that Nextel will attempt to avoid this analysis by arguing that it has not asked the Court to invalidate the tax statute, but has asserted only an as-applied challenge involving only itself and only a particular tax year. That, however, is disingenuous.

As we detailed in our initial briefing, Judge Pellegrini, in his dissent, correctly criticized this characterization of the challenge at issue.

> The majority . . . pretends that because Nextel is purportedly not making a facial challenge, what is "only" to be declared unconstitutional is the NLC deduction provision as applied to Nextel for the 2007 Tax Year. Realizing the effect that this opinion would have, the majority opinion states that "to the extent our decision in this as-applied challenge calls into question the validity of the NLC deduction provision in any other or even every other context, the General Assembly should be guided accordingly."

DRP-2. As we also previously pointed out, numerous cases have been held pending the resolution of this action. Accordingly, Judge Pellegrini went on to correctly state:

> Unless our state case law means nothing no matter whether you call it – "as applied" challenge or facial challenge – the effect of our holding is that Section 401(3)4.(c)(1)(A)(II) can no longer cap the amount of NLC deduction for all taxpayers.

DRP 2-3. Finally, as we pointed out in our initial reply brief, in *R.B. Alden Corp. v. Commonwealth*, ___ A.3d ___ , 2016 WL 3266111 (Pa. Cmwlth. 2016), the Commonwealth Court was faced with another uniformity challenge to the net loss deduction, though for a different taxpayer and for a different tax year. Nevertheless, the Commonwealth Court, citing to *Nextel*, held that the net loss deduction cap was unconstitutional. The Commonwealth Court went on to render the same remedy. *Id*. at *14. Just as Judge Pellegrini predicted, the "effect of [*Nextel*] is that Section 401(3)4.(c)(1)(A)(II) can no longer cap the amount of NLC deductions for all taxpayers." DRP-3. Whatever Nextel seeks to call it, the effect of Commonwealth Court's *Nextel* decision and certainly the effect of any affirmance by the Court is, and would be, the constitutional invalidation of the tax statute at issue.

Turning then to the first prong of the *Oz Gas*/*Chevron* test, any affirmance by the Court of the Commonwealth Court's decision below would surely establish a new principle of law. Accepting Nextel's effective tax rate argument would be a significant divergence from the Court's long-established precedent that, for corporate net income tax purposes, the standard for uniform tax rates applies to the statutory

tax rate. *Turco Paint*, 184 A. at 40; *Warner Bros. Theatres*, 27 A.2d at 64. As discussed above, the uniformity violations in *Cope's Estate*, *Kelley*, and *Mt. Airy* all resulted from statutes that imposed varying statutory – not effective – tax rates. Thus, a decision that upholds the net loss deduction cap as constitutional would not be in conflict with any of those decisions. In *Amidon*, the Court did analyze varying effective tax rates but it also explained the fundamental difference between personal and corporate taxation. In this action, there is no lack of uniformity with respect to the statutory tax rate. And until the Commonwealth Court's decision below, disparity in the effective tax rate has never been held unconstitutional in the corporate context. Nextel invites the Court to make precisely the same error made by the Commonwealth Court by ignoring these differences and, indeed, ignoring corporate tax case law completely. If that error is allowed to stand, it would be the first time that the uniformity analysis has been applied in this manner, fundamentally altering existing law.

As to the next factor – whether retroactive application would forward the operation of the decision – the Court in *Oz Gas* made clear that retroactive application would not forward the operation of a decision where the decision clearly establishes that the taxes are uncollectible going forward. *Oz Gas* at 283. The Commonwealth anticipates Nextel's argument that purely prospective relief would deny Nextel and other corporations refunds and would also deny them any incentive to bring a uniformity case regarding an income tax. The Court, rejecting a very similar argument in *Oz Gas*, emphasized that the retroactive interest in civil cases is distinct from those involved in criminal cases. *Oz Gas*, 938 A.2d at 284. In a civil

context, there are resources available, from taxpayers generally, to institute and pursue a matter to establish new law without the expectation of a benefit in that lawsuit. *Oz Gas*, 938 A.2d at 284 (citing *American Trucking Associations, Inc. v. McNulty*, 596 A.2d 784 (Pa. 1991)). As *Oz Gas* makes clear, the question here is not whether Nextel individually may or may not be discouraged from seeking to overrule existing precedent but whether denying a refund would have the effect of discouraging litigants generally. *Id*. at 284. As the Court concluded in *Oz Gas*, "in cases such as this, moreover, there is always an incentive in the avoidance of liability for payment of taxes or fees in the future to challenge the validity of a statute." *Oz Gas*, 938 A.2d at 284 (citing *American Trucking Associations, Inc. v. McNulty*, 596 A.2d 784 (Pa. 1991)). That is also this case and, accordingly, Nextel or any other taxpayer would remain incentivized to challenge any tax statute because of the potential ramifications of reducing future year tax liabilities.

The last of the *Oz Gas* factors is the equities of purely prospective application. In *Oz Gas*, the Court emphasized that the taxing authorities collected and made use of the taxes at issue with the good faith belief that they were legally entitled to them and that refunding the taxes would cause substantial financial hardships to the communities involved. *Oz Gas*, 938 A.2d at 283. If a tax statute under which a political subdivision has been collecting taxes is declared invalid, the future effect on the political subdivision is clear and those entities can budget public monies to account for any decrease in tax revenue. *Id.* at 285. As the Court explained, "[t]o apply such a decision retroactively, however, subjects the taxing entities to potentially devastating repercussions of having to refund taxes paid, budgeted and already spent." *Ibid.*

Finally, the Court concluded that "to avoid the potential devastating consequences to taxing entities it is important that taxes collected pursuant to a valid statute remain valid unless and until otherwise determined by this Court." *Ibid*.

In consideration of these equities, a remedy that grants an uncapped net loss deduction on a retroactive basis would most certainly subject the Commonwealth to devastating budgetary repercussions of having to refund taxes paid, budgeted and already spent. The Department of Revenue properly collected Nextel's corporate net income tax in accordance with the applicable statutory provisions. As all statutes are presumed constitutional, the Department acted with the good faith belief that it was legally entitled to collect this tax revenue from Nextel and all other corporations. The potential devastating budgetary repercussions of having to refund this tax revenue is demonstrated by the Commonwealth of Pennsylvania's 2016 General Obligation Bond disclosure, estimating that the Commonwealth's exposure on this net loss deduction cap issue could result in refunds exceeding $500 million.[1] A prospective-only remedy, however, would afford the General Assembly the opportunity to budget for this significant decrease in tax revenue, which was a critical consideration in *Oz Gas* when the Court rejected retroactive relief. The Commonwealth anticipates that Nextel will seek to isolate itself and continue to suggest that the affirmance by the Court would only concern Nextel and only for one tax year.

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[1] *See* COMMONWEALTH OF PENNSYLVANIA, "Official Statement: $988,175,000 General Obligation Bonds," p. 58-59 (June 1, 2016), *available at* http://www.budget.pa.gov/PublicationsAndReports/InvestorInformation/Documents/May%202016%20Bond%20Sale/OS_Final_5-2016.pdf.

As the Commonwealth presented in prior briefs and again detailed throughout this brief, the effect of the Commonwealth Court's decision already can be seen to be much more far reaching than impacting only Nextel and only for the 2007 tax year, having precisely the same type of potentially devastating consequence referenced in *Oz Gas*.

All three of the *Chevron* prongs that were applied in *Oz Gas* weigh in favor of the Commonwealth here. Accordingly, if the Court finds that the net loss deduction cap violates uniformity and allows for an unlimited net loss deduction, such relief should be prospective only.

CONCLUSION

The Court should reverse the judgment of the Commonwealth Court. In the alternative, the remedy for any constitutional disparity should be the severing of the dollar cap on the net loss deduction leaving the percentage cap in place.

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APPENDIX M

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 E.A.P. 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Appellee

v.

