



June 22, 2016

Dear Members of the Pennsylvania General Assembly:

CompetePA is a statewide coalition of over 130 members – including nearly all statewide and regional business groups, small businesses and Fortune 500 companies – that formed in 2005 to help make Pennsylvania’s business climate more competitive. We would like to alert you to the following issue regarding Pennsylvania’s net operating loss (“NOL”) provision within the Corporate Net Income Tax (“CNIT”) policy, which we believe warrants immediate legislative action.

Pennsylvania’s CNIT restricts employers from reducing taxable income from NOLs by up to \$5 million or 30 percent of income.<sup>1</sup> Federal tax law and virtually every state in the U. S. allow for 100 percent deductions. The Commonwealth Court recently and unanimously held, in two separate cases, that the "fixed rate" relief provision, which is currently \$5 million, violates the "uniformity clause" of the Pennsylvania Constitution because it treats corporate taxpayers differently based on the amount of taxable income.<sup>2</sup>

The Pennsylvania Supreme Court is set to hear at least one of the cases later this year. Most of those following the case believe the Supreme Court will agree with the Commonwealth Court’s decision that the current NOL cap structure is unconstitutional. Few agree on what remedy the Court will apply. As a result, depending on the remedy the Supreme Court chooses, there are significant risks to both taxpayers and the Commonwealth that merit a legislative solution now.

#### **RISKS OF INACTION:**

**RISK 1. \$400 Million General Fund Hit.** The Supreme Court could conclude that the entire NOL cap is unconstitutional. While this would benefit CNIT taxpayers with NOLs, it would create in excess of a \$400 million hole in the General Fund budget.

**RISK 2. \$200 Million Tax Increase CNIT Taxpayers.** In the event the Court merely strikes down the \$5 million fixed rate cap, it would trigger a \$200 million tax increase on CNIT taxpayers that have been able to utilize the fixed rate cap.

#### **SOLUTION:**

The General Assembly should not defer to the Supreme Court to decide whether a tax windfall should benefit taxpayers or the General Fund. It should enact a revenue neutral legislative fix that strikes the “fixed” \$5 million relief provision, as the dissenting Commonwealth Court decision recommended, takes the \$200+ million revenues and

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<sup>1</sup> A CNIT taxpayer with \$10 million in historic losses and \$10 million in taxable income may reduce its income by \$5 million, or the equivalent of 50 percent. On the other hand, a CNIT taxpayer with \$10 million in losses and \$30 million in income may reduce taxable income by \$10 million, or 30 percent of income.

<sup>2</sup> “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.” *Nextel v. Commonwealth*, September 16, 2015, Page 16. “Indeed, we held in *Nextel* that ... the net loss carryover deduction provision 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 Clause.” **RB Alden Corp. v Commonwealth of Pennsylvania**, June 15, 2016, Page 28.

applies those revenues directly toward the percentage based relief provision, which could increase from the current 30 percent to 44 percent.

This legislative solution is both revenue neutral and risk averse. In addition, it would make nearly 50 percent progress toward the elimination of the NOL cap, which is a win for everyone.

CompetePA remains committed to working with lawmakers to enact responsible policies that will help make Pennsylvania a leader in job growth and economic opportunity. In order to do this we urge you to consider this legislative solution to the NOL cap as you move through the budget process.

Sincerely,

The CompetePA Coalition  
[Membership List Attached]