

IN THE SUPREME COURT OF THE STATE OF MISSISSIPPI

**ST. PAUL FIRE AND MARINE INSURANCE
COMPANY; TRAVELERS CASUALTY AND
SURETY COMPANY OF AMERICA; FIDELITY
AND GUARANTY INSURANCE COMPANY; AND
THE UNITED STATES FIDELITY
AND GUARANTY COMPANY**

APPELLANTS

v.

CAUSE NO. 2009-CA-01248

**ED MORGAN, CHAIRMAN, MISSISSIPPI STATE
TAX COMMISSION**

APPELLEE

CONSOLIDATED WITH

FIDELITY & GUARANTY INSURANCE COMPANY APPELLANT

v.

CAUSE NO. 2008-CA-01931

**JOSEPH L. BLOUNT, IN HIS OFFICIAL CAPACITY AS
COMMISSIONER OF THE MISSISSIPPI STATE
TAX COMMISSION**

APPELLEE

**ON APPEAL FROM THE
CHANCERY COURTS OF HINDS COUNTY, MISSISSIPPI**

BRIEF OF APPELLEES

ORAL ARGUMENT REQUESTED

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STATEMENT ON ORAL ARGUMENT

In light of the constitutional issues raised in this appeal, *vel non*, oral argument is requested because the Commission believes it will aid the Court in a proper determination of the merits in this matter.

STATEMENT OF THE ISSUE

The Brief of the Appellants¹ correctly states the issue before the Court.

STATEMENT OF THE CASE

The Brief of the Appellants properly states the course of proceedings below.

STATEMENT OF THE FACTS²

This is a sales tax case involving the contractual duties of the Appellants pursuant to the payment or performance bonds they write for certain construction companies, their principals, doing business in Mississippi.

A little background information regarding the underlying tax at issue may prove helpful as the Court considers the issues before it. Appellants' reference to Section 31-5-57, Miss. Code Ann. is misplaced in the instant matter. The bonding statute at issue is governed by Section 27-65-21 Miss. Code Ann. This statute provides that entities engaged in construction activities are required to pay contractor's tax in the amount of three and one-half percent (3-1/2%). Failure to timely pay the contractor's tax when due can result in the assessment of penalties ranging from ten (10%) to fifty (50%) or interest at the rate of one percent (1 %) per month or both pursuant to Section 27-65-39, Miss. Code Ann. In addition to the tax, Section 27-65-21 also requires that any person entering into a contract over seventy-five thousand dollars (\$75,000.00) shall either pay the contractor's tax in advance or shall execute and file with the Commission a bond in a surety company authorized to do business in Mississippi conditioned on the assurance that all taxes due the State will be paid.

¹ For clarity, due to the number of surety companies involved in the instant appeal, they will be collectively referred to as "Appellants."

² For the purposes of this brief, the Commission will use the same reference system as the Appellants. Citations to the record on appeal are abbreviated as follows: "Rec02" indicates a citation to the clerk's papers by page number related to the Aaim Action; "Rec09" indicates a citation to the clerk's papers by page number related to the Multi-party action; "TR1" indicates a citation to the transcript of the June 10, 2008 hearing; and "TR2" indicates a citation to the March 13, 2009 hearing.

Section 27-3-31 Miss. Code Ann. authorizes the Commission to adopt rules and regulations necessary to implement the duties assigned to it by law. Title 35, Part IV, Subpart 1, Chapter 3, Section 100(6), Mississippi Administrative Code, formerly Commission Sales Tax Rule 41, was adopted by the Commission to address the bond requirement. (Rec02, 310). The rule requires that the bond be approved by the Commissioner. Pursuant to Section 27-65-21, the Commission also requires the bonds to contain a rider. The rider used by the sureties and their principles was approved by the Commissioner and specifically requires the payment of "all taxes, damages, interest and penalties, which may accrue to the State of Mississippi." (Example at Rec02, 348).

As part of its statutory responsibilities, the Commission undertook sales tax audits of various construction companies doing business in Mississippi. As a result of the audits, the Commission found additional tax liabilities were due from the taxpayers in the instant matter on various construction contracts covering various time periods. Pursuant to Section 27-65-37 Miss. Code Ann., assessments were issued to the taxpayers reflecting the tax liabilities determined to be due and owing the State of Mississippi. (Example at Rec02, 294-96) The assessments reflected the amount of additional tax due and a sum for damages and interest. Additionally, the assessments provided that the taxpayer could timely request a hearing before the Commission's Board of Review for a review of the assessment and tax liability. Pursuant to Section 27-65-57 Miss. Code Ann., failure to pay the tax, damages (penalties) and interest after receiving notice and demand (the assessment), and if such taxpayer has not filed a timely appeal to the Board of Review, the Commissioner may proceed to file notices of tax liens for the sales tax, damages and interest with the circuit court in which the taxpayer resides or owns property. In other words, if the tax assessment is not appealed and remains unpaid, it is considered to be a finally determined tax liability subject to no further administrative or judicial review.