COMMONWEALTH OF PENNSYLVANIA,
Appellant

Appeal from an Order of the Commonwealth Court, dated December 30, 2015, Docket Number 98 F.R. 2012

APPELLEE'S SUPPLEMENTAL BRIEF ADDRESSING THE COURT'S OPINION IN MOUNT AIRY #1, LLC v. DEPARTMENT OF REVENUE

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* * *

III. This case involves the long-standing constitutional rule prohibiting tax classification based on quantity. This Court should apply that rule to the uniformity violation Nextel suffered in 2007. Even though this is "retroactive," *Mount Airy* does not require an opposite result.

In *Mount Airy,* this Court wrote in a footnote that a "decision of this Court invalidating a tax statute takes effect as of the date of the decision and is not to be applied retroactively."[16] That observation was rendered by this Court in a short footnote, without analysis. This Court did not need to analyze the retroactivity question, however, because *Mount Airy* was a declaratory judgment action,[17] and thus retroactivity was not an issue squarely before this Court.[18]

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[16] *Mount Airy,* 34 E.M. 2015, Slip Op. at 18,n. 11.

[17] Mount Airy's action was brought under a special provision, 4 Pa.C.S. § 1904 (providing this Court jurisdiction "to render a declaratory judgment concerning the constitutionality of this part"). *See Mount Airy,* No. 34 E.M. 2015, Slip Op. at 2, 4 (General Assembly "assigned this Court broad authority ... to adjudicate constitutional challenges to the Gaming Act" without "a developed factual record...."). "Declaratory relief ... by its nature, is forward looking." *Oz Gas Ltd. v. Warren Sch. Dist. et al.,* 938 A.2d 274, 276 (Pa. 2007). Thus, this Court properly refused to consider claim for "damages," citing *Kaucher v. Cnty. of Bucks,* 2005 WL 283628 (E.D. Pa. 2005) (Pennsylvania Constitution does not authorize implicit cause of action without statutory authorization); *Balletta v. Spadoni,* 47 A.3d 183, 192 (Pa. Commw. 2012) (same).

[18] On this jurisdictional point, the government in *Mount Airy* agreed—to secure retrospective relief, Mount Airy was required to bring a refund claim under specific statutory provisions that authorize tax refunds. See Respondent's Brief in Support of

By contrast, Nextel's case is a tax refund action under a statutory tax refund provision.[19] It is axiomatic that a tax refund requires "retroactive" application of principles of law to a taxpayer's past. Here, the principles that apply are not new principles of law. Thus, the procedural posture of Nextel's case is for this Court to apply established uniformity principles to Nextel's facts for the 2007 year.

Indeed, the government has never, at any stage of the proceedings in this case, suggested that the courts should not apply the relevant principles of law to the 2007 tax year. Nevertheless, since the issue of retroactivity was mentioned by this Court in *Mount* Airy—albeit in a footnote—we will address retroactivity here.

Background

The General Assembly enacted a dollar-based threshold on the net loss deduction limitation twenty years ago. In numerous tax years since then, various affected taxpayers have challenged that threshold in Commonwealth Court on uniformity grounds. Indeed, going back as far as the 1995 tax year, the government has settled numerous cases with various taxpayers who have been affected by the net loss limitation.[20]

Prelim. Obj., in *Mount Airy #1, LLC v. Pennsylvania Dept. of Rev.,* 34 E.M. 2015, at 10.

[19] 72 P.S. § 10003.1(a). So unlike *Mount Airy,* Nextel is not seeking declaratory judgment regarding a statute. This case is an as-applied uniformity question. *See Nextel's Brief* at 37; *Nextel,* 129 A.3d at 11.

[20] *See e.g., Centocor, Inc. v. Commonwealth,* 626 F.R. 2006 (Commw. Ct.) (sole issue whether flat dollar threshold for net loss deduction disallowance violated Uniformity Clause for 2003 tax

When this issue proceeded to litigation for the 2007 tax year, the Commonwealth Court followed 100 years of precedent and held—unanimously that since the net loss limitation was a classification based on quantity, it violated the Uniformity Clause. In doing so, the court relied on "simple adherence to a straightforward reading of the Uniformity Clause."[21]

The Commonwealth Court, after finding a "straightforward" violation of the Uniformity Clause, applied that long-standing constitutional rule to Nextel's 2007 tax year and ordered a refund so that Nextel would be treated the same as 19,000 other corporations whose income fell below the $3 million threshold. That year is the only year at issue in this as-applied challenge. In fact, the record shows, in the years following 2007, "Nextel ... has no customers so it's not generating revenue, so there's not an expectation of Nextel earning revenues to utilize the loss carryforwards."[22]

For the first time in this litigation, the government argues that this "simple adherence to a straightforward reading of the Uniformity Clause" should not be (Commw. Ct.) (major issue whether flat dollar threshold for net loss deduction disallowance violated Uniformity Clause for 1995, 1998-2001 tax years; settled in 2011). *See also* various other petitioners, 527 F.R. 2007 and 75 F.R. 2008 (Commw. Ct.) (same, involving 2004-2005 tax years, settled in 2009); 570

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year; parties settled in 2010); *Ford Motor Co. v. Commonwealth,* 843, 846-851 F.R. 2007

[21] *Nextel,* 129 A.3d at 10.

[22] R.R. 14a S/F Ex. H, at R.R. at 198a, Frederick Deposition at 30:16-19. *See also* R.R. 14a S/F Ex. H, at R.R. at 182a, Frederick Deposition at 14:20-23 ("Since we haven't had income since 2008 ... we've had losses since then so we haven't been able to utilize NOLs.")

F.R. 2009, 379 F.R. 2010 (same, involving 2004 and 2005 tax years, settled in 2011). applied "retroactively" to Nextel's 2007 tax year.[23] Yet "retroactive" application of an established legal principle to past facts is the job of the courts;[24] retroactive application of the law is "overwhelmingly the norm," not the exception.[25] Retroactive application is inappropriate only if: A) a judicial interpretation establishes a new principle of law; B) retroactive application of that principle would not further the purpose of that principle; and C) fair balancing of equities favors prospective-only application of the new principle.[26] As we will show next, none of these so-called *"Chevron"* factors supports prospective-only application of the rule prohibiting quantitative classification. (In *Mount Airy,* this Court

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[23] *Government's Supplemental Brief* at 2.

[24] *Gregory v. Ashcroft,* 501 U.S. 452, 487, n. 1 (1991)(Blackmun, J., dissenting) ("A judge is first and foremost one who resolves disputes....").

[25] Richard S. Kay, *Retroactivity and Prospectivity of Judgments in American Law,* 62 Am. J. Comp. L. 37, 42 (2014) ("[I]t must be stressed ... that retroactively is 'overwhelmingly the norm.' Thus a litigant seeking prospective-only application must firmly convince a court that each factor favors such a decision.") *quoting James B. Beam Distilling Co. v. Georgia,* 501 U.S. 529, 535 (1991). *See also Harper v. Virginia Dept of Taxation,* 509 U.S. 86, 114 (1993) (O'Connor, J., dissenting) ("In the usual case, of course, retroactivity is not an issue; the courts simply apply their best understanding of current law in resolving each case....").

[26] *Oz Gas,* 938 A.2d at 278 (applying factors from *Chevron Oil Co. v. Huson,* 404 U.S. 97, 106107 (1971)) *cited* by this Court in *Mount Airy,* 34 E.M. 2015, Slip Op. at 18, n. 11. *See also American Trucking Ass'ns, Inc. v. McNulty,* 596 A.2d 784, 790 (Pa. 1991)("the factors of *Chevron Oil v. Huson* remain determinative...."); and *Automobile Trade Ass 'n of Greater Phila. v. City of Phila.,* 596 A.2d 794, 796 (Pa. 1991) (applying *Chevron* factors).

cited *Oz Gas* for the retroactivity principle; *Oz Gas* had applied the *Chevron* factors.)

