IN THE SUPREME COURT
STATE OF FLORIDA
TALLAHASSEE, FLORIDA

IN RE: ADVISORY OPINION OF
THE GOVERNOR'S REQUEST OF
MAY 12, 1987

CASE NO. 70,533

**REPLY BRIEF OF FISERV TAMPA, INC.
CHALLENGING THE CONSTITUTIONALITY
OF EXEMPTION 35**

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INTRODUCTION

This Reply Brief will address the arguments raised by Florida Informanagement Services, Inc. ("FIS"), the apparent architect and sole beneficiary of Exemption 35. Neither the Governor nor any other interested party has attempted to justify Exemption 35's economic protectionism and consequent burden on interestate commerce.

Even FIS has been compelled to acknowledge that Exemption 35 must be declared unconstitutional if it amounts to economic protectionism or imposes an unreasonable burden on interstate commerce. Despite the clear purpose and effect of economic protectionism, however, FIS has painted a rather misleading picture of itself, attempting to make it appear that FIS is nothing more than a non-profit group essentially providing "in-house" services to S&Ls. In reality, however, FIS is the largest S&L data processing company in Florida with 1984 and 1985 revenues of $23,117,379 and $26,766,810, respectively. (A.19.) FIS had 1984 and 1985 net income of $1,456,914 and $216,766, respectively. (A.19.) FIS has larger per-client revenues than FIserv, stockholders who are not serviced by FIS, and customers who are not investors in FIS. FIS is committed to earning and increasing its own profits. (A.2.) Given the millions of dollars FIS has invested in computer equipment and facilities (A.3, 7-10), its large staff of employees (A.4, 11-12), and its multitude of customers (A.13-14), it strains

credulity to assert that FIS is analogous to an in-house S&L data processing department.

Contrary to FIS's assertions, there is practically no difference between FIS and FIserv. Both companies are "for profit," as reflected in their annual reports and confirmed by their financial statement accounting for profits and retained earnings. Both companies employ outside sales forces that actively compete for financial institution business. And both companies are equally subject to all other Florida and federal taxes. The only real difference between the companies is the list of shareholders.

In addition, FIS has as much as admitted that the service tax could have a disasterous consequence on companies such as FIserv, thus eliminating any competition in the market and hurting S&Ls who depend on FIserv's data processing. The clear purpose of Exemption 35 is to confer an economic benefit on FIS, impose a substantial burden on data processing companies such as FIserv, and to hurt S&Ls who depend on the economies of scale and efficiency of independent data processing. To say that S&Ls can perform their services in-house tax free is to ignore the fundamental economic reasons which cause S&Ls to choose FIserv's more efficient services. To say that FIserv's S&L clients can band together and form their own company is to ignore the vast capital requirements and expertise required for such a company, as evidenced by the millions of dollars invested by FIS in its own computer equipment, facilities, and staff.

Exemption 35's barrier to interstate competition, as well as its irrational and arbitrary classifications violate the fundamental requirements of the commerce clause as well as equal protection and due process.

I. THIS COURT MAY PROPERLY RENDER AN ADVISORY OPINION ON THE CONSTITUTIONALITY OF EXEMPTION 35.

FIserv's challenge to Exemption 35 comes squarely within this Court's interlocutory order of May 13, 1987, granting review of the constitutionality of the service tax. If the Justices determine that Exemption 35 is unconstitutional, elimination of Exemption 35 will add tax revenue, and provide the Governor with an accurate assessment of total expected revenues from the tax, (even possibly offsetting any loss of revenue resulting from other challenges to the tax). In addition, a constitutional determination at this point, persuasive on lower courts, could allow the State to collect full tax revenues from FIS, thus eliminating the discriminatory taxing of companies such as FIserv. Eliminating this disparity as soon as possible would substantially lessen the risk that the State may be liable for damages and/or a tax refund if the tax were discriminatorily applied only to companies such as FIserv. See, e.g., Osterndorf v. Turner, 426 So.2d 539, 545 (Fla. 1982) (homestead exemption refund available to challengers); State of Florida ex rel. Palmer-Florida Corp. v. Green, 88 So.2d 493, 495 (Fla. 1956) (recovery of documentary tax); City of Miami v. Florida Retail Federation, Inc., 423

So.2d 991, 993 (Fla. 3d DCA 1982) (refund of taxes paid pursuant to unlawful assessment).