One or more of the construction companies appealed the assessments to the Board of Review where they were given a hearing and an opportunity to contest the assessments. In each of the appeals, the Board affirmed the assessments. Although taxpayers, aggrieved by the decision of the Board of Review, had the right of further appeal to and review by the State Tax Commission, a three-member panel appointed by the governor, no further appeals were made by any of the subject taxpayers. Therefore, the assessments became final and collection efforts were initiated but were without success.

Once it was determined that portions of the contracts involved in the subject audits were covered by surety agreements between the taxpayers and the Appellant sureties, demands for payment were made upon the Appellants pursuant to Section 27-65-57 Miss. Code Ann., which provides that “[u]pon failure to pay the taxes imposed under this chapter by any taxpayer who has executed any surety bond under the provisions of this chapter, the commissioner shall give notice of such failure to the sureties of such bond and demand payment of the tax, damages and interest within ten (10) days.”

The Appellants, having attempted unsuccessfully to exercise the due process rights due and already afforded the taxpayers before the Commission, either paid the taxes under protest and filed an appeal or filed for injunctive relief. In both instances, the Appellants were unsuccessful in the lower courts. (Rec02, 776-83; Rec09, 475-84).

SUMMARY OF THE ARGUMENT

The Commission believes and asserts that the case *sub judice* is nothing more than a simple contract case and that, as a result of surety agreements entered into by and between the principal taxpayers and the Appellants, the Appellants became liable to the State of Mississippi for the tax, penalty and interest arising as the result of tax audits and subsequent assessments against the taxpayers by the Commission. The Commission asserts (1) that the penal sum of the

bonds or surety agreements in question clearly provided for the payment of tax, penalty and interest and that the payment thereof to the Commission by the Appellants as surety is entirely consistent with Mississippi law; (2) that the Commission had the authority to require that the bonds guarantee the payment of tax, penalty and interest and that the Appellants should be estopped from arguing that the bonds can only guarantee the payment of tax owing by the principal when the bonds expressly require the payment of tax, penalty and interest, were issued by Appellants without objection and relied upon by the Commission; (3) that collecting the sum of tax, penalty and interest assessed to the taxpayers from Appellants does not absolve the taxpayers from its mistakes and unfairly shift the burden of the penalty to Appellants because Appellants are engaged in the business of issuing such bonds and assumed the risk inherent in the issuance thereof, and because the taxpayers remain liable to Appellants for the full sum of the tax, penalty and interest paid by Appellants; and (4) that the Appellants attempt to have the constitutional due process guarantees afforded to the principals as taxpayers extended to Appellants in their capacity, not as taxpayers, but as sureties, is novel and unprecedented, would upset traditional understandings of contract law, would be in conflict with express confidentiality provisions of the tax code and could subject Commission employees to loss of employment and criminal sanctions.

STANDARD OF REVIEW

This matter involves judicial review of an administrative agency's determination. It is well established that when an administrative determination has been made by the Commission the affected party may appeal to the judicial tribunal designated to hear the appeal, but that, because the Court cannot enter the field of administrative agency, the Court will only entertain the appeal to determine whether or not the action of the administrative agency (1) was supported by substantial evidence, (2) was arbitrary or capricious, (3) was beyond the power of the

administrative agency to make, or (4) violated some statutory or constitutional right of the complaining party. *See Mississippi State Tax Comm'n v. Mask*, 667 So.2d 1313, 1314-15 (Miss. 1995) and *Mississippi State Tax Comm'n v. Vicksburg Terminal, Inc.*, 592 So. 2d 959, 961 (Miss. 1991). To the extent the Appellants have raised constitutional issues; the appeal is *de novo* on those issues alone.

ARGUMENT

THE COURTS BELOW DID NOT ERR IN FINDING NO DUE PROCESS VIOLATIONS

This Is A Contract Case

Appellants spend twenty plus pages arguing that they are entitled to substantive and procedural due process. Like the herring that is dragged across a trail to throw the hounds off scent, the Commission respectfully advises the Court not to allow this argument to divert it from the central issue. As both Courts hearing this matter below determined, this is a contract issue not an issue of constitutional law. (Rec02, 776; Rec09, 475). Appellants were the sureties on several bonds wherein various construction businesses were designated as principals and the owners of the various projects were designated as obligees with one of the conditions under the bonds being the payment of all taxes, damages, interest and penalties, which may accrue to the State of Mississippi. Appellants had a contractual relationship with their principals to guarantee the payment of certain tax liabilities in the event the principals defaulted on making the payments. Appellants, as the sureties, do not have standing to raise the constitutional issues of procedural and substantive due process owed and provided to their principals (taxpayers).

