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Supreme Court of Texas.
First American Title Insurance Company and Old Republic National Title
Insurance Company, Petitioners,
v.
Susan Combs, Comptroller of Public Accounts of the State of Texas, and
Greg
Abbott, Attorney General of the State of Texas, Respondents.
No. 05-0541.

April 11, 2007

Appearances:
Steven Reed, for petitioners.
Christine Monzingo, for respondents.

Before:

Chief Justice Wallace B. Jefferson, Nathan L. Hecht, Harriet
O'Neill, Dale Wainwright, Scott A Brister, David Medina, Paul W. Green,
Phil Johnson, Don R. Willett, Supreme Court Justices en banc.

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CHIEF JUSTICE JEFFERSON: Court is ready to hear argument in 05-0541, First American Title and Old Republic National Title versus the Comptroller and Attorney General of Texas.

COURT MARSHAL: May it please the Court. Mr. Reed will present argument for the petitioner. Petitioners have reserved five minutes for rebuttal.

ORAL ARGUMENT OF STEVEN REED ON BEHALF OF THE PETITIONER

MR. REED: Good morning. May it please the Court. This is a case about insurance retaliatory taxes. Everyone agrees that the purpose of retaliatory taxes, which is to equalize taxes between the various states by penalizing companies from states that impose excessive insurance taxes relative to those collected by the retaliating state. Everyone agrees that's the purpose. The key issue in this appeal is whether the Comptroller can apply the Texas retaliatory tax statute in a way that disregards 85 percent of the tax paid on the title insurance premiums in Texas and thereby virtually insures retaliation against companies from every other state in the country even if those other states impose lower taxes on insurance than Texas. Now, let's start with a brief overview of retaliatory taxes. The retaliatory tax is a

mirror image tax that requires a comparison of the insurance tax in Texas to the insurance taxes in the home state of the company being retaliated against. For example, Old Republic is a company from Minnesota, so the comparison would be if Minnesota's insurance taxes on a Texas company would be higher than Texas' taxes on Old Republic. Texas would impose a retaliatory tax equal to the difference in order to encourage Minnesota to lower its tax.

JUSTICE: Not-- but not income taxes or other-- do we consider other kinds of tax burdens?

MR. REED: Generally speaking, your Honor, retaliatory taxes are imposed on taxes that are specific to insurance. They're generally not imposed on personal income taxes or for franchise taxes, taxes that everyone, every business is subject to generally. They're specifically aimed at the, the tax on the insurance transaction. And in this case, both in, in other states and in this state, the principal insurance tax is the premium tax.

JUSTICE O'NEILL: Is our state though unique in that it doesn't, at least the Court of Appeals interpreted the statute, not to make the insurer ultimately liable? That, I mean, that's a little bit different than the other state statutes, isn't it?

MR. REED: It is quite a bit if, if that interpretation of the premium tax statute were accepted, and we'll come back to that question in a moment, but even if you assume that, that is very unique. In most, in virtually every state, I believe the insurance premium tax falls solely on the insurer.

JUSTICE O'NEILL: And that, well that being the case, since the premium tax, 85 percent of it, does not fall on the insurer, then it doesn't it fit the plain language of the statute to interpret it the way the comptroller did.

MR. REED: I think there are two reasons why it does not fit the plain language, and in fact, we submit the plain language supports the appellant's position. First of all, the language of the retaliatory tax statute itself speaks of the taxes that are directly imposed on the out-of-state company. And in this case, the tax is paid directly by the out-of-state company, 100 percent of it paid to this, to the comptroller.

JUSTICE O'NEILL: Well, but, but only through remittance from the agent. In other words, if it wasn't paid, then the comptroller could not come against the insurer for 85 percent.

MR. REED: Well, -

JUSTICE O'NEILL: So when you say it's paid by, that's a little bit confusing.

MR. REED: - well, your Honor, let me turn to the words of the statute itself, and we have hopefully tried to put this on a poster board here. This is Section 223.003(a), which is the current version of the title insurance premium tax statute. If you read Section 223.003(a), it directly says, number one, that the tax is imposed on the title insurance company, and secondly, that the taxable premiums of the company include the premiums retained by the title insurance agent. I don't think the legislature could have any more clearly said that 100 percent of the premium tax ...

CHIEF JUSTICE JEFFERSON: The tax, the tax is shared. The tax is shared. Isn't that correct? The premium tax between the agent ...

MR. REED: That's not how I would look at it, your Honor. I believe

...

CHIEF JUSTICE JEFFERSON: Between-- Excuse me, Counsel.

MR. REED: All right.

CHIEF JUSTICE JEFFERSON: - The tax is shared between the agent and the corporation that is, that, that is not how you interpret the way the tax is assessed?