A. *Nextel* does not establish a new principle of law.

The first *Chevron* factor is whether the Court's decision establishes a new principle of law. Indeed, under *Chevron,* for a "decision to be applied nonretroactively, [it] *must* establish a new principle of law."[27] The Commonwealth Court's decision in *Nextel* does not establish a new principle of law. Rather, the majority's decision was based on the "simple adherence to a straightforward reading of the Uniformity Clause." [28] The Commonwealth Court applied precedent going back over 100 years that had consistently invalidated taxes with dollar-value thresholds. For example, *Cope's Estate* invalidated a tax that included a $5,000 threshold for an estate tax;[29] *Kelley* invalidated a tax that included dollar-based thresholds for an income tax;[30] *Bethlehem Steel* invalidated a tax that included a dollar-based threshold for an occupation tax.[31] Thus, given the similarities between the $3 million net loss threshold in *Nextel* and the thresholds that had been invalidated before—and given the fact that the Commonwealth has settled numerous uniformity cases regarding the net loss threshold over the past twenty years—the

[27] *Chevron,* 404 U.S. at 106 (emphasis added).

[28] *Nextel,* 129 A.3d at 10.

[29] *Cope's Estate,* 43 A. 79.

[30] *Kelley,* 181 A. 598.

[31] *Bethlehem Steel,* 196 A.2d 664.

Commonwealth could "hardly claim surprise" that the flat-dollar threshold was unconstitutional.[32]

By contrast, a new principle of law may be applied nonretroactively only if there is "such an abrupt and fundamental shift in doctrine as to constitute an entirely new rule which in effect replaced an older one."[33] Consider the following cases that involved a "new principle of law":

- Oz Gas. In Oz Gas,[34] the case that this Court cited in *Mount Airy,*[35] taxpayers had "for nearly 100 years ... paid *ad valorem* taxes on oil and gas interests" in reliance on past precedent, which held that oil and gas was taxable as real estate.[36] The Court, in *IOGA,* changed this law by holding that oil and gas interests are not part of taxable real estate.[37] This Court concluded that the *IOGA* case, because it established a new rule of law, should be applied prospectively.

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[32] *American Trucking Assns. v. Smith,* 496 U.S. 167, 182 (1990).

[33] *Hanover Shoe, Inc. v. United Shoe Mach. Corp.,* 392 U.S. 481, 498 (1968) (although precise question under Sherman Act was not answered before, decision applied retroactively because it was not "a radically new interpretation of the Sherman Act.") *cited by Chevron,* 404 U.S. at 107.

[34] 938 A.2d 274.

[35] *Mount Airy,* No. 34 E.M. 2015, Slip Op. at 18, n. 11.

[36] *Oz Gas,* 938 A.2d at 283 ("The decision in *IOGA* established a new principle of law in that, prior to the decision, these sorts of taxes were deemed collectible pursuant to statute and precedent" so "the decision ... unsettled expectations and a long-standing governmental reliance interest.").

[37] *Independent Oil and Gas Ass'n v. Board of Assessment Appeals of Fayette County,* 814 A.2d 180 (Pa. 2002).

- *Chevron.* In *Chevron,* relied on by this Court in *Oz Gas,* a "line of federal court decisions" had established that the doctrine of laches applied to certain personal injury cases.[38] In *Chevron,* the plaintiff relied on that line of cases. But then a new case, *Rodrigue,* "entirely changed the complexion" of the law, and replaced the doctrine of laches with a one-year statute of limitations that would foreclose the Plaintiff's suit.[39] The *Chevron* Court held that because of this change in law, *Rodrigue* would be applied prospectively.
- *McNulty.*[40] *McNulty* was also relied on by this Court in *Oz Gas.*[41] In *McNulty,* the United States Supreme Court had issued a decision *(Scheiner*[42]*)* that "obviously established a new principle of law by overruling clear past precedent."[43] Former law, under *Aero Mayflower,* had allowed flat taxes on highway trucks.[44] The *Scheiner* decision reversed that long line of cases.[45] This Court in *McNulty* held that the new rule should be prospective only.[46]

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[38] *Chevron,* 404 U.S. at 99.

[39] *Id.* at 105.

[40] *McNulty,* 596 A.2d 784.

[41] *Oz Gas,* 938 A.2d at 282-285.

[42] *American Trucking Assns., Inc. v. Scheiner,* 483 U.S. 266 (1987).

[43] *McNulty,* 596 A.2d at 788.

[44] *Aero Mayflower Tansit Co. v. Georgia Public Service Comm'n,* 295 U.S. 285 (1935).

[45] *Scheiner,* 483 U.S. 266.

[46] *See also Smith,* 496 U.S. 167 (same holding regarding Alabama tax). *But see Automobile Trade Ass'n of Greater Phila.,*

Nothing like this happened in *Nextel*. *Nextel* involves a "simple adherence to a straightforward reading of the Uniformity Clause" consistent with over 100 years of precedent and a long line of settlements.

B. Applying *Nextel* to the 2007 tax year furthers the purposes of uniformity. Prospective-only application frustrates uniformity.

The second *Chevron* factor is whether retroactive application of the legal principle would not further the purpose of that principle.[47] As explained next, applying the uniformity principle retroactively to the 2007 tax year would further the purpose of uniformity. Applying that principle prospectively-only would frustrate uniformity.

1. Applying *Nextel* to the 2007 tax year furthers uniformity.

The Uniformity Clause prohibits classifications based on quantity. The purpose of the rule is to treat taxpayers the same, regardless of the quantity of their income, receipts, or wealth. In 2007, 19,303 corporations paid zero tax because their income in 2007 was below $3 million and thus they could deduct their net losses without limitation. Meanwhile, in 2007, Nextel paid almost $4 million of tax because its income in 2007 exceeded $3 million, and its net loss deductions were therefore severely limited. The purpose of the uniformity rule—to treat taxpayers the same regardless of the quantity of their income—is furthered only

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596 A.2d at 278-279. (questioning whether "lower courts' determination not to grant retroactive relief' comports with due process.)

[47] *See Chevron,* 404 U.S. at 106-107; *See also Oz Gas,* 938 A.2d at 135-136

if Nextel is allowed to deduct its net losses in 2007 in the same manner as other taxpayers whose income was $3 million or less.

Compare this with the facts of *Chevron*. *Chevron* involved a judicial decision *(Rodrigue)* that changed the law governing personal injury claims on the Outer Continental Shelf. The change switched the governing law from admiralty law to state law. The purpose of the change "was to aid injured employees by affording them comprehensive and familiar remedies" provided under state law.[48] Yet as applied to the plaintiff in *Chevron,* the new rule had the effect of shortening the statute of limitations from multiple years (under the old rule) to one year (under the new rule). The Court concluded that to adopt that rule retroactively to the plaintiff would "abruptly terminate" the plaintiff's lawsuit and would be "inimical to the ... purpose" of the new rule. Thus, to further the purpose of the new rule, the Court ordered that the new rule be applied prospectively only.

Chevron thus is completely different than Nextel. Nextel paid tax because its income exceeded the $3 million threshold. The purpose of the Uniformity Clause is that taxpayers are not classified based on quantity of income. To further that rule, the tax that Nextel paid should be refunded to Nextel so that it pays tax for 2007 on the same basis as the 19,000 other comparable taxpayers who had $3 million or less in income.

2. Nonretroactivity, if applied to questions of quantitative classification, would frustrate uniformity.

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[48] *Chevron,* 404 U.S. at 107-108.

Furthermore, nonretroactivity would be "inimical to the ... purpose" of uniformity. There are two reasons for this.

(a) Many taxpayers would have no remedy.

In this case, the only year at issue in this case—and the only year that matters for Nextel—is 2007. The record in this case shows that Nextel did not have taxable income after 2008.[49] If Nextel does not get relief for the discrimination it suffered in 2007, it will not benefit from the litigation. Likewise, any income-tax taxpayer that recognizes a one-time gain, or who has income over a limited period of time, will never be able to vindicate its rights under the Uniformity Clause if it is enforced only prospectively.

