WHAT CAN SLOT MACHINES TELL US ABOUT THE TREATMENT OF NOLS UNDER PENNSYLVANIA'S CORPORATE NET INCOME TAX?

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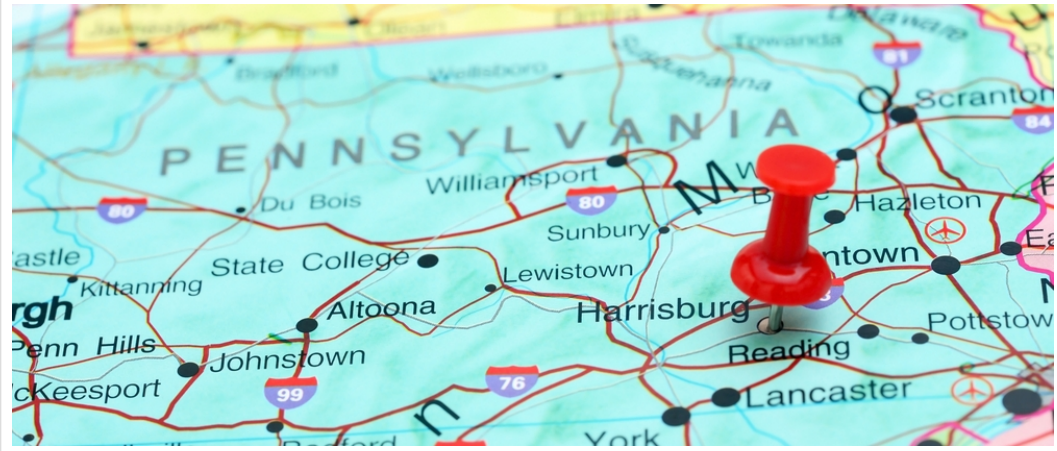

In December of 2015, Pennsylvania's Commonwealth Court issued an important decision holding that the structure of the net loss carryover deduction for the Corporate Net Income Tax violated the uniformity clause of the Pennsylvania Constitution. *Nextel Communs. of the Mid-Atlantic, Inc. v. Commw.*, 129 A.3d 1 (Pa. Commw. 2015). Specifically, the court held that the cap on the deductibility of losses violated the uniformity clause by treating taxpayers in a disparate fashion based on their taxable income without any reasonable justification. *Nextel,* 129 A.3d at 9-10. The court ordered a refund to remedy the violation. *Id.* at 12-13. Currently, the case is on appeal to the Supreme Court of Pennsylvania; all briefs have been filed and the matter is awaiting further action from the court. *Nextel Communs. of the Mid-Atlantic, Inc. v. Commw.*, No. 6 EAP 2016 (Pa.).

On September 28th, the Supreme Court ruled that the local share assessment imposed under Section 1403 of the Pennsylvania Race Horse Development and Gaming Act violated the uniformity clause of the Pennsylvania Constitution because casinos were taxed differently based upon the amount of their gross slot machine revenue. *Mount Airy #1 LLC v. Pennsylvania Dep't of Rev.*, No. 34 EM 2015, 2016 Pa. LEXIS 2174, *3-*4 (Pa. Sept. 28, 2016). In *Mount Airy*, the tax differentiated between casinos outside of Philadelphia based upon their gross slot machine revenues; those with revenues under $500 million had to pay a minimum of $10 million in tax, while those with revenue of over $500 million had to pay to 2% of their gross slot machine revenue. *Mount Airy*, 2016 Pa. LEXIS 2174 at *11.

An 1899 case proved central to the Supreme Court's rationale for invalidating the local share assessment:

In any view that can reasonably be taken of [the Uniformity Clause], it must be manifest to any reflecting mind that the act in question offends [it] 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 . . . . If the legislature had authority, under the constitution, to do what was done in this case, they had like authority to . . . 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.

Mount Airy, 2016 Pa. LEXIS 2174 at *11-*12 (quoting *In re Cope's Estate*, 191 Pa 1, 43 A. 79, 81 (1899)). From *Cope's Estate*, the court gleaned a "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.' " *Id.* at *12 (quoting *In re Cope's Estate*, 43 A. at 82).

So what is the connection? While predicting the result of litigation is difficult, it is worth noting that the Supreme Court's analysis in *Mount Airy* is very similar to the reasoning of the Commonwealth Court in *Nextel*, which featured the very same quote from *Cope's Estate*, and gleaned the very same principle that monetary value was not a reasonable basis of classification that would support disparate treatment of taxpayers. *See Nextel*, 129 A.3d at *10. The similarity in the rationale offered in *Mount Airy* to the reasoning currently under review in *Nextel* suggests that the Supreme Court will likely affirm *Nextel* on the merits of the uniformity challenge.

That's the good news.

There is also language in *Mount Airy* that raises a question about the viability of the refund remedy ordered by the Commonwealth Court in *Nextel*. In a footnote, the Supreme Court observes, in response to a vague claim for "damages," that a decision invalidating a tax statute should not be applied retroactively applied. *Mount Airy*, 2016 Pa. LEXIS 2174 at *27-*28. To the extent that this may put the availability of a refund in doubt, there is contrary authority from the court. *Annenberg v. Commonwealth*, 562 Pa. 581, 757 A.2d 338, 349-50 (2000) (decided under the Commerce Clause).

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