Finally, the undeniable effect of the discriminatory tax on companies such as FIserv would result in FIserv losing taxable revenue, and possibly being driven out of business. Once these events take place, the State will no longer have a source of tax revenue from FIserv, and will be left with substantially reduced service tax revenues.

II. THE GLITCH BILL AMENDMENTS TO EXEMPTION 35 FURTHER SECURE THE PROTECTIONIST ADVANTAGE CONFERRED ON FIS.

Only days after FIserv and North American Financial Services, Ltd. submitted their briefs to this Court, an amendment was presented in the House Finance and Taxation Committee meeting of June 1, 1987, slightly modifying Exemption 35. The amendment adopted by the House Committee but not the Senate, was successfully inserted in the conference bill which ultimately passed. The amended section, taken directly from the Glitch Bill (with legislative editing in place) is set out below:

> (35) Data processing services performed for a financial institution by a service corporation of that a financial institution ~~described in SIC Major Group 61~~, provided:
>
> (a) The service corporation is organized pursuant to s.545.74, Rules of the Federal Home Loan Bank Board;
>
> (b) All captial stock of the service corporation may be purchased by only savings and loan associations and savings banks having operations in this state;

(c) No savings and loan association or savings bank owns, or may own, more than 10 percent of such service corporation's outstanding capital stock;

(d) Every eligible savings and loan association or savings bank shall may own an equal amount of capital stock or shall may, on such uniform basis as the service corporation shall may determine, own an amount of such stock equal to a stated percentage of its assets or savings capital at the time the stock is purchased, or an amount of such stock equal to its pro-rata share of accounts serviced.

(e) As used in this subsection, "financial institution" means any savings and loan association or savings bank organized under the laws of this state, or of another state, or of the United States.

The effect of amended Exemption 35 is to provide exempt data processing for S&Ls who are also shareholders of FIS, but to impose the service tax on all interstate competition with FIS. The taxation burden falls primarily on two areas of interstate commerce: (1) it burdens independent companies such as FIserv by taxing data processing services for S&Ls without being afforded an exemption under any circumstances; and (2) it requires S&Ls who now purchase data processing services from independent companies either to pay the tax, restructure their entire data processing function by bringing it in-house, or go through the convoluted ownership requirements in setting up an exempt service corporation. Exemption 35 burdens these S&Ls by requiring a combination of at least 10 investors, all with ownership of less than 10% of the stock, and all willing to invest in equal or pro rata proportion. In addition, such a group of S&Ls must make the very substantial capital

investments required for establishing a data processing company that can operate with economies of scale. The artificial ownership constraints, as well as the substantial capital and technological requirements for start-up of such a company, effectively bar any other S&Ls from following FIS.

In addition, Exemption 35 effectively bars any out-of-state S&L from investing in such an exempt service corporation. The architects of Exemption 35 accomplished this goal by taking clever advantage of pre-existing federal law (unrelated to taxation) that requires an S&L service corporation to be a corporation of the same state in which the financial institution has its home office. 12 U.S.C. § 1464(c)(4)(B). As an example of Exemption 35's burden on out-of-state S&Ls, a Georgia S&L is precluded under preexisting federal law from joining an exempt Florida service corporation. Even if the Georgia S&L were an investor in a Georgia service corporation, it would not be allowed the exemption unless the service corporation meets the ownership requirements of Exemption 35 and only if all of the participating S&Ls had operations in Florida as required by Exemption 35. An out-of-state S&L having operations in the State of Florida would therefore only be entitled to form such an exempt service corporation if it were able to do so with at least nine other S&Ls of its home state, who likewise have operations in Florida, and who have the financial and technical wherewithall to establish and operate a data processing service corporation. Exemption 35, therefore, read in light of preexisting federal

regulations, prevents out-of-state S&Ls from participating in an exempt Florida service corporation and effectively prevents them from forming an out-of-state tax free service corporation.