Similarly, consider estate taxes, which were at issue in *Cope's Estate.* That case is the seminal Uniformity Clause case that this Court relied on in *Mount Airy.*[50] If this Court only ever enforced the Uniformity Clause prospectively, no estate would have any incentive to ever bring a uniformity challenge. After all, the imposition of the estate tax is a singular event in the "life" of an estate.[51]

Thus, prospective-only application of the rule against quantitative classification would frustrate, not

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[49] R.R. 14a S/F Ex. H, at R.R. at 182a, Frederick Dep. at 14:20-23 ("Since we haven't had income since 2008 ... we've had losses since then so we haven't been able to utilize NOLs.")

[50] *Mount Airy,* No. 34 E.M. 2015, Slip Op. at 11-12 *discussing Cope's Estate,* 43 A. 79.

[51] Indeed, the prohibition against quantitative classification was applied retroactively in *Cope's Estate. See* text accompanying footnote 86.

further, uniformity because many taxpayers would be entirely foreclosed from a remedy.

(b) A general policy of nonretroactivity would incentivize the General Assembly to classify based on quantity.

Tax litigation often takes between five and six years. Indeed, Nextel's refund claim, for example, was filed in 2011. If this Court offers only prospective relief in a uniformity case, the General Assembly will be able to collect and keep many years' worth of discriminatory tax revenues. That would incentivize the General Assembly to adopt non-uniform laws that classify based on quantity because the Commonwealth could retain taxes collected during the pendency of any litigation.

C. Balancing equities favors application to Nextel's 2007 tax year.

The third *Chevron* factor involves a balancing of equities.[52] Most typically, courts have found it inequitable to retroactively impose an abrupt law change on a litigant who has reasonably relied on old law. In those cases, if the benefits of the new rule do not offset the burden on the litigant who has been taken by surprise—and if the purpose of the rule will be fulfilled by prospective application in any event—the courts will apply the change prospectively. In Nextel's case, there is no abrupt law change, so there is nothing

[52] *Oz Gas,* 938 A.2d at 279, *citing Chevron,* 404 U.S. at 135. *See also Chevron,* 404 U.S. at 107. Note, the Court balances the *equities,* not the burdens. A losing litigant is always burdened if that litigant has acted unlawfully. See text accompanying footnote 65.

to balance. The Uniformity Clause has prohibited quantitative classifications for over 100 years.

In addition, in a limited number of tax cases, even if there is no change to a principle of law, this Court has applied decisions prospectively if—and only if—retroactive application would severely burden a local tax authority (with limited means to fill a revenue gap), and prospective application will still provide a significant, meaningful remedy to the taxpayer.[53]

As discussed next, in Nextel's case there is no special burden on a local taxing authority. Indeed, the classification at issue is a state-tax classification, and it has been the subject of litigation and settlement for 20 years—allowing the Commonwealth plenty of time to plan for any refunds. Therefore, there is nothing inequitable about applying *Nextel* retroactively. Further, unlike the taxpayers in the local tax uniformity cases decided by this Court, there will be no remedy whatsoever to Nextel with prospective-only application. We discuss these two points in detail next.

1. Retroactivity does not produce the kind of burden that this Court has sought to avoid.

In *Mount Airy,* this Court ordered that its decision be applied prospectively. That case involved millions of dollars of annual tax revenue to be distributed to Mount Pocono, Pennsylvania. Mount Pocono borough, in the 2010 census, had a population of 3,170

[53] Of course, it is far more common for our courts to interpret the tax law to past tax years, which, after all, is the principal business of the courts.

residents.[54] The retroactive loss of revenue from the invalidation of the casino tax would severely impact that locality. Similarly, *Clifton v. Allegheny County*[55] involved a county-wide property tax that generated a substantial portion of that county's overall revenue.[56] A retroactive refund of that tax would have severely impacted the county. *Oz Gas* involved property taxes imposed by Warren County and certain rural school districts and townships. A retroactive refund of tax on mineral rights would severely impact those localities.

In each of these cases, the "financial hardship to the communities involved" was relevant to its decision to apply the decision prospectively only.[57] This Court is sensitive to the burdens on localities, not only because they are small, relative to the state, but also because localities are limited in their ability to raise revenue from alternative sources. For example, localities are only authorized to impose certain kinds of taxes,[58] and

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[54] *See* Mount Pocono borough's population in 2010 by clicking "Pennsylvania" on *http://www.census.gov/popest/data/cities/totals/2015/SUB-EST2015.html.*

[55] 969 A.2d 1197 (Pa. 2009).

[56] For example, for 2012, the earliest year for which data is publicly available, property tax revenues in Allegheny County accounted for $341 million out of total budget of $799 million (i.e., 42.6% of county's total budget for the year). *See http://www.alleghenycounty.us/budget-finance/county-budgets.aspx,* Allegheny County's 2012 Operating Budget at 15-16.

[57] *Oz Gas,* 938 A.2d at 283, 285 ("refunding of the taxes would cause substantial financial hardship to the communities involved.";"to apply such a decision retroactively ... subjects the taxing entities to ... potentially devastating repercussion of having to refund taxes ....").

[58] Local taxes must be authorized by the state. For example, many localities are limited to taxes authorized by the Local Tax Enabling Act (53 P.S. §§ 6924.101 *et seq.).*

are not free to impose any tax that is already imposed at the state level.[59] And for limited taxes that localities may impose, significant restrictions apply.[60] Thus, this Court recognizes the special burden that a retroactive interpretation of law would have on a locality because of its size and its limited means to raise replacement revenue.

By contrast, this case involves a state tax. The only issue is whether Nextel was treated non-uniformly in 2007 and is therefore entitled to a refund of $4 million to put it on par with other taxpayers in that year.[61] That $4 million, which relative to the Commonwealth's $54 billion annual budget, is not a burden comparable to the burden imposed on localities.[62]

Despite this, the government, in its brief, has exaggerated the financial stakes involved this case—presumably for strategic purposes—arguing that the

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[59] 53 P.S. § 6924.305 (conferring upon political subdivisions "the power to levy, assess and collect taxes upon . . . subjects of taxation . . . which the Commonwealth has power to tax but which it does not tax or license . . .").

[60] *See, e.g.* 53 P.S. § 6924.311(imposing limitations on the rates of certain taxes); 53 P.S. § 6924.301.1 (imposing limitations on the aggregate amount of all taxes imposed).

[61] Unlike *Mount Airy,* Nextel has not asked this Court to "invalidate" a tax statute. *Compare* Brief for Appellee, Nextel, 6 E.A.P. 2016, at 37 and *Nextel Communications of the Mid-Atlantic, Inc. v. Commonwealth,* 129 A.3d 1, 11 (2015) with *Mount Airy,* No. 34 E.M. 2015, Slip Op. at 3 ("Mount Airy seeks a declaratory judgment that the [tax] violates the Uniformity Clause ... facially....").

[62] *See http://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Pages/PastBudgets2015-16To2006-07.aspx,* 2006-07 Enacted Budget Slide Presentation.

implications of this case are $500 million.[63] Yet that number is not a matter of record, because the government did not raise this issue at any stage of the litigation, so neither Nextel nor this Court has any way to evaluate it.[64] For example, does that number represent forgone revenue that may be lost over many years? Does the number include refunds—and how does that number take into account the fact that the statute of limitations has expired for most refund claims? Does that number take into account the fact that 2016 and other recent and future tax years may be the subject of corrective legislation by the General Assembly? Does that number assume that every corporate taxpayer with a net loss will be permanently harmed by the net loss limitation and thus will file a refund claim? That number is, therefore, an inappropriate basis for this Court to decide this case.

