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- Insurance Tax Bulletin

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Texas Court Upholds Retaliatory Tax May 23, 2008

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The Texas Supreme Court May 16 upheld the "retaliatory" tax applied by Texas to out-of-state title insurance companies (*First American Title Insurance Co. v. Combs*, Tex., No. 05-0541, 5/16/08).

First American Title Insurance Company (First American) and Old Republic National Title Insurance Company (Old Republic) are out-of-state title insurance companies doing business in Texas. First American is California-based and issues Texas policies directly and also through independent agents; Old Republic is Minnesota-based and issues policies in Texas only through independent agents. For several years, Texas collected and both insurers remitted premium and retaliatory taxes to the Comptroller, calculating the retaliatory tax owed based on the full amount of premium taxes they remitted to the State. However, in 1996, the state comptroller adopted a new rule. The result was that foreign insurers' premium tax liability dropped compared with what other states imposed on Texas insurers, thus substantially increasing the foreign insurers' retaliatory tax liability. This change required First American to pay an extra \$1.4 million in retaliatory taxes and interest for 2001 and 2002; Old Republic paid a total of \$219,626.40 in retaliatory taxes for 2002. Both insurers challenged the taxes and, in each case, the trial judge awarded summary judgment in favor of the state comptroller. Both insurers appealed, and the court of appeals affirmed the decision, finding that the comptroller's revised interpretation of the statutes was reasonable and constitutional.

The insurers argued that, although the full amount of the premium tax was not directly imposed on them, the comptroller's revised interpretation should fail because it conflicted with various portions of the retaliatory tax provision. The insurers also argued that the retaliatory tax provision did not just require insurance companies to compare the taxes imposed by Texas and their home states, but also to compare "other obligations . . . directly imposed" by the state. According to the insurers, the comptroller did not give them credit for all of the burdens they had; namely, the comptroller excluded from consideration the obligation to report and remit the full amount of the premium tax to the state.

The Supreme Court concluded that although the comptroller's current interpretation may represent a change from the past practice, it is in line with the 1987 legislative amendments that first established the agent-insurer pass-through premium tax collection system. The Court said the insurers failed to show that the full amount of the title insurance premium tax was "directly imposed" upon them and that the comptroller's interpretation of the retaliatory tax scheme did not comport with the plain language of the premium and retaliatory provisions of the insurance code.

The Supreme Court also rejected arguments by the insurers that the comptroller's interpretation of the retaliatory tax scheme violated the state and federal constitutions. Finally, the Court added that the comptroller's interpretation of the retaliatory tax scheme equalized the tax burdens borne by title insurers in a way that was rationally related to a legitimate state purpose and, therefore, the Court rejected the insurers' state and federal equal protection claims.

PwC Observes: In a similar case, Illinois Supreme Court also ruled that the state's retaliatory tax on foreign corporations was constitutional (*Sun Life Assurance Co. of Canada v. Manna*, Ill., No. 103849, 11/29/07). "Foreign" insurance companies doing business in Texas should review their prior Texas filings.

For additional information please call Anthony DiGilio at (202) 414-1702 or contact your local insurance tax professional. Please visit us at: <http://www.pwc.com/us/insurance/tax>

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