The Sureties Were Not Entitled To Due Process

Appellants seek to have due process rights enjoyed by their principals, as taxpayers, extended to them in their capacity as a surety. Due process is difficult to quantify. In that regard it has been said that:

The term “due process of law” asserts a fundamental principle of justice, rather than a specific rule of law, and thus is not susceptible of more than a general statement of its intent and meaning, which are ascertained in the history of specific applications to cases requiring judicial decisions. The primary guide in determining whether a principle is a fundamental principle of justice protected by the Due Process Clause is historical practice.

16B AM. JUR. 2D, *Constitutional Law*, § 896.

In the case before the Court, Appellants seek to upset well-established law in favor an unprecedented constitutional standard. The Courts “are bound to enforce contract language as written and give it its plain and ordinary meaning if it is clear and unambiguous.” *Mississippi Farm Bureau Ins. Co. v. Britt*, 2001-CA-01011-SCT (Miss. 2002). Each of the bonds issued by Appellants specifically provides for the payment of “tax, damages, interest and penalties.”

It is also well settled that a creditor has no obligation to care for the interests of the surety. It has been said that:

Inasmuch as the creditor owes no duty of active diligence to take care of the interests of the surety, his mere failure voluntarily to give information to the surety of the default of the principal cannot have the effect of discharging the surety. The surety is bound to take notice of the principal’s default and to perform the obligation and he cannot complain that the creditor has not notified him in the absence of a special agreement or express provision in the surety contract.

74 AM. JUR. 2D, *Suretyship*, § 30.

Furthermore, the bonds in question only authorize the Commission to release confidential taxpayer information to the surety in the event of a claim. Each of the bonds contains the following language:

NOTWITHSTANDING the tax information and return confidentiality provisions contained in Sections 27-65-1 et seq., 27-67-1 et seq., 27-7-1 et seq., 27-13-1 et seq., 27-7-301 et seq., and 27-55-301 et seq., Mississippi Code of 1972, and amendments thereto, principal hereby authorizes the State Tax Commission to release to surety any information *relating to any claim against said surety made by the State Tax Commission which is covered by this bond*.

(Example at Rec02, 348) (emphasis added). The bonds contain no provision requiring the Commission to notify a surety of any default by its principal. Should the Commission have

released the information prior to making a claim, as demanded by Appellants, the Commission would have been in clear violation of Sections 27-3-73 and 27-65-81 Miss. Code Ann., in the case now before the Court. Section 27-3-73 Miss. Code Ann., provides

[e]xcept in accordance with proper judicial order, it shall be unlawful for the members of the State Tax Commission, any deputy, agent, clerk or other officer or employee, to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required on any taxes collected by reports received by the State Tax Commission.

Section 27-65-81 Miss. Code Ann., provides that

[a]pplications, returns and information contained therein filed or furnished under this chapter shall be confidential, and except in accordance with proper judicial order or as otherwise authorized by this section, it shall be unlawful for members of the State Tax Commission or members of the Central Data Processing Authority, any deputy, agent, clerk or other officer or employee thereof, or any former employee thereof to divulge or make known in any manner the amount of income or any particulars set forth or disclosed on any application, report or return required.

Additionally, releasing the information prior to making a claim could conceivably result in the imposition of criminal penalties and the loss of employment under Section 27-7-87 Miss. Code Ann., if the audit involved income taxes.

The Commission has twice argued that the sureties have an implied obligation to know their principals. They are in the best position to monitor their principals in the performance of the terms of the bond. They certainly have the contractual ability to periodically require the principals to keep the sureties apprised of their financial status, proof of performance and conformity to tax laws. Additionally, they can require the principals to provide waivers or powers of attorney to allow the sureties to communicate with the Commission relative to tax matters on bonded projects. (TR1, 29-30; TR2, 34-36). The use of powers of attorney and waivers of confidentiality has been common with the Commission for many years. There is nothing new in the Commission's requirement that one be presented prior to the Commission's divulgence of confidential information to a third party.