But even if that were in fact an accurate estimate of the Commonwealth's exposure, the Commonwealth has a wide variety of tools to deal with that burden, which in any event, amounts to a very small fraction of the state's overall budget.[65] Indeed, even if faced with a burden of that magnitude, the Commonwealth,

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[63] *Government's Supplemental Brief,* at 15.

[64] See Section III.E of this brief.

[65] For example, if the $500 million amount reflects possible refunds, those refunds would be payable over at least three years given Pennsylvania's three year statute of limitations for refund claims under 72 P.S. § 10003.1(a). Thus, it represents at most 0.2% of the Commonwealth's $217.1 billion budget over a three year period. *See* 2015-2016 total operating budget of $78.6 billion at *http://budgetfiles.pa.gov/budget2015/GBD2015.html;* 2014-2015 total operating budget of $71.8 billion at *http://budgetfiles.pa.gov/budget2014/GBD2014.html;* 2013-2014 total operating budget of $66.7 billion at *http://budgetfiles.pa.gov/budget2013e/GBD_2013 e.html.*

unlike local governments, has plenary powers of taxation, and can increase tax rates and impose whatever taxes are necessary (including by taxing corporations)—limited only by the state and federal constitutions.[66]

Finally, and most importantly, this Court should ascribe little weight to the Commonwealth's financial burden, since the state has for over a decade been on notice of the exposure related to the constitutional problems with the net loss threshold and has had the opportunity to minimize the exposure.[67] Thus, this case contrasts with *McNulty,* a case in which the Commonwealth had reasonably relied on a prior United States Supreme Court case *(Aero Mayflower)*

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[66] For example, the General Assembly enacted Act 21 of 1989, P.L. 95, § 1, imposing ten-fold tax rate increase on pay for refunds of bank shares tax after *Dale National Bank v. Commonwealth,* 465 A.2d 965 (Pa. 1983) and *First National Bank of Fredericksburg v. Commonwealth,* 553 A.2d 937 (Pa. 1989). *See Fidelity Bank, NA. v. Commonwealth,* 645 A.2d 452, 462 (Pa. Commw. 1994) ("The 1989 amendments to the bank shares tax was designed to recoup for the Commonwealth revenue that they lost because of credits given in compliance with *Fredericksburg.")*.

[67] *McKesson Corporation v. Division of Alcoholic Beverages and Tobacco, Department of Business Regulation of Florida,* 496 U.S. 18, 44-45 (1990) ("We do not find this [financial burden] concern weighty in these circumstances. A State's freedom to impose various procedural requirements on actions for [refund] relief sufficiently meets this concern with respect to future cases. The State might, for example, . . . enforce relatively short statutes of limitations ...and/or place challenged tax payments into an escrow account . . . [the State's] failure to avail itself of certain of these methods of self-protection weakens any 'equitable' justification for avoiding its constitutional obligation to provide relief."); *Automobile Trade Ass'n of Greater Philadelphia,* 596 A.2d at 797 (citing *McKesson* and rejecting the "conclusory assertion that requiring refunds would impose a substantial hardship on the City's budget").

that had explicitly sustained highway use taxes. Nextel's case is more like *McKesson,* a case involving a wholesale liquor distributor who alleged that Florida's liquor excise tax provided preferential treatment for beverages that were manufactured from certain "Florida-grown" citrus and other agricultural crops, and thus violated the Commerce Clause of the United States Constitution.[68] In that case, other, similar taxes had been struck down by the Court—just like this Court has struck down quantitative thresholds in the past. The United States Supreme Court in *McKesson* was unconvinced by the potential financial hardship to the state.[69] The Supreme Court observed that the loss of revenue was not a surprise to Florida, which could therefore avail itself to procedural protections to minimize its exposure to allow for sound fiscal planning while maintaining relief for taxes unlawfully collected.[70]

Similarly, in Nextel's case, the government was on notice of the uniformity issues with the net loss threshold for almost the entire period during which it has been on the books. As discussed above, there has been a case pending regarding the uniformity of the net loss cap covering many of the past 20 tax years the threshold has been in effect.[71] Despite this notice, the government failed to take procedural protections, such as placing such challenged tax payments into an escrow account or shortening the statute of limitations.[72] Therefore, even if it is appropriate to weigh

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[68] *McKesson,* 496 U.S. at 22-23.

[69] *McKesson,* 496 U.S. at 44-45.

[70] *McKesson,* 496 U.S. at 44-46.

[71] *See* footnote 20.

[72] *McKesson,* 496 U.S. at 45.

the financial burdens, this Court should discount the weight of the state's financial burden in this case because the government brought that hardship upon itself by persisting with an unconstitutional (or at least questionably unconstitutional) quantitative classification.

2. Unless *Nextel* is applied retroactively to the 2007 tax year, Nextel will have no remedy.

In each of the special cases in which this Court ordered prospective-only relief, the taxpayer-litigant benefitted from the prospective-only treatment. For example, in *Mount Airy,* the taxpayer continues to "operate[] a licensed facility (as defined under the Gaming Act),"[73] and thus benefits from the prospective declaration by this Court that the casino tax is unconstitutional.[74] Therefore, as a going concern that it would continue to be subject to that tax—year in and year out—Mount Airy benefitted from this Court's declaration, even if that declaration is nonretroactive.

Similarly, in *Oz Gas,* the taxpayer continued to own real estate with oil and gas interests, and would benefit from a prospective exclusion of the value of oil and gas from the tax base.[75] Likewise, in *Clifton,* the

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[73] See Petitioner's Application for Relief in the Nature of Complaint or Declaratory and Other Relief Under 4 Pa.C.S. § 1904 of Mount Airy #1, LLC in *Mount Airy #1, LLC v. Pennsylvania Department of Revenue,* 34 E.M. 2015, at ¶ 13 at p. 4.

[74] Indeed, Mount Airy specifically (and principally) requested "declaratory judgment concerning the constitutionality of municipal assessment under the Gaming Act. *Id.* at ¶ 6 at p. 3.

[75] *Oz Gas,* 938 A.2d at 283 (observing that Oz Gas will receive "substantial relief even from prospective-only application as they will not be subject to this tax going forward").

taxpayers were property owners who continued to own property and who would benefit from uniform revaluation of their properties.[76] And in *Smith* and *McNulty,* the taxpayers were associations of trucking companies, whose members would continue to operate trucks and who would benefit from the prospective invalidation of the axle tax.[77]

Nextel's case contrasts with all of these. For Nextel, the limit on the deductibility of a net loss was a "one-time" problem that manifested itself in 2007. The record shows that Nextel made various investments in its cellular network that generated losses of $150 million.[78] In 2007, the tax year at issue, Nextel generated income of $45 million.[79] After that, the record shows, Nextel generated very little income.[80] Indeed, as the record shows, "Nextel ... has no customers so it's not generating revenue, so there's not an expectation of Nextel earning revenues to utilize the loss carryforwards."[81] Nextel would have no remedy for the uniformity problem ifa uniformity violation is only susceptible to a prospective remedy. This case is about whether Nextel can deduct losses, in full, against income in 2007.

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[76] *Clifton,* 969 A.2d 1197.

[77] *Smith,* 496 U.S. 167; *McNulty,* 596 A.2d 784.

[78] R.R. 14a S/F ¶ 10 at R.R, 16a.

[79] R.R. 14a S/F ¶ 11 at R.R. 16a.

[80] R.R. 14a S/F Ex. H, at R.R. at 182a, Frederick Deposition at 14:20-23 ("Since we haven't had income since 2008 ... we've had losses since then so we haven't been able to utilize [net losses].")

[81] R.R. 14a S/F Ex. H, at R.R. at 198a, Frederick Deposition at 30:16-19.