MR. REED: Well, first of all, again, looking at the words of the statute, I believe it clearly states that 100 percent of the tax is imposed on the insurer. The insurer clearly has ...

CHIEF JUSTICE JEFFERSON: So agents don't pay any premium taxes in Texas.

MR. REED: The agent simply remits 15 percent of the premium to the title insurance company.

CHIEF JUSTICE JEFFERSON: So they-- but just, did they pay premium tax and not agents?

MR. REED: We do not believe that the agent pays the premium tax, your Honor. Certainly, the agent does not write a check to the comptroller. Only the insurance company writes the check. Only the insurance company files a tax return.

JUSTICE O'NEILL: But it, it comes out of the 80 percent of the agent's premium.

MR. REED: Well, again, your Honor, I ...

JUSTICE O'NEILL: It doesn't come out of the insurer's premium.

MR. REED: If you look at the statistical report of the Texas Department of Insurance, the Department of Insurance sets the premium division between the agent and the insurer. Their statistical report, which is in the record, shows a line item for the expense on the insurance company's side of the ledger for gross premium tax. 100 percent of the gross premium tax goes on the insurer's side of the ledger. There's no comparable line on the agent's side. So when the insurer, Insurance Department, is setting division of premium, they are not allocating the tax between the two, two entities. They're saying 100 percent of this is treated as an expense of the insurer and when you look at ...

JUSTICE O'NEILL: But presume, just presume for purposes of argument, that it is divided that way. Presume that the agent pays on his 85 percent and, and, and he's the only one that pays that percentage of the premium tax and the insurer, 'cause that appears to be the Comptroller's intent, which was to divide these up and not make the insurer liable for its agent's tax burden. If that's the case, then how is this unconstitutional?

MR. REED: Your Honor, I think that the constitutional problem, even if you assume that, in reality, the agent is paying and, and we certainly don't think that's the reality of what's happening here because the premium that's being charged with the point of sale is bearing this 1.35 percent tax rate any way you look at it and it's being paid literally by the insurance company. But even if you indulge the assumption that somehow, the agent is responsible because there's a sharing of this tax, when every other state imposes all of the insurance tax on the insurance company, regardless of the division with the-- you know, the division of the premium in those states with the agent, and Texas applies its retaliatory tax in a way that, not taking into account the total tax burden on that insurance transaction, you're creating a disparity that undermines the, the constitutional purpose the Supreme Court has found for retaliatory taxes. In the Western and Southern case, the Court upheld retaliatory taxes but clearly indicated that the purpose of that tax is not to raise revenue for the State, but rather to equalize taxes among the various states, try to create this national model of moderate and equal taxation. And when one state begins to apply its, its retaliatory tax in a way that is so out of

line with every other state, they essentially cross the line from trying to deter other states from charging greater taxes to simply double taxing the premiums that are collected in Texas, and the effect of the comptroller's interpretation is the 85 percent that she deems to fall on the agent is taxed once through the, the tax that is paid by the insurance company after the division with the agent and then is taxed a second time through the retaliatory tax.

JUSTICE O'NEILL: But how can we say that there's not a rational basis for the Comptroller's decision if, if you presume that she's dividing them based upon what each actually pays, and then there's, there is a quid pro quo here and we'd-- we're not really looking at whether it's smart or good or right, it just has to have a rational basis, and it would seem that just inherently would have a rational basis based upon the premise that she's dividing it up on his paying.

MR. REED: Well, your Honor, I think first of all, in constitutional tax cases, the case law is quite clear that you are not required to defer to the characterization of the tax. The form of the tax is not what's important. It's the substance of it. And our position is, is substance. The insurer is paying 100 percent of the tax, and that is certainly how every other state is going to look at it. And secondly, the,-- as I think the American Fire (A 2d, 2006 WL 2974134) case from New Jersey illustrates, when one state is applying a very unique interpretation of its own tax laws and the result is they're going to be retaliating against virtually every other state, you have to stop and ask, is this really accomplishing what retaliatory taxes were designed to do and ...

JUSTICE O'NEILL: But I guess my question is, is that a judicial decision or is that something that should be left to the comptroller if, if, if havoc happens as a result of this interpretation, are we stepping on her territory line getting involved?

MR. REED: Well, I think, your Honor, that goes to a very fundamental question here. The court of appeals certainly took the view that they should defer the comptroller's interpretation of these statutes, and we maintain, for a number of reasons, that's inappropriate here. First of all, as we've been discussing, I think there is a serious equal protection clause question raised here and the Court's normal approach is to interpret statutes to avoid those-- avoid essentially creating a constitutional issue about the statute.

JUSTICE WILLETT: We-- Has this Court ever held that an economic regulation violates equal protection?