In the matter of *American Fidelity Fire Ins. Co. v. State Bd. of Equalization*, 34 Cal. App. 3d 51 (1973), the California Court of Appeals addressed a matter almost on point with the instant appeal before this Court. When faced with a complaint of a surety company, purporting to be a class action, seeking a refund of penalties it and others similarly situated had paid on behalf of retailers defaulting on sales and use tax, the court affirmed the lower court's entry of judgment in favor of the taxing authority. The court rejected the surety's contention that its right to due process of law was violated by the imposition of liability on it for penalties assessed against the defaulting taxpayers without advance notice that would enable it to pay the tax before any penalty was imposed. The facts of the case are very similar to those before this Court. The California appellate court noted that

[d]ue process, as it has evolved with respect to taxes, has been described in the following terms:

'It may be stated as a general rule that the due process clause of the federal constitution, Amend. 14, is satisfied in matters of taxation if, at some stage before a tax becomes irrevocable {sic} fixed the Taxpayer is given the right, of which he shall have notice, to contest the validity or amount of the tax before a board or tribunal provided for that purpose.' (Citations omitted).

Id. at 55.

Finding in favor of the Board, the court held,

Plaintiff argues that the taxing system, imposing penalties, is unreasonable; serves no useful purpose, punishes the surety rather than the actual wrongdoer, the defaulting taxpayer; and compels the surety to participate in an illegal contract. We find no merit in these contentions. The bonding requirement is a reasonable method of securing payment of revenue to the state. So, too, are the penalty provisions, the major purpose of which is to insure payment of taxes to the state, rather than to punish individual taxpayers or their sureties, who are not compelled to write bonds but do so for remuneration. Consideration of prompt payment is unusually present in the taxing situation when assurance is sought that revenue will be received in timely fashion from small business establishments, such as those whose bonds were the subject of this action by the plaintiff.

Id. at 56.

As argued below, the Commission deals with thousands of bonds. Contractors do not always bond all of their projects with the same surety, in the F&G case below, only six of fourteen bonds were written with F&G. (TR1, 26). When the contractor made his tax payments, the Commission had no way of knowing to which project the payments were related until the contractor was audited. Accordingly, the audit of the taxpayer in this case involved projects, income and tax liabilities unrelated to the F&G bonds. Unlike the Commission, the surety is in the first and best position to know how its principal is doing and to take action to protect its contractual obligations and potential liabilities. This argument was thoroughly developed and accepted by the lower court. (TR1, 29-39).

It is well settled that a creditor owes no duty to take care of the interests of the surety, that the surety is bound to take notice of the principal's default and that the surety cannot complain that the creditor has not notified the surety in the absence of a special agreement or express provision in the surety contract. *See* 74 AM. JUR. 2D, *Suretyship*, § 30.

The bonds in question contain no provision whatsoever requiring the Commission to notify the surety of any audit of the principal, of any assessment against the principal, of any hearing involving the principal or of any offer of settlement. In fact, the bonds recognize that the release of such information prior to the making of a claim would violate the confidentiality provisions of our tax law. The foregoing confidentiality provision makes it clear that not only are notifications of the kind demanded by Appellants not required by the bonds but the taxpayer only authorized the release of such information to the sureties in the specific event of a claim. If the Court were to rule in favor of Appellants on this issue, traditional notions of contract law would be upset in favor of an unprecedented constitutional standard that would completely ignore the express provisions of the bonds issued by Appellants and relied upon by the Commission as well as disrupt well-settled law.

In so far as the Appellants rely on the testimony of a Commission employee to make their case that confidentiality is not an issue, Meg Barnes, former Director of the Sales and Use Tax Bureau, simply misspoke during her deposition, when she was asked if there was anything that would prohibit providing F&G with copies of a notice of an audit, the audit results and the notice of the hearing before the Board of Review. (Rec02, 82) It is and has been the Commission's longstanding position that all of this communication is confidential and prohibited from disclosure to third parties short of written authorization from the taxpayer pursuant to Section 27-65-81 Miss. Code Ann. The Commission classifies information regarding a "return" to consist of return information which includes, among other things, the taxpayer's identity, address and account number; the nature or source or amount of payments, receipts, exemptions, credits, liabilities, tax liability and assessments; and whether a return is being, or will be examined or subject to other investigation, processing or collection activities.

Chancellor Wise agreed with this argument, writing in her order of October 21, 2008, "Aaim was the only entity entitled to the due process right afforded a taxpayer under United States or Mississippi law." The Court continued, "F&G is a large institution with extensive knowledge regarding the terms and enforcement of Bonds; therefore, this Court is convinced that F&G was aware and understood the confidentially [sic] policy and terms contained in the Rider and in the Mississippi Tax Code. . . . Further, this Court agrees with the Commission's assertion that they were statutorily prohibited from providing F&G with notice of the audit, assessment, and August 2, 2001 hearing." (Rec02, 776 at 781).