D. Unless a court is changing the law, Due Process requires it to apply existing law to litigants before it.

Courts "are as a general matter in the business of applying settled principles and precedents of law to the disputes that come to bar."[82] It is only if a court announces a change in law "that an assertion of nonretroactivity may be entertained...."[83] So if a state court announces a *change* in law, the Due Process Clause does not require that change be applied retrospectively.[84]

Yet if a matter comes before a court, and the resolution of the matter involves "straightforward" application of existing law, there is no place for "nonretroactivity." The litigant is entitled to a have that law applied to him or her.[85]

Consistent with these principles, when this Court has in the past issued a decision that involves the straightforward application of settled tax uniformity principles to a tax period in the past, it has provided the litigant with a remedy—which is necessarily "retroactive." For example, consider *Cope's Estate—the* case that this Court relied on in *Mount Airy.* In *Cope's Estate,* Marmaduke Cope died in 1897.[86] Two

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[82] *James Beam,* 501 U.S. at 534.

[83] *Id.* at 534.

[84] *Great Northern Railway Co. v. Sunburst Oil & Refining Co.,* 287 U.S. 358, 364 (1932) ("This is a case where a court has refused to make its ruling [changing the law] retroactive.... We think the federal constitution has no voice upon the subject.").

[85] U.S. Const., Amdt. 14, § 1.

[86] *Cope's Estate,* 43 A. at 79; *Cope's Estate,* Opinion of the Orphans' Court on the Exceptions and Decree Thereon (November 26, 1898). *See* Attached as Exhibit A.

years later, in 1899, this Court held that the direct inheritance tax was unconstitutional. This Court affirmed the Orphans' Court's decision, which had "retroactively" stricken the tax as applied to Cope's 1897 inheritance.[87] Similarly, in *Commonwealth v. Budd* Co.,[88] this Court, in 1954, ordered a reduction of Budd's 1944 taxes after holding that a statutory limitation on the timing of a net loss carryback violated the Uniformity Clause.

Nextel's case involves a similar straightforward application of long-standing uniformity law. The law prohibits classification based on quantity. Nextel paid tax as a result of that unlawful classification. Nextel timely petitioned for refund of the tax resulting from that unlawful classification and followed the process established by statute to remedy that wrong. Nextel is therefore entitled to an order for the refund of that tax—otherwise there has been no "due process of law."

Additionally, as a matter of due process, Nextel's entitlement to relief cannot hinge on whether the government is burdened by tax refunds. Pennsylvania law affords taxpayers a choice between filing an appeal before paying tax ("predeprivation") and filing an appeal after paying tax ("postdeprivation"). So Nextel had two choices here:

- Predeprivation remedy: Nextel could have disregarded the net loss disallowance on its original return and paid $0 tax on its original return,

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[87] *Id*. at 83.

[88] *Commonwealth v. Budd Co.,* 63 Dauph. 164 (1952), *aff'd,* 108 A.2d 563 (Pa. 1954) (in 1954, this Court affirmed the trial court's order that Budd's 1944 taxes be "resettled"—i.e., recalculated). The trial court's decision and order is attached at Exhibit B.

which would have been assessed by the government, and which Nextel could have challenged.

- Postdeprivation remedy: Nextel could have reported and paid its tax consistent with the statutory net loss disallowance provision, then filed a refund petition.[89] This, of course, is the route Nextel chose.

The Commonwealth certainly had "the flexibility to maintain an exclusively predeprivation (i.e., no refund) remedial scheme, so long as that scheme is 'clear and certain.'"[90] In that case, there would have been no exposure to refunds. However, under the United States Supreme Court's decision in *Newsweek,* due process is violated if the Commonwealth were allowed to "bait and switch" the taxpayer "by holding out what plainly appears to be a clear and certain postdeprivation remedy" (i.e., the refund process) and "then declare, only after the disputed taxes have been paid, that no such remedy exists."[91] If the state changes the rules of the game during the course of a tax dispute, that violates due process.[92] Thus, as a matter of due process, Nextel cannot be penalized because it chose to pay the tax and file a refund claim.[93]

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[89] 72 P.S. § 10003.1(a).

[90] *Newsweek, Inc. v. Florida Dept of Revenue,* 522 U.S. 442, 444 (1998).

[91] *Id.* (internal quotations omitted).

[92] *Harper v. Virginia Department of Taxation,* 509 U.S. 86, 102 (1993).

[93] *Newsweek,* 522 U.S. at 445 (it "reasonably relied on the apparent availability of a postpayment refund when paying the tax.").

E. The government has waived the issue of nonretroactivity.

This tax refund matter is over five years old. The government has never, at any stage of the proceedings, made an argument that Nextel's interpretation of the law—if it is correct—should be applied nonretroactively. Now, for the first time in the supplemental briefing, the government argues that a decision in favor of Nextel should not apply to Nextel. Yet since the Commonwealth did not raise this issue at trial, there is nothing in the record that the Commonwealth can use to meet its burden of establishing nonretroactivity.[94] Nothing in the record establishes an unreasonable burden on the Commonwealth. Nothing in the record supports any "surprise" on the Commonwealth.

Procedurally, therefore, the government has waived this argument, and the government has not met its burden of proof. The waiver is not a mere technical foot-fault by the government. The government, by not raising the issue has failed to develop the legal framework and factual record that would support a prospective-only application of the law. Indeed, the government failed to raise this issue at every key stage of the litigation where it was required to do so:

- *The government waived the issue at the trial court.* The government did not raise the issue of nonretroactivity before the Commonwealth Court, which serves as the trial court in state tax matters.[95] In a state tax case, under Pa. R.A.P.

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[94] It is the burden on the party seeking nonretroactivity to establish that nonretroactivity is appropriate. See footnote 25, supra.

[95] *Consol. Rail Corp. v. Commonwealth,* 670 A. 2d 722 (Pa. Commw. 1996); Pa.R.A.P. 302(a) ("Issues not raised in the trial

1571(c), a taxpayer files a petition for review with the Commonwealth Court raising questions for the court to decide; the government may, in turn, raise additional issues—but is required to do so within 20 days of the trial. Pa. R.A.P. 1571(e). The parties create the record through a stipulation of facts. Pa. R.A.P. 1571(f). The stipulated factual record does not contain any facts that would support nonretroactivity. And no lower-court brief argues for nonretroactivity.[96]

- *The government waived the issue on exceptions.* After the Commonwealth Court ruled against the government, the government was required to file exceptions. Under Pa. R.A.P. 1571(i), issues "not raised on exceptions are waived and cannot be raised on appeal." In this case, the government did not raise, in its exceptions, any argument regarding nonretroactivity.
- *The government waived the issue on appeal to this Court.* After the Commonwealth Court rejected the government's exceptions, the government filed an appeal with this Court. In connection with that appeal, the government filed a *Jurisdictional Statement* which included

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court are waived and cannot be raised for the first time on appeal."); *Piper Grp., Inc. v. Bedminster Twp. Bd. of Sup'rs,* 30 A.3d 1083, 1097 (Pa. 2011) ("This issue is waived, because it was not raised in the trial court. Pa.R.A.P. 302(a) . . .") (internal quotations omitted).

[96] Pa. R.A.P. 2116(a)("No question will be considered unless it is stated in the statement of the questions involved or is fairly suggested thereby.").

"questions presented for review."[97] The government did not include the issue of nonretroactivity in that statement. Under Pa. R.A.P. 910(a)(5), only questions in that statement will ordinarily be considered by this Court.

- *The government waived the issue in its principal brief to this Court.* Finally, in its principal brief to this Court, the government did not discuss the issue of nonretroacivity. Under Pa. R.A.P. 2116(a), "kilo question will be considered unless it is stated in the statement of questions involved or is fairly suggested thereby."

The Commonwealth has, therefore, waived the question of nonretroactivity.

Conclusion

Typically, an appeal comes to this Court because this Court selects it to decide an important question of law. But in a state tax case, the losing party may come here as a matter of right. Thus, the fact that Nextel's appeal is here does not mean that this Court has determined that this case is an appropriate vehicle to decide the facial validity of a statute or to answer questions like nonretroactivity.