In fact, Exemption 35 conflicts with federal law by placing limitations on the formation of service corporation inconsistent with the federal regulations found in 12 C.F.R. § 545.74. (A.66-71.) Nothing in section 545.74 places limitations on service corporation ownership akin to Exemption 35, but rather imposes its own criteria for investment. See § 545.74(d)(1). Although section 545.74 justifiably imposes limitations on loans available to certain service corporations, see § 545.74(d)(3), ownership criteria related to loans have nothing to do with data processing or taxation. As a result, Florida has now established a separate set of ownership criteria for service corporations performing data processing services that is more restrictive than established by federal regulation.

Finally, even if there were a realistic option available to S&Ls to form an exempt service corporation, many S&Ls are precluded from doing so by existing one-to-five-year contracts with independent data processors. In this area as well, FIS receives a tailor made competitive advantage.

The architects of Exemption 35 may not therefore hide behind federal regulations or glib suggestions in attempting to justify burdens that they themselves have imposed on independent data processors as well as other S&Ls. They must take full responsibility for a discriminatory exemption that

will result in a tax-free benefit to one and only one corporation in the State of Florida -- FIS.

III. EXEMPTION 35, AS AMENDED, CONSTITUTES ECONOMIC PROTECTIONISM AND IMPOSES AN UNCONSTITUTIONAL BURDEN ON INTERSTATE COMMERCE.

FIS has acknowledged the constitutional prohibition against economic protectionism but has attempted to ignore the clear protectionist purpose and effect of Exemption 35. Both the United States Supreme Court and this Court have consistently recognized that discriminatory taxing measures that impose a tax exemption for in-state companies and a consequent tax burden on interstate competition will be readily declared unconstitutional. E.g., Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 194 S.Ct. 3049, 82 L.Ed 2d 200 (1984); Delta Air Lines, Inc. v. Department of Revenue, 455 So.2d 317 (Fla. 1984).

As this Court recognized in Delta Air Lines, "No state may, consistent with the commerce clause, impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." 455 So.2d at 319, quoting Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 329, 97 S.Ct. 599, 607, 50 L.Ed. 2d 514 (1977). In Delta this court declared unconstitutional a tax credit system analogous to Exemption 35 which conferred "an artificial economic advantage on those interstate air carriers who maintain corporate or business homes in Florida over those competing air carriers who base their corporate headquarters outside the state." Exemption 35 attempts to confer the same

artificial advantage on FIS at the expense of interstate competition from firms such as FIserv. Exemption 35 likewise grants an exemption to entrenched Florida S&Ls at the expense of competition from out-of-state S&Ls.

A. Economic Protectionism

The clearest form of economic protectionism imposed by Exemption 35 is the benefit conferred on FIS at the expense of FIserv. Both companies provide exactly the same service, in the same market, and in the same manner. Yet FIS's operations now become tax free while FIserv and all other data processors must collect a 5% tax from its Florida customers. The exemption provides a classic example of protecting a particular local interest by burdening interstate commerce and competition.

The next clearest example of economic protectionism is the benefit conferred on the S&Ls who happen to be shareholders of FIS, at the expense of S&Ls who now depend on independent data processors. The S&Ls who are shareholders of FIS will be allowed tax free data processing services even though they do <u>not</u> process data in-house, or even through a small cooperative venture. The FIS shareholders are part of a profitable multi-million dollar Florida data processing corporation that has now been granted a monopoly on tax-free services to its owner-customers. The clear effect of this protectionism is to grant and entrench certain Florida S&Ls in their home market while erecting entry barriers to interstate competition.