MR. REED: I couldn't name a decision like that, your Honor, but certainly the U.S. Supreme Court in the Ward case issued exactly that sort of ruling under the equal protection clause dealing with the taxation of out-of-state insurance companies.

JUSTICE WILLETT: As you construe the case [inaudible] different-- significant difference between Texas and U.S. equal protection case law?

MR. REED: I believe this Court has said that its own equal protection clause is at least as stringent as the U.S. equal protection clause. I'm not sure whether it goes beyond. Some states have interpreted their uniformity clauses is to oppose a higher burden than rational basis. I'm not sure this Court has actually addressed that question. The other cause they're imposing a penalty on the out-of-state company, not for anything it did, but in order to influence the behavior of the other state. And because these statutes are punitive in nature, they-- it's long been interpreted that they should be strictly construed against the state and in favor of the taxpayer for two

reasons. First of all, to insure fairness to the taxpayers who were subject to these punitive taxes, but more importantly, to ensure that you don't create unnecessary conflicts with other sovereign states who have their own taxing systems.

JUSTICE O'NEILL: But it seems to me that the insurance company gets something in return here. They are, and I know you, you dispute this, but under the comptroller's interpretation, they are no longer liable for the agent's portion of the tax premium if the agent have, if the agent goes under, if, if the agent doesn't remit, they're relieved of a certain chunk of liability here.

MR. REED: Well, that's, that is the Comptroller's position, apparently, but we, we don't see any real evidence in the record of any cases where the agent has ever been required to pay the tax or of companies being let off the hook for substantial amounts of retaliatory tax. I think that in virtually every case, first of all, the statute clearly says again that the taxes imposed on the insurance company and at the later section of the same [inaudible] says that if the insurance company fails to pay all of the taxes due, that one of the sanctions is they can lose their license to write insurance in, in Texas. I think it is clear that their obligation is to pay all of the tax. They may be relieved in certain circumstances, for example, if they never get the remittance, I think it's reasonable to interpret that they never received the premium, and therefore, they're not, they don't owe the tax. That's different from saying they aren't liable when they actually have received the premium and have to pay the tax.

CHIEF JUSTICE JEFFERSON: The comptroller has said that her interpretation would not cause other states to retaliate, and I understand that Minnesota has done that. Would you, would you speak to that first?

MR. REED: Yes, your Honor. I, I think two things: Minnesota certainly has, as was noted in the briefs, issued the revenue notice indicating that a hypothetical very close to actual facts of this case that Minnesota will impose a retaliatory tax measured by this double tax that, that Texas is imposing. And I think Minnesota's theory, presumably, they don't spell it out in the revenue notice, but is that they're looking through the transaction and saying, 'Look, the effect of tax that's really being imposed on the insurance company in Texas is the full tax, not just 15 percent, and that's what we're going to react to.'

CHIEF JUSTICE JEFFERSON: And this sort of leads me to-- there's a question about on similar lines as Justice O'Neill's not deferring to the comptroller, but isn't there a legislative fix? I mean, if it turns out that because of the way the comptroller interprets this statute, other states retaliate and raise the premium taxes on title companies from Texas that the legislature then would revise this statute to make clear that this interpretation is erroneous. So is there a legislative fix rather than a constitutional problem?

MR. REED: Well, certainly, your Honor, the, the legislature could fix this problem with a stroke of a pen, no question about it, but our point is, if you look at the statute as written, we believe that the legislature has already spoken for this issue. They have said that the taxes were directly imposed on the insurance company or what we're concerned about. I think any kind strict construction of that statute would include the tax that's paid directly to the state by the insurer, an retained by the agent, is the taxable premium of the insurer. So if there's to be a legislative fix, I think, first you would want a clear statement from the legislature that they really did intend this form of

retaliation that is so out of step with what other states have done for which there is precedent that we can find in any other jurisdiction. You'd want a clear statement from the legislature they really intended that before you had to address the question whether this is a constitutional way to proceed.

JUSTICE WILLETT: Remind me, this rule change occurred in the, was it mid-90s?

MR. REED: A little vague, your Honor, at that the interpretation seems to have been first published as a change in around 2000.

JUSTICE O'NEILL: The amicus brief that Stewart Title filed says that if the Court invalidates the comptroller's current interpretation, it estimates it [inaudible] an additional 7.4 million in premium taxes in 22 states. Do you know why that would be?

MR. REED: Your Honor, I'm not entirely clear. They don't spell out what their theory behind that is, but the only thing I could speculate is that they are hoping to take the ruling that that only 15 percent is paid in Texas to other states [inaudible] states to lower their retaliatory tax. That's been the law on how the other states interpret this. Based on the one example we have from Minnesota, it does not appear that Minnesota is viewing this the same way that Stewart Title is, and in fact, rather than lowering their tax, they're planning to raise it but ...