Indeed, Nextel's case is not the appropriate case to decide either. Nextel's case involves a single taxpayer with unique facts, challenging the disallowance of its net losses in a single tax year-2007. Neither Nextel nor the government has developed a record that would make this case an appropriate vehicle for deciding

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[97] *See* Jurisdictional Statement for Appellant, Commonwealth of Pennsylvania in *Nextel Commc'ns of the Mid-Atlantic v. Commonwealth,* 6 E.A.P. 2016, ¶ 5(b).

whether the net loss disallowance provision is unconstitutional for all taxpayers for all tax years. And Nextel is not an appropriate case to decide principles of nonretroactivity. The record is woefully deficient to make the government's point on that issue. Thus, this Court should affirm the Commonwealth Court's decision, which dealt solely with Nextel's as-applied case for the 2007 tax year.

If more needs to be done, that can be done later. If the net loss statute ought to be changed prospectively, the General Assembly can do that. If other taxpayers in other tax years believe they are like Nextel, they may develop a record and prove it. Indeed, in such a case, if the government truly believes its newfound nonretroactivity theory, it may develop a record and prove it.

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APPENDIX N

IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 6 EAP 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,

Appellee,

v.

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF REVENUE,

Appellant.

SUPPLEMENTAL REPLY BRIEF FOR APPELLANT

APPEAL FROM THE ORDER OF THE
COMMONWEALTH COURT
ENTERED ON DECEMBER 30, 2015
AT NO. 98 F.R. 2012

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* * *

II. ANY RELIEF IN THIS APPEAL SHOULD BE PROSPECTIVE BASED ON THE PRINCIPLE THAT DECISIONS CONSTITUTIONALLY INVALIDATING A TAX STATUTE TAKE EFFECT AS OF THE DECISION DATE AND ARE NOT APPLIED RETROACTIVELY.

In *Mt. Airy*, the Court reiterated the principle that "a decision of this Court invalidating a tax statute takes effect as of the date of the decision and is not to be applied retroactively." *Mt. Airy*, Slip Op. at 18, n.11, 2016 WL 6210519 at *8 (citing *Oz Gas Ltd. v. Warren Area School District*, 938 A.2d 274, 285 (Pa. 2007)); *see also American Trucking Assoc., Inc., et al. v. McNulty*, 596 A.2d 784, 790 (Pa. 1991). In our supplemental brief, applying *Oz Gas* and its progeny, we detailed how, if this Court upholds the Commonwealth Court's decision below, that principle is applicable in this action. Nextel, in challenging application of that principle here, refers to each prong of the three-part test discussed in *Oz Gas*. We will do the same.

The first prong in *Oz Gas* looks to whether the decision establishes a new principle of law. *Oz Gas,* 938 A.2d at 282. Nextel repeatedly asserts in its Supplemental Brief that the Commonwealth Court decision below does not establish a new principle of law, but mere repetition does not make it so. For corporate net income tax purposes, the standard for uniform tax rates applies to the *statutory* – not *effective* – tax rates. *See, e.g., Turco Paint*, 184 A. at 40; *Warner Bros. Theatres,* 27 at 64; *Westinghouse Electric Corp.*, 386 A.2d 491 (Pa. 1978). Nextel asks this Court to import a uniformity analysis designed for personal taxes into the very different context of corporate taxes, even though this notion was explicitly

rejected in *Amidon v. Kane*, 279 A.2d at 63. Accepting Nextel's effective tax rate analysis and allowing the Commonwealth Court's error to stand would be a fundamental shift in existing law.

The second *Oz Gas* prong examines whether retroactive application of the decision would forward the operation of the decision. Applying this prong, this Court has explained that retroactive application would not forward the operation of a decision when, as here, the decision clearly establishes that the taxes are uncollectable going forward. *Oz Gas*, 938 A.2d at 283. Nextel seeks to escape this prong by suggesting that it is not met where it and other taxpayers may have no remedy. There are a number of problems with this suggestion.

First, Nextel analogizes the corporate net income tax to a "singular event" tax, similar to the estate tax in *Cope's Estate*. Nextel Supplemental Brief at 19. However, the corporate net income tax is not at all similar to a singular event tax; this is demonstrated by Nextel's own activities. Prior to 2007, Nextel invested nearly $2 billion on its infrastructure, R.R. 192a-193a (Dep. pp. 24-25), with the expectation that, eventually, its investment would be profitable, R.R. 180a (Dep. p.12, lines 13-20). Obviously, Nextel did not anticipate recovering its investment costs in a single year. Further, the net loss deduction provision grants a 20-year carryover period for net losses incurred after 1998, giving corporations up to twenty years to recover a loss incurred in each year. 72 P.S. § 7401(3)4.(c)(2)(A). Thus, it is quite wrong to suggest that the corporate net income tax is a "singular event" tax.

The second problem with Nextel's contention is that proper application of the second *Oz Gas* prong should

not be impacted by the fact that Nextel is currently operating an unsuccessful business model. Nextel still has employees and property in Pennsylvania. R.R. 199a, (Dep. p.31, lines 1-4, 16-21). Moreover, Sprint, the parent company, is still profitable, R.R. 198a (Dep. p.30, lines 20-22), and could implement a profitable business through Nextel, R.R. 206a (Dep.38, lines 9-11).

Finally and more fundamentally, the second prong contemplates whether denying a refund would have the effect of discouraging litigants generally. *Oz Gas*, 938 A.2d at 284. Considering the lifespans of corporations and the fluctuations of corporation activity, Nextel and other corporations would benefit from an unlimited net loss deduction, even if such relief were granted on a prospective-only basis.

The last of the *Oz Gas* prongs considers the equities. The Court has made it clear that "[t]o apply such a decision retroactively, however, subjects the taxing entities to potentially devastating repercussions of having to refund taxes paid, budgeted and already spent." *Oz Gas*, 938 A.2d at 285. As the Commonwealth presented in our supplemental brief, the budgetary repercussions of having to refund this tax revenue is demonstrated by the Commonwealth of Pennsylvania's 2016 General Obligation Bond disclosure, estimating that the Commonwealth's exposure on this net loss deduction cap issue could result in refunds exceeding $500 million.[2]

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[2] *See* COMMONWEALTH OF PENNSYLVANIA, "Official Statement: $988,175,000 General Obligation Bonds," p. 58-59 (June 1, 2016), *available at* http://www.budget.pa.gov/PublicationsAndReports/InvestorInformation/Documents/May%202016%20Bond%20Sale/OS_Final_5-2016.pdf.

Nextel challenges these equities, first by questioning the $500 million figure because it is not a matter of record. Nextel Supplemental Brief at 23. The $500 million estimate is a public record and the Court may take judicial notice of such records. *In re F.B.*, 726 A.2d 361, 366 n .8 (Pa. 1999). The estimate takes into account refunds that would be owed if an unlimited net loss deduction were granted in the appeals that have been held pending the outcome of this case.[3] This estimate also considers refunds that would be owed for other appeals that can still be filed within the three-year refund appeal period. In fact, the Commonwealth's overall financial exposure would be even greater than the $500 million estimate considering foregone revenue in future tax years – which would not result in "refunds" – if an unlimited deduction is permitted. Nextel also ignores that the third prong is not merely a consideration of the impact of the refunds to the overall budget, but rather the fact that these monies have been budgeted and spent by the Commonwealth for the benefit of all, and that having to refund taxes retroactively would have a devastating effect on the Commonwealth.