Sureties' Liability for Tax, Penalty and Interest

The penal sum of the bonds issued by the Appellants, as surety, on behalf of the construction companies, as principal, clearly provide for the payment of tax, penalty and interest, and payment thereof by Appellants to the Commission and is entirely consistent with Mississippi

law. Once again, courts “are bound to enforce contract language as written and give it its plain and ordinary meaning if it is clear and unambiguous.” *Britt*, 2001-CA-01011-SCT ¶ 14. “There is an ambiguity in an insurance contract when the policy can be interpreted as having two or more reasonable meanings.” *Id.* Here the riders provide as follows:

WHEREAS, under the provisions of Section 27-65-21, Mississippi Code of 1972, as amended, the said Principal is required to and has furnished the attached bond guaranteeing payment of all taxes, damages, interest and penalties which may accrue to the State of Mississippi under Section 27-65-1 et seq., and Section 27-67-1 et seq., and Section 27-7-1 et seq., and Section 27-13-1 et seq., and Section 27-7-301 et seq., and Section 27-55-313, Mississippi Code of 1972, and amendments thereto, on account of entering into said contract.

NOW THEREFORE, in addition to the obligations set forth in the attached bond, there is hereby imposed the additional obligation by this Rider that the Contractor shall promptly make payment when due of all taxes, damages, interest and penalties which may accrue to the State of Mississippi under Section 27-65-1 et seq., and Section 27-67-1 et seq., and Section 27-7-1 et seq., and Section 27-13-1 et seq., and Section 27-7-301 et seq., and Section 27-55-313, Mississippi Code of 1972, and amendments thereto, on account of the execution of the aforesaid contract.

(Example at Rec02, 348). As one can readily see, the language contained in the bonds is in fact clear and unambiguous. Our courts have enforced clear and unambiguous contract provisions contained in bonds such as one requiring the payment of attorney’s fees. *Stowell v. Clark*, 118 So. 2d 370, 372 (Miss. 1928). Additionally, in *Stowell*, the Court found that the purpose of the bond was to protect the beneficiaries thereof, “and, in order to do so, the bond provided that all expenses and costs and attorney’s fees incurred by them in the enforcement of their rights should be paid by the obligors in the bond.” *Id.* Here it is clear that the purpose of the bond was to make the State of Mississippi whole including the payment of all taxes, damages, interest and penalties that may due.

As to *State v. Moody*, 198 So. 2d 586 (Miss. 1967), which Appellants rely upon to support the proposition that a surety is only liable for interest that accrues after demand on the surety, the Commission asserts that said decision merely stands for the proposition that interest

beyond the penal sum can be collected from a surety on account of the surety's default only after notice to the surety; not that interest can never be included in the penal sum. It is cited as such in a treatise on risk management, which states as follows:

Another issue commonly faced in the area of public official bonds is whether the surety should be liable for interest on the amount of the loss caused by the principal from the time of the loss, or whether the interest is recoverable only from such time as the surety is notified of the default of the principal and refuses to make good that default.

The cases are split on this point. When interest has not been allowed from the time of default, it has been because the interest is viewed as a penalty on the principal sum (citing *Moody*). Under this view, the surety should not be penalized until it has defaulted on its obligation. This occurs at such time as the surety has been advised of the breach of the terms of the bond by its principal and demand made of the surety to make good that breach.

When interest is allowed from the date of default of the principal, it is under the rationale that the principal is liable for interest from the date of default and that the undertaking of the surety is to make good the entire default of the principal.

INSURANCE RISK MANAGEMENT--*State & Local Governments* § 27.07, Copyright 2003, Matthew Bender & Company, Inc. (Rec02, 310-21). As is readily evident here, the penalty of the bond in the case before the Court includes tax, penalty and interest.

With regard to the Commission's demand for tax, penalty and interest and with regard to the Appellants' due process concerns, these matters are controlled by Section 27-65-57 Miss. Code Ann., which provides in part as follows:

Upon failure to pay the taxes imposed under this chapter by any taxpayer who has executed any surety bond under the provisions of this chapter, the commissioner shall give notice of such failure to the sureties of such bond and demand payment of the tax, damages and interest within ten (10) days. If the sureties on the taxpayer's bond shall fail or refuse to pay the penal sum demanded within the ten (10) days allowed, the commissioner shall file a notice of tax lien with the circuit clerk of the county in which the sureties reside or own property which shall be enrolled upon the judgment roll, and the commissioner may proceed to collect from the sureties as hereinafter provided for collecting from any judgment debtor.