JUSTICE O'NEILL: But there is an alternative argument that it could have the effect of lowering.

MR. REED: Well, again, if the other state accepts at face value that the tax is only paid on 15 percent of the premium, I suppose that's what Stewart would argue in other states, but as we point out, the reality here is that I think other states are going to view this as states traditionally have viewed it. The insurance premium tax, which is on the actual transaction of selling title insurance, which is paid 100 percent to the State, falls on the insurer. And that's the logical way I think for any other state to look at it and I think it's the fairest reading of the statutes on their face. And certainly when the rule of strict construction is taken into account, I think the only possible outcome here. If there are no further questions, I'll reserve the rest for rebuttal.

CHIEF JUSTICE JEFFERSON: Further questions? Thank you, Counsel. The Court is ready to hear argument from the respondents.

COURT MARSHALL: May it please the Court. Ms. Monzingo will present rebuttal for the respondents.

ORAL ARGUMENT OF CHRISTINE MONZINGO ON BEHALF OF THE RESPONDENT

MS. MONZINGO: May it please the Honorable Texas Supreme Court. I'd like to address a couple of misstatements first. Petitioner claims that the Texas retaliatory tax would apply even if other states had lower taxes. That's incorrect. The retaliatory tax only applies in the situation where the other states have higher tax rates or higher tax basis. Secondly, the petitioner said that business and occupation and income taxes are not considered under the retaliatory act. They are expressly stated in the retaliatory statute.

JUSTICE HECHT: How can you-- How is it even possible to consider that?

MS. MONZINGO: Well, take California for example. California

imposes net income tax on the agents and on insurers. When the insurer calculates its Texas retaliatory tax, it takes the gross premium that it has received, it deducts the agent's portion of the gross premium and it calculates its net premium that tax is due on. California taxes insure on generally 10 percent of the premium and taxes the agent generally on 90 percent of the premium. California allows the insurer and the agent to determine the premium split by contract. So in California, First American's home state, there is a normal split of 90/10, and the insurer only pays tax on 10 percent of the premium. In Tex ...

JUSTICE HECHT: Doesn't it-- looks like to me it all comes out of the same pot.

MS. MONZINGO: Well, in Cal ...

JUSTICE HECHT: It never pays. I mean, in saying well, we're going to do this business and you're going to get this piece and I'm going to get this piece, but you're worrying about what you're going to have at the end of the day and not how this particular piece is split.

MS. MONZINGO: Well, Justice Hecht, in a sense that's correct, but in all states, including Texas, there are different mechanisms for taxing the agent and the insurer. In Texas, what we have in the premium statute that is somewhat unusual is that the insurer collects the tax from the agent so the state doesn't have to collect tax from 500 agents. It's simply an efficient ...

JUSTICE HECHT: But the insurer collects the premium [inaudible].

MS. MONZINGO: The insurer collects the premium and the statute says that the premium is-- it includes the agent's share of premium tax, and as a result of that, the agent, title insurance agents are exempt from franchise tax and other gross receipts taxes while other insurance agents are not.

JUSTICE HECHT: But would your argument be any different if the agent remitted 100 percent of the premium to the insurer and then the insurer sent back 85 percent.

MS. MONZINGO: Insurer sent back 85 percent?

JUSTICE HECHT: Yeah, sent back 85, the agent sends the whole premium to the insurer. The insurer sent it back 85 percent. It comes out the same way but just -

MS. MONZINGO: Well it ...

JUSTICE HECHT: - it just goes back and forth. Surely, the argument wouldn't mean any different.

MS. MONZINGO: It's correct that 100 percent of the premium is taxed but the way that Texas statute is set up, it's taxed by being collected from the agent. The, the situation you described is somewhat analogous to the Washington case in which First American took the position that the business and occupation tax should not be assessed 100 percent on it because it was simply the pass through for the, the premium. In, in Washington State, the insurer collects the entire premium and gives 10 percent to the agent. The State attempted to tax 100 percent and the Court held that no, the insurance company was the simply the pass through for the premium. So it was not their income. Here, the insurance company is simply the pass-through remitter for the agent. Now, there would be no ...

JUSTICE HECHT: But, but let me ask, let me try it again. If the insured pays the premium to the agent, 'cause that's what he's dealing with ...

MS. MONZINGO: Yes.

JUSTICE HECHT: - the agent sends the whole thing to the insurer.

MS. MONZINGO: Yes.

JUSTICE HECHT: The insurer sends back 85 percent, would your argument be any different?

MS. MONZINGO: It wouldn't be any different because it would, that is exactly analogous to the Washington State situation.