Finally, Nextel asserts that these equities should somehow be discounted because the Commonwealth was put on notice of the alleged exposure at issue. In support of this assertion, Nextel points to past appeals and certain settlements concerning those appeals. However, simply filing an appeal is not a means of

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[3] The docketing statement for *Commonwealth v. Ford Motor Company*, No. 846 F.R. 2016, lists approximately two hundred appeals that were known to be held pending a decision in this appeal as of December 22, 2016. *See* Exhibit A. There are undoubtedly even more cases that would be affected if this Court upholds the Commonwealth Court's decision.

putting the Commonwealth on notice that a particular statute is unconstitutional. The Commonwealth receives many such appeals, and many are settled for nominal amounts simply because they are not worth the cost of litigation. As the Commonwealth has explained in detail throughout, the uniformity analysis asserted by Nextel and adopted by the Commonwealth Court is in direct conflict with decades of this Court's clear precedent. Previous appeals that were settled without litigation certainly did not put the Commonwealth on notice of such a striking alteration to existing law.

III. DUE PROCESS DOES NOT FORECLOSE PROSPECTIVE RELIEF IN THIS ACTION.

Nextel makes one other assertion concerning prospective relief which requires a brief response. Specifically, Nextel asserts that due process forecloses prospective relief. It does not.

First and foremost, even Nextel acknowledges that where a state court announces a change in law, due process does not require retrospective application of that change. Nextel Supplemental Brief, p. 29. That is this case. Moreover, it is axiomatic that the federal constitution is silent on the subject of whether a state court may decline to give its decisions retroactive effect, and that where, as here, questions of state law are at issue, state courts make that determination pursuant to their discretion on a case-by-case basis. *American Trucking Assoc. v. Smith*, 496 U.S. 167, 177 (1990) (plurality); *August v. Stasak*, 424 A.2d 1328, 1330 (Pa. 1981) (citing *Linkletter v. Walker*, 381 U.S. 618 (1965)). Nextel seeks to circumvent these principles by suggesting that this action is similar to the Supreme Court's decision in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco of Florida, et al.*, 496 U.S. 18 (1990). It is not.

McKesson involved a state tax statute that was held invalid under the federal Commerce Clause. In that action, where the state clearly violated settled federal law, it was obligated to provide relief consistent with federal law. *See McKesson,* 496 U.S. at 36-43. In the *Smith* decision, decided the same day as *McKesson*, the Court emphasized that under such circumstances, equitable considerations play only the most limited role in delineating the scope of relief. *Smith,* 496 U.S. at 181. The Court in *Smith* also emphasized "of course we had no occasion to consider the equities of retroactive application of new law in *McKesson* because that case involved only the application of settled Commerce Clause precedent." *Id*. The *Smith* decision also pointed out that in *McKesson*, "the State enacted a tax scheme that 'was virtually identical to the Hawaii scheme'" that had been invalidated pursuant to federal law six years earlier. *Id*. at 182 (quoting *McKesson*, 496 U.S. at 46). Nothing like that has occurred here. This action does not involve the finding of federal unconstitutionality based on settled law. This action involves a fundamental alteration in state law by the Commonwealth Court. It is either to be adopted or rejected by the Court. The *Smith* decision made clear that, even in the federal context, where "the State cannot be expected to foresee that a decision . . . would overturn established precedents, the inequity of unsettling actions taken in reliance on those precedents is apparent." *Smith,* 496 U.S. at 182.

Here, it is up to the Court to determine whether its decision is to be given prospective effect. In *American Trucking Associations, Inc., et al. v. McNulty*, 596 A.2d 784 (Pa. 1991), this Court was presented with an argument by taxpayers remarkably similar to that presented by Nextel – that the Commonwealth had a mandatory duty to make refunds in accordance with

the statutes and stipulations[4] if the tax was paid, timely challenged, and then held to be unconstitutional. *McNulty*, 596 A.2d at 787. The Court in *McNulty* responded:

> The deficiency in this argument is that it fails to perceive the effect of a declaration that a ruling is to be applied purely prospectively . . . [I]t is as though the taxes collected prior to the date of the . . . decision were not unconstitutional . . . [T]he holding of unconstitutionality applies *from the date of the decision*, and not before. A decision on the retroactive or prospective effect . . . is thus indispensable to determining whether the statutes or the stipulations require that refunds be made.

McNulty, 596 A.2d at 787 (emphasis in original). Pursuant to *McNulty* and *Oz Gas*, if this Court determines that an adverse decision in this action is purely prospective, then Nextel is not, as a matter of law, legally entitled to any refund.

As detailed above, application of the *Oz Gas* tests clearly weighs in favor of prospectively relief, and in this state law context due process does not come into play at all. Therefore, if this Court holds that the net loss deduction cap violates uniformity and allows an unlimited net loss deduction, such relief should be prospective-only.

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[4] It is worth noting that, unlike the parties in *McNulty*, neither the Commonwealth nor Nextel stipulated to a refund outcome in this appeal.

CONCLUSION

The Court should reverse the judgment of the Commonwealth Court. In the alternative, the remedy for any constitutional disparity should be the severing of the dollar cap on the net loss deduction leaving the percentage cap in place.

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APPENDIX O

IN THE SUPREME COURT OF PENNSYLVANIA

No. 6 E.A.P. 2016

NEXTEL COMMUNICATIONS OF THE MID-ATLANTIC, INC.,
Appellee,

v.

COMMONWEALTH OF PENNSYLVANIA,
Appellant.

APPELLEE'S APPLICATION FOR REARGUMENT with APPLICATION FOR CONSOLIDATION with R.B. ALDEN CORP. v. COMMONWEALTH, 60 MAP 2017 or with APPLICATION FOR REMAND TO CORRECT A FACTUAL ERROR

Application Related to the Opinion and Order of this Court entered on October 18, 2017, at No. 6 E.A.P. 2016, affirming in part and reversing in part the Order of the Commonwealth Court, entered on December 30, 2015, at No. 98 F.R. 2012

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* * *

C. The Court's opinion violates the Due Process Clause of the United States Constitution.

The Due Process Clause of the United States Constitution prevents a state from "depriv[ing] any person of . . . property, without due process of law."[13] If an interest is protected by state law,[14] the Due Process Clause prevents the state from depriving a person of that protected interest without due process even if federal law would not independently protect the interest. For example, in *Board of Pardons v. Allen*, the United States Supreme Court held that even though federal law does not provide a right to parole, a state deprives prisoners of liberty if state law entitles prisoners to parole yet the state refuses to carry out that state law.[15]

This case undoubtedly involves the taking of property—$4 million of Nextel's money. The state took that property in a way that this Court determined violated state law—namely, other similarly situated taxpayers in 2007 were not similarly deprived of property. This Court acknowledged that the Commonwealth cannot equalize this disparity by assessing taxpayers that paid no tax during 2007.[16] The only way to equalize the class for 2007 was to grant a refund to Nextel. By refusing to do so, this Court refused to fulfill the "central tenet of the Uniformity Clause that the tax burden be borne equally by the class of tax-

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[13] U.S. Const. Amdt. XIV, § 1.

[14] *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972);

[15] *See e.g., Board of Pardons v. Allen*, 482 U.S. 369, 382 (1987).

[16] *Nextel*, Slip Op. at 31 n. 21, 36 n. 27.

payers subject to paying it."[17] Therefore, the Court's order violates the Due Process Clause of the United States Constitution.[18]

* * *

For the foregoing reasons, Nextel respectfully requests that this Court order reargument and consolidation with *RB Alden* on the legal questions in Section I of this Application. In the alternative, because this Court's opinion relies on a finding of fact that is not supported by the record, Nextel requests that this Court order reargument and remand the matter to the Commonwealth Court for findings related to whether the Department will, in fact, apply the court's reasoning to "all corporations for the tax year 2007"[19] and thereby equalize the tax liabilities for that year.

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[17] *Nextel*, Slip. Op. at 36.

[18] For the same reasons, the Court's decision also constitutes a judicial taking. *See Stop the Beach Renourishment, Inc. v. Florida Dept. of Environmental Protection,* 560 U.S. 702, 715 (2010) (Scalia, J.) (plurality) ("If a legislature *or a court* declares that was once an established right of private property no longer exists, it has taken that property . . . .") (italics in original).

[19] *Nextel*, Slip. Op. at 36.