Section 27-65-57 Miss. Code Ann. (emphasis added).

The controlling rule of legislative construction dispositive of this case is that each section of the Code dealing with the same or similar subject matter must be read *in pari materia* and to the extent possible, each section of the Code must be given effect so that the legislative intent can be determined. See *Mississippi Public Service Comm'n. v. Municipal Energy Agency*, 463 So. 2d 1056 (Miss. 1985) (citing *Atwood Chevrolet-Olds, Inc. v. Aberdeen Municipal School Dist.*, 431 So. 2d 926 (Miss. 1983); *Lamar County School Bd. of Lamar County v. Saul*, 359 So. 2d 350 (Miss. 1978)). It is elementary that statutes *in pari materia* are to be taken together in ascertaining the intention of the legislature, and that courts will regard all statutes upon the same general subject matter as part of one system. It is unquestionable that the Commission's statutorily imposed duty to notify and make demand on the surety arises only after the taxpayer has failed to pay an assessment that is final. The Commission has no duty or authority to notify the surety before the taxpayer fails to pay a final assessment.

With regard to the Appellants' liability for penalty and interest, Section 27-65-57 Miss. Code Ann., clearly contemplates the payment of tax, damages and interest. As noted above, statutes must be read together. The mere fact that Section 27-65-21 Miss. Code Ann., only refers to tax is not controlling when the legislature clearly requires the Commission to demand payment of "tax, damages and interest." More importantly, the rider itself provides for the payment of "tax, damages and interest."

The assertion by the Appellants that the Commission did not have the authority to collect penalty and interest assessed to the principal taxpayer from the sureties under bonds written by the sureties, because the statute authorizing the bonds, being Section 27-65-21 Miss. Code Ann., only requires that such bonds ensure the payment of tax, rather than tax, penalty and interest, is incorrect. While Section 27-65-21 does in fact require that such bonds will be conditioned so that all taxes due the State of Mississippi will be paid when due, it does not act as a limitation

which would prevent the Commission from including tax, penalty and interest in the penal sum of any bond as in the case now before the Court. Section 27-3-31 Miss. Code Ann. authorizes the Commission to adopt rules and regulations necessary to implement the duties assigned to it by law. As addressed above, Rule 41 was adopted by the Commission to address the bond requirement contained in Section 27-65-21. Rule 41 requires that the bond be approved by the Commissioner. The bonds that are the subject of this action are approved by the Commissioner and specifically require the payment of "all tax, damages, interest and penalties, which may accrue to the State of Mississippi." (Rec02, 348) Moreover, the Appellants were and are engaged in the business of issuing such bonds for a fee or premium. Because the Commission relied upon bonds willingly issued without objection by the Appellants as sureties, Appellants are estopped from now arguing that the bond exceeded that authorized by statute and could only protect the State of Mississippi against the loss of tax rather than tax, penalties and interest.

Although the purpose of exacting penalties from taxpayers who fail to follow the tax code is to induce prompt payment of taxes from those taxpayers and the principal's negligence caused the penalties to be assessed. The Commission was acting within its statutory authority when it collected penalty and interest from Appellants because of their principals' failure to pay their taxes when due. The principals are not absolved of the obligation. It is well settled that, when a surety pays the debt of another, the surety is entitled to reimbursement from the principal debtor. Accordingly, the principals, the parties that engaged in the conduct that precipitated the penalty, continue to be liable for the entire sum of the tax, penalty and interest but to Appellants as sureties rather than to the Commission.

THE TRIAL COURTS DID NOT ERR IN FINDING THAT THE SURETIES LACKED STANDING

Appellants in the Multi-party action sought relief pursuant to Section 11-13-11 Miss. Code Ann. This section provides that “[t]he chancery court shall have jurisdiction of suits by one or more taxpayers in any county, city town, or village, to restrain the collection of any taxes levied or attempted to be collected without authority of law.” Section 11-13-11 Miss. Code Ann. The Appellants in this matter did not have standing, as they were and are not “taxpayers” or “the taxpayer” relative to the underlying tax liabilities at issue in the Commission’s collection attempts. They are not and were never at any time relative to this matter the taxpayer with the statutory definitions provided by Section 27-65-3 Miss. Code Ann., which provides that a taxpayer is any person liable for or having paid any tax to the State of Mississippi under the provisions of this chapter. The statute further provides that taxpayers are required to obtain a sales tax permit before engaging in business in this state.