JUSTICE HECHT: But it looks to me like there, then you would say well, but the tax that the insurer pays is, they're paying all in 100 percent of the premium. They're just sending 85 percent back. It, it doesn't seem to me that it matters how that-- when that split occurs.

MS. MONZINGO: Okay. It matters under the statute because the statute says that the division of premium is structured so that the agent's share of tax is remitted to the insurer with the division of premium, and the-- as a result, the agent is exempt from other taxes. There would be no reason for the Texas legislature to exempt these business enterprises from other gross receipts and franchise taxes if they did not pay 'cause they were not subject to the insurance premium tax and in fact, the Franchise Tax Act says the exemption provision says you're exempt from franchise tax because you're paying annual tax on gross premium.

JUSTICE O'NEILL: But that's not really relevant to determining the retaliatory tax issue. I mean, that's, that's more of a quid pro quo the legislature given in the circumstance but they didn't really affect how other states would calculate retaliatory tax.

MS. MONZINGO: Well, other states calculate retaliatory tax based upon the comptroller's interpretation. That's the standard. The National Association of Insurance Commissioners publishes a manual, which is distributed to all states, and all states, except Minnesota right now, take the agency's word for how the statute is interpreted and calculate retaliatory tax using that. Minnesota is an outlier. During the, the pending of the petition for review, Minnesota issued a revenue ruling which is contrary to every other state's application of retaliatory tax. Under the Minnesota revenue ruling, you, you add the retaliatory tax to the premium tax to calculate retaliatory tax. No one else does that. There is no basis for it. That would ...

JUSTICE HECHT: Is that in reaction to this case?

MS. MONZINGO: Old Republic is domiciled in Minnesota. There is nothing in the record that says there is a direct relationship.

JUSTICE HECHT: And you say they're an outlier, but has anyone else considered the issue that you know of in the United States.

MS. MONZINGO: Yes. The State of Oregon in 1996 agreed that the insurance agent is subject to 85 percent of the premium tax and calculated Stewart Title's tax based on the 15 percent of the gross premium share under the Texas statute.

JUSTICE WILLETT: Is it really unclear when this rule change became effective?

MS. MONZINGO:-- It is clear that, that the, there are two changes. One is the, the gross premiums tax statute itself, which, in 2001 said that the insurer and the agent are proportionately liable for the tax. That change was prior to the other periods in issue. The other periods are 2001 and 2002.

JUSTICE WILLETT: And since then, aside from the Minnesota revenue ruling, are there other examples of actual retaliation against the insurance companies in Texas?

MS. MONZINGO: No, there aren't. And as a constitutional matter, actual retaliation by another state is irrelevant. The Western and Southern Life case is controlling precedent here, and it says that retaliatory statutes are constitutional. They have a rational basis. They serve the legitimate purpose of, of helping domestic companies in

their interstate business.

CHIEF JUSTICE JEFFERSON: What is the revenue impact of the comptroller's interpretation the-- from before and after? Is it more revenue because of the, because of this?

MS. MONZINGO: There is nothing in the record about the revenue and I'm not, I don't know. I mean, I would assume that because they, the insurers got 6.6 times more credit in the past than they do now that they would be paying more; however, the title insurance premium taxes an extremely small percentage of the general revenue and it is only about 4.5 percent of all insurance taxes anyway.

CHIEF JUSTICE JEFFERSON: Is it important to a constitutional analysis whether this is a revenue enhancer or not?

MS. MONZINGO: No, it is not.

CHIEF JUSTICE JEFFERSON: It certainly was mentioned by Justice [inaudible] in *Western*.

MS. MONZINGO: Yes. Yes. But regardless of whether it and in fact, is a revenue enhancer is irrelevant under the equal protection standard because the standard is, is there a legitimate purpose? The U.S. Supreme Court said yes, retaliatory taxes have a legitimate purpose and then ...

JUSTICE HECHT: But they didn't say if you could call it a retaliatory tax, it's okay. They just said if you structure it this way, it's okay.

MS. MONZINGO: Well, let's discuss the difference between the, the New Jersey tax cap and the investment credits and *Metropolitan versus Ward* (470 U.S. 869), versus this case. In *Metropolitan versus Ward*, the State wanted to promote the purpose of helping its domestic insurance companies in that State, and the Supreme Court said, that may or may not be a legitimate purpose, but you can't do that by imposing three times the premium tax. There is no differential in tax rate. The only difference is that tax is collected in this way in Texas for efficiency purposes. In the New Jersey case, the Court construed two statutes that appear to have differing objectives. In one statute, the retaliatory statute, of course, was designed to encourage domestic's interstate business. The other-- the purpose of the premium tax cap was to encourage investment in the state. And in that case, the Court harmonized the statutes by saying, basically, we did not-- the legislature could not have intended to give with one hand and take away with the other. To give the insurance companies credit for investing in New Jersey and then take it away through retaliatory tax. So when you compare, for purposes of retaliatory tax, the home state and New Jersey State, you have to use the actual statutory tax rate. You can't use an effective tax rate. Now, there's ...