Admittedly, the Appellants are taxpayers in their own individual right, for the businesses they operate, St. Paul, Travelers, Fidelity and Guaranty and USF&G are insurance or surety companies, and as such they regularly write payment or performance bonds and serve as sureties on these bonds. As such, they probably do pay various taxes to the taxing jurisdictions within which they operate.

When the Appellant surety companies made payment to the Commission as required by the subject bonds, they were not making a tax payment; the sureties were paying a debt, incurred by various principals, which the surety was contractually obligated to pay. The Court must not be led astray by the Appellants’ attempts to recreate or recast themselves as the taxpayers in this matter.

“Statutes in effect at the time when a suretyship is entered into are to be considered in interpreting it and if statutory law gives to the contract a certain legal effect, that law is as much

a part of the contract as if incorporated in it, and the surety is bound according to such law.” 74 AM. JUR. 2D, *Suretyship*, § 24.

Not only would Appellants have the Court ignore the foregoing, they would do so without offering to the Court a single example of another Court extending the same constitutional protections on the basis of similar facts. Appellants rely on *Exchange Mutual Ins. Co. v. Olsen*, 667 S.W.2d 62 (Tenn. 1984), a Tennessee case which they allege addressed this issue; however, *Exchange* can be easily distinguished from the case at bar. *Exchange* is a 1984 decision in which Martha Olsen, Commissioner of Revenue for the Tennessee Department of Revenue, was attempting to collect on the bonds held by Exchange for the payment of alcoholic beverage consumption taxes owed by the principal restaurant. An audit was completed and an erroneous finding was made that all taxes were paid and the surety was discharged from any obligation to the State of Tennessee. A subsequent audit was made resulting in a finding of tax liability covered under bonds held by Exchange. Demand was made by the State of Tennessee, the Surety paid the taxes under protest, and a refund suit was filed.

In the refund claim, Exchange Mutual contended that the issue was one of performance of contract, and in serving as surety in the matter, Exchange completely performed its obligation and was thereafter discharged by the Department of Revenue. Under this theory, Exchange argued that the discharge operated to sever the contractual relationship that existed between these two parties. The Tennessee Supreme Court disagreed finding the surety, Exchange, was liable for taxes and that the “surety stands in the shoes of the principal.” *Exchange*, 667 S.W.2d at 63.

It is both important and interesting to note that Appellants omitted a key sentence from the decision. Where counsel opposite places an ellipsis or *** in its quoted language from the case, the opinion actually continued “[F]urthermore, the bonds executed in this case contain a clause placing the surety in the position of the principal.” *Id.* at 63 (emphasis added). The

surety and principal expressly contracted in the bonds that the surety would stand in the shoes of the principal. This is quite different from the facts in the case at bar.

Additionally, in *Exchange*, the Tennessee Supreme Court relied on two prior decisions, *In Re Estate of Darwin* (1973) and *City of Nashville* (1913). Both of these cases were decided prior to the 1977 enactment of the relevant Tennessee confidentiality statutes codified as Sections 67-1-1701 through 67-1-1706 Tenn. Code Ann. Currently, Tennessee confidentiality statutes, like those of Mississippi, prohibit the employees of the Department of Revenue from disclosing information regarding tax returns, tax information and tax administration information in any manner. See Tenn. Code Ann. § 67-1-1702(a). Finally, Section 67-1-1706(b) Tenn. Code Ann. expressly provides that “[i]f any taxpayer is required to submit a bond to secure the payment of any taxes that may be due to the department, the amount of the outstanding obligation of the tax payer **may** be disclosed to any person who stands as surety on the bond for such taxpayer.” Tenn. Code Ann. § 67-1-1706(b) (emphasis added). If the surety stands in the shoes of the taxpayer, why the necessity for this section and why is the disclosure permissive but not mandatory? The Commission asserts it is because Tennessee has adopted an administrative appeal process similar to that utilized in Mississippi and the surety is not statutorily involved in the process until the administrative appeal process is completed and a bond claim is made against the surety.

While Appellants cite many cases to support their due process theories, they have not cited a single case in which the due process rights afforded to a taxpayer such as the underlying principals have been extended to a third party such as the Appellants in its capacity as a surety. Although Appellants cite *Cooper Industries* and *Hanberry Corp.* in footnote 7, page 45 of their brief as support for the proposition that in Mississippi, a surety stands in the shoes of the principal, both of these cases involve sureties who actually take over performance of the contract

and where the sureties themselves act as the contractor upon the principals' default on the contract. Each of these cases is easily distinguished from the instant matter and Appellants' reliance upon them is misplaced.

Appellants have not produced a case in which any court has held that the due process rights afforded to a principal must be afforded to the principal's surety under the facts of the instant case. Appellants have not produced such a case because there is no such duty.