JUSTICE O'NEILL: Is, is it true, as the petitioner states in their motion for rehearing, that every other state deems the tax paid by the insurer regardless of how it's collected?

MS. MONZINGO: No. That's absolutely not true. California, for example, going back to California, the, the insurance company is subject to net income tax on only its share of the premium. In Washington, the insurance company is subject to tax on its share of premium. And others, other states do, there is Minnesota ...

JUSTICE O'NEILL: Well, let me make sure that we're, we're talking about apples and apples here. I understand that the, it makes them each responsible for that portion but for purposes of calculating the retaliatory tax, is there a deeming that goes on that deems it all paid by the insurer?

MS. MONZINGO: No, there is not. There is not. On-- in the record

on page 758, there is a form that First American uses to calculate its Texas tax and that clearly shows that gross premium is the starting point then-- there is a deduction for premiums retained by the underwritten title companies, which is the agents, and that the total premiums received subject to tax is the net amount of that. So for purposes of calculating its Texas retaliatory tax, First American need only use and must use its 10 percent contractual share of premium.

JUSTICE HECHT: Question. That the-- I thought the question was does any other state do that?

MS. MONZINGO: Does any other state do have the collection mechanism that Texas has?

JUSTICE HECHT: Any other state in calculating the retaliatory tax divide it between the insurer and the agent?

MS. MONZINGO: Yes, they just have different methods of doing it. For example, in Minnesota, well Minnesota is, is a little unusual in that it taxes premium twice. It taxes at 100 percent against the insurance company and exempts the insurance company from income tax and it taxes the agent at a 9.8 percent income tax rate but exempts them from premium tax. So in effect, the premium is taxed twice. But in Texas, the premium is taxed once and as a result, the legislature gives the exemption from other taxes.

JUSTICE WAINWRIGHT: So one other state does that?

MS. MONZINGO: California?

JUSTICE WAINWRIGHT: Two?

MS. MONZINGO: Well, -

JUSTICE WAINWRIGHT: The, the question was how many others and you answered in different times with California and Minnesota. Are there others?

MS. MONZINGO: There are only two other states that have statutory division of premium, and they do not have the collection mechanism that Texas uses.

JUSTICE O'NEILL: Again, I, I want to make sure. I'm not talking about just division of the premium. I'm talking about in terms of calculating that retaliatory tax deeming that the insurer collects it all as opposed to how it's actually collected, and you're saying that other states do deem that regardless. I mean, Texas isn't the only one that operates this way in terms of every other state deems it being the insurer do pays, ' cause I think I keep, I keep hearing your argument being: 'How they collect it,' as suppose to whether it's deemed collected by the insurer.

MS. MONZINGO: Okay. Well, the, the key point about the Texas premium tax statute is that it's simply sets up a collection mechanism. Taxes directly imposed on both parties but the insurer collects it and pays it over. In other states, there is no-- the collection mechanism is different but it's just a collection mechanism. It doesn't have any constitutional significance and of course ...

JUSTICE HECHT: It-- whatever you call it, collection mechanism or whatever, we're just trying to get whether if Texas is unique, that was the statement by the petitioner.

MS. MONZINGO: Texas is unique in its collection.

JUSTICE HECHT: Okay.

MS. MONZINGO: It is not unique in that the insurance company is subject to tax only on its division of premium.

CHIEF JUSTICE JEFFERSON: Are there any examples in the record in which a, an agent has defaulted on its payment to the insurers so that the insured doesn't have to pay the entire ...

MS. MONZINGO: Yes. First American proved in this lawsuit that

approximately \$4,000 in premium tax that the premium related to that was not collected by it and the comptroller has agreed on the record that if First Texas timely files a refund claim that it is entitled to receive that back. I'd also like to note that the statute is not the statute that is in issue. This is, this statute over here went into effect in 2005. It is a codification of the statute. It was not meant to be a modification of the statute, and therefore the comptroller's interpretation at the time the statute was enacted was presumably accepted by the legislature. The statute that's in issue is ...

JUSTICE HECHT: What do you-- I'm sorry. You, you -

MS. MONZINGO: The statute ...

JUSTICE HECHT: - you mean that the result in this case would be different under this statute?

MS. MONZINGO: No, it would not be different. But I just wanted to point out that that is not the statute that is an issue in this case.

JUSTICE HECHT: Well, but does it matter I guess is ...

MS. MONZINGO: That statute doesn't matter.

JUSTICE HECHT: No. I mean, does it matter that it's not?

MS. MONZINGO: No.

JUSTICE HECHT: I mean, has it-- has the legislature changed anything?

MS. MONZINGO: Supposedly, the legislature has not changed the substance. They said they were making a non-substantive codification, and in the legislative bill analysis, the legislature noted that because title insurance agents and insurance companies are subject to premium tax, they are exempt from franchise tax. It reiterated the causal relationship between the exemption and the subject to tax.

JUSTICE HECHT: Well, the, the language and annual taxes imposed on each title insurance company, we don't claim that because that's now the language it's something different from the prior statute.

MS. MONZINGO: That language is different, your Honor. There's no question, but that's ...

JUSTICE HECHT: Does it matter is what I'm trying to get matter.

MS. MONZINGO: It does not matter.

JUSTICE HECHT: Sorry?

MS. MONZINGO: It does not matter because the legislature included in the codification the provisions about the agent remitting the tax to the insurer in the division of premium and that the insurer is to collect the tax and remit it to the comptroller. So the same collection mechanism is, is set up there.

JUSTICE HECHT: Do you disagree with the Texas-Minnesota example in the petitioner's brief on the matters?

MS. MONZINGO: Yes, because it assumes erroneously that retaliatory tax should be added to the premium tax to calculate the out-of-state company's retaliatory tax. No other state does that. And ...

JUSTICE HECHT: So, so it wouldn't, I mean, the, the example would not come out the way it kind of ...

MS. MONZINGO: Are you talking about just the example of how it was before and after the Texas ...

JUSTICE HECHT: Yeah.

MS. MONZINGO: Okay. No, I don't-- we don't disagree with that. But the fact is that Minnesota taxes at a higher rate, and so Texas will be imposing retaliatory tax based on the differential of the rate and the, and the tax base.

JUSTICE WILLETT: Is this what's unique among the 50 states in our collection mechanism?

MS. MONZINGO: Yes.

JUSTICE WILLETT: But not in terms of imposing the tax on net proceeds.

MS. MONZINGO: Right. Well, the tax, of course, the entire tax is imposed on 100 percent of gross premium.

JUSTICE WILLETT: Gross premium.

MS. MONZINGO: Yes. It's the collection that's different. Also, it's important to note that the Texas retaliatory statute is not substantially different from the statute that was upheld in the *Western and Southern Life* (451 U.S. 648, 681 LEd 2d 514) case. All the statutes have essentially the same language, that Texas does not have in its statute that the insurers and their agents income, etc., etc. But effectively, Texas does the same thing because if the agent is a division or employee of the insurance company, then Texas, of course, 'cause it's one entity, allows a retaliatory tax calculation to include 100 percent of the gross premium. That the, the situation here is that the agents are separate businesses, and as the Washington Supreme Court said in the business and occupation tax case, the nature of the title insurance industry is such that they are separate business entities. Tax is imposed on them separately.

CHIEF JUSTICE JEFFERSON: You said there's a National Association of Insurance Commissioners?

MS. MONZINGO: Yes.

CHIEF JUSTICE JEFFERSON: And it has reviewed this-- Texas' statute?

MS. MONZINGO: It-- it does not review the statutes per se. It publishes the State's interpretation of the statutes so that other, so that out-of-state companies can calculate their retaliatory tax. It also does the same for premium taxes so that they can calculate the premium tax.

JUSTICE HECHT: Petitioner was asked about amicus Stewart Title's statement. What's your reaction to that, to the statement that they made?

MS. MONZINGO: Yes.

JUSTICE HECHT: And ...

MS. MONZINGO: If other states, as Minnesota has, adopts petitioner's reading of the statute, then Stewart Title would owe more tax because it would be-- the retaliatory tax would be added to the premium tax in Minnesota to calculate the retaliatory tax. In other words, everything would be added together instead of separately considered.

JUSTICE HECHT: But their statement-- the statement in the brief was if the Court invalidates the comptroller's current interpretation, Stewart will owe more, owe more.

MS. MONZINGO: Yes. And meaning, if the Court accepts the petitioner's interpretation of the statute, and other states do what Minnesota has done, then Stewart Title will owe substantially more. Because the-- it, it makes it seem that the Texas premium tax is higher than it's 13.50, that the insurer's obligation is \$13.50 on a thousand-dollar premium as opposed to 0.023 cents on a thousand-dollar premium, and so the lower the tax in, I'm sorry, the greater the differential between the foreign state and the home state, the more retaliatory tax there is.

CHIEF JUSTICE JEFFERSON: Further questions? Thank you, Counsel.