THE COURTS BELOW DID NOT ERR IN THE APPLICATION OF LAW

As addressed above, in the case before the Court, Appellants seek to upset well-established law in favor an unprecedented constitutional standard. Courts are to enforce contract language as written and give it its "plain and ordinary meaning" if it is clear and unambiguous. Each of the bonds issued by Appellants specifically provides for the payment of "tax, damages, interest and penalties."

The Commission incorporates the argument and reasoning previously addressed herein, specifically those on pages 10-14, as basis for why the lower courts did not err in the application of the law. The Commission reiterates that our courts have enforced clear and unambiguous contract provisions contained in bonds. *Stowell* 118 So. 2d at 372. In the instant matter, it is clear that the purpose of the bond was to make the State of Mississippi whole including the payment of all taxes, damages, interest and penalties that may due.

The Appellants' *Moody* argument has previously been addressed, the Commission asserting that the decision merely stands for the proposition that interest beyond the penal sum can be collected from a surety on account of the surety's default only after notice to the surety not that interest can never be included in the penal sum.

Finally, the Appellants should be estopped from arguing that the bonds can only guarantee the payment of tax owing by the principal when the bonds expressly require the

payment of tax, penalty and interest, and were issued by Appellants without objection and relied upon by the Commission.

CONCLUSION

At all times relevant to the case, the principals were the taxpayers entitled to the full protection of substantive and procedural due process. The record reflects the Commission afforded the principals with due process. Appellant sureties were not entitled to the due process rights, which were intended for the taxpayer, and Appellants did not have proper standing to raise these issues in the lower court.

Appellants' position that the Commission's actions are an unconstitutional violation of their right to substantive and procedural due process is misplaced. Appellants' argument to the contrary, they did not step into the shoes of the taxpayer and they were not entitled to the due process rights accorded to the taxpayer. Appellants do not have standing to raise the constitutional issues of procedural and substantive due process owed the taxpayers.

The matter before the Court is essentially a contract case. The Appellants were the surety on various bonds wherein numerous contractors were designated as principals and the owners of the various projects were designated as obligees with one of the conditions under the bonds being the payment of all taxes, damages, interest and penalties, which may accrue to the State of Mississippi. A reading of the language contained in the bond and rider clearly evidences that Appellants had a contractual relationship with the principals to guarantee the payment of certain tax liabilities in the event they defaulted on making the payments. As the insurer, Appellants had the ability, and maybe even the responsibility, to investigate the principals, its insureds, and to take the necessary steps to assure itself that the liabilities for which it contracted itself to be liable for were paid by their principals in a timely manner.

The Commission was statutorily prohibited from disclosing to the Appellants the tax information that they argue they were entitled. Although the Appellants may not have been able to receive information directly from the Commission relative to the principals' tax status, Appellants had the ability to require the principals to provide them with a power of attorney or waiver allowing it to discuss the principals' tax status with the Commission. This they chose not to do.

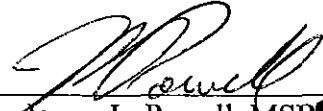


The Commission was acting within its statutory authority when it collected penalty and interest from Appellants because of their principals' failure to pay their taxes when due. The principals are not absolved of the obligation. When a surety pays the debt of another, the surety is entitled to reimbursement from the principal debtor. Accordingly, the party that engaged in the conduct that precipitated the penalty continues to be liable for the entire sum of the tax, penalty and interest but to the Appellants as sureties rather than to the Commission.

In each instance before the Court, the principal defaulted on a tax liability that was properly assessed against it and after being afforded with due process. Based upon the contractual agreement between the principals and Appellants, as expressed in the subject bonds and riders, Appellants were obligated to pay the tax liability for which demand was made by the Commission.

The Commission respectfully prays that the Court, after hearing oral argument or upon due consideration of the submissions, will affirm the Hinds County judgments in favor of the Commission.

Respectfully submitted this 1st day of July, 2010.

**MISSISSIPPI DEPARTMENT OF REVENUE,
FORMERLY THE MISSISSIPPI STATE TAX
COMMISSION**

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CERTIFICATE OF SERVICE

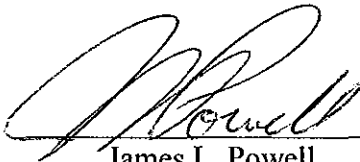
I, James L. Powell, attorney of record for the Mississippi State Tax Commission, hereby certify that I have this day caused to be served a true and correct copy of the foregoing Brief of the Appellee, via First Class United States mail, postage prepaid, to the following:

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This the 1st day of July, 2010.


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