REBUTTAL ARGUMENT OF STEVEN REED ON BEHALF OF PETITIONER

MR. REED: Let's go first to the Section 223.003. This is clearly a non-substantive re-codification of Article 9.59, which was in effect at the time the case arose. But I believe that this Court's prior holdings suggest that a non-substantive re-codification is deemed to reflect the same intent as the original statute. At best, the comptroller has argued that the original statute was ambiguous. I think the wording of 223.003 makes very unambiguous what the legislature intended which was a 100 percent of the tax dispose on the insurer and if it was appropriately included in the insurance retaliatory tax. There was ...

JUSTICE O'NEILL: Did they, did they perpetuate that ambiguity after knowing the comptroller's interpretation here when could have corrected it?

MR. REED: It's, it's not clear at all, your Honor, that the legislature was focusing on the interpretation that's been offered here. This case was in controversy at the time.

JUSTICE O'NEILL: That's never clear under our statute re-construction rules.

MR. REED: I'm sure that's right, your Honor. But I think it certainly if the legislature had intended to codify the version of the Comptroller offers, which is 85 percent of the tax falls on the agent, they would hardly abuse the language that appears on 223.003(a) to do that. There was also, and I would point out that in this Court's decision in the Lexington Insurance case involving surplus lines, it was referenced to 223.003 as imposing tax on the title insurer. The, the New Jersey case was discussed in terms what is the impact here, and I think the important lesson to draw from the New Jersey case, which is an interpretation of Western and Southern is that there are equal protection limitations on how far a state can go. We do not, to be clear, contest the proposition that retaliatory taxes are generally constitutional. That's what Western and Southern held. But they're constitutional when they're applied in the structure that was upheld in Western and Southern where you're comparing apples to apples. When you get to a situation where one state has a very unusual twist on how they're applying their or how they're interpreting their premium tax and in calculating the, the retaliatory tax, they're applying that twist to essentially disregard the best bulk of the tax that's imposed on this insurance transaction, you're necessarily upsetting the balance that the Court was assuming when they upheld retaliatory taxes and I think given the ambiguity in the statute, there's clear-- an easy path here, which is for the Court to construe this narrowly, as other states have done historically, and as this State has-- as this Court has indicated in cases involving punitive statutes so as to avoid the constitutional issue. As ...

JUSTICE GREEN: Let me ask you: Why, why would the State completely exempt agents from any kind of tax?

MR. REED: Your Honor, I think that's primarily because-- clearly the legislature viewed the entire premium as being taxed. One hundred percent of this premium is being taxed. We can dispute who's paying the tax, but clearly, they knew that 100 percent of the premium was being taxed and that the agents-- an expressed exemption would be a kind of a sitting duck for this tax 'cause they actually collect the entire premium at the closing. They then turn their share over to the insurer, but if there was no exemption in the statute, there's-- quite possible that other taxing bodies like municipalities would look to that and say well, we can tax the agent on that, and the State was effectively

saying don't double tax this, the, the tax has already been paid by the premium tax.

JUSTICE GREEN: And that, that the legislature is well, the statute says that the agents are exempted from franchise and other business taxes and you're arguing that the insurer that takes all of this tax is responsible for all that, which means that the agent has no tax liability.

MR. REED: Well, that is certainly within the discretion of the legislature, I think, to determine that the cost of premium has already been taxed, that there's no reason to tax the agent on the same collection, in effect. Whether or not the agent actually pays any tax, certainly the fact they're subject to tax simply indicates this is a transaction that can be taxed, and there was some discussion about the Washington Supreme Court case involving First American. There I think the situation was very different from what we have because The Washington Supreme Court was not addressing the retaliatory tax consequences of the-- the way premium tax was paid in Washington. And more importantly, the issue there was whether when the agent already paid a business and occupation tax on its share of the premium, whether the insurance company had to pay a tax on that same premium on top what the agent had paid, and the Washington Supreme Court said, no we're not going to let you double tax the same premium when you've already taxed it to the agent, and Washington is somewhat out of step with the other states because I think as we said in our brief and I still think it's correct, every other state use the premium tax as falling solely on the insurance company, and that's even true in California, which there was some discussion of. To be clear, in California, that the insurer's share of the premium, whether it's 10 percent or whatever they negotiate with the agent, is subject to a premium tax, which is collected directly from the insurer. The agent, the underwritten title company, collects income from all sorts of sources. It's partly from the premiums, from the title insurance, but other services they perform, that's subject to a net income tax not a premium tax.

CHIEF JUSTICE JEFFERSON: Further questions? Thank you, Counsel. The cause is submitted and the Court will take a brief recess.

COURT MARSHAL: All rise.

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