FIS does not deny that Exemption 35 burdens companies such as FIserv, and essentially acknowledges that Exemption 35 was designed to protect a portion of the data processing market regardless of the effect on interstate competition. Because the exemption imposes a direct and palpable burden on FIserv and other interstate competitors, it is per se unconstitutional. While FIS attempts to justify the economic protectionism conferred on FIS, the existence of some beneficial purpose for aiding a local industry is never a justification for economic protectionism. Bacchus, 468 U.S. 263, 272-73.

Moreover, FIS's arguments do not withstand scrutiny on their own terms. First, FIS argues that the exemption merely extends tax-free data processing from the "in-house" function to FIS. But there is no legitimate comparison between FIS and an in-house data processing department. FIS, by its own admission, is a profit oriented company made up of numerous investors which markets its services and charges each of its clients for the services performed. FIS is virtually indistinguishable from FIserv; it is a fiction to contend otherwise.

Second, FIS contends that tax-free data processing is available to other S&Ls. But this argument ignores the substantial burden of start-up costs and artificially constrained ownership criteria previously discussed. Moreover, the structure and effect of Exemption 35 belies the so called salutary purpose of making the exemption available to the S&L

industry. The artificially defined ownership requirements imposed by Exemption 35, as well as the substantial capital and technical expertise required to establish and operate a data processing company efficiently, place a substantial burden, rather than a benefit, on all S&Ls who are not affiliated with FIS. While it may be true that the legislators responsible for this amendment knew what they were doing, the inescapable conclusion is that their purpose was to confer an economic benefit on FIS.

Third, FIS argues that out-of-state S&Ls need not pay the service tax as long as they purchase data processing out-of-state. The argument ignores the fundamental concept of taxing services used or consumed in Florida. All out-of-state S&Ls who have operations in Florida will be taxed for their Florida-related data processing regardless of where these services are performed. The tax will burden interstate competition, whether the competition is from data processors such as FIserv or out-of-state S&Ls.

B. Unreasonable Burden On Interstate Commerce

Even putting aside the obvious economic protectionism imposed by Exemption 35, this Court may declare Exemption 35 unconstitutional by recognizing the burden it places on interstate commerce without truly serving a legitimate local purpose in the least restrictive manner. E.g., Hughes v. Oklahoma, 441 U.S. 322, 336, 99 S.Ct. 1727, 60 L.Ed. 2d 250 (1979); Pike v. Bruce Church, Inc., 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970). The burden imposed on interstate

commerce by Exemption 35 is to effect a substantial competitive disadvantage on any company or entity wishing to compete with FIS. If the company is an independent data processing company such as FIserv, the burden is an absolute 5% tax on all services, with no means of avoiding the economic penalty. If the company is an out-of-state S&L institution, the burden consists of either paying a 5% tax on data processing, or abandoning a data processor such as FIserv and being required to invest substantial capital in an artificially defined and controlled service corporation capable of meeting the requirements of Exemption 35. Either way, interstate competition suffers while FIS flourishes.

Contrary to FIS's assertion, the burden on interstate commerce is created by Exemption 35, not federal law. Moreover, even if the burden were "incidental," it would still be unconstitutional if it did not serve a legitimate local purpose, or if the local purpose could be promoted as well by less restrictive means.

Exemption 35 does not truly serve a legitimate local purpose, but rather aids FIS while imposing unnecessary burdens on independent companies such as FIserv and other S&Ls who have chosen a more efficient means of data processing. The purpose of aiding the S&L industry is not served by taxing efficient private data processing and erecting artificial barriers to free competition. Aiding FIS is not a legitimate purpose.

In addition, the least restrictive method for benefiting the S&L industry would be to apply the exemption

equally to all S&L data processors. There is absolutely no justification for artifically restricting the exemption in a way that burdens interstate competition and hurts S&Ls. Moreover, the state is free to provide other incentives and benefits to the S&L industry without directly burdening interstate commerce.

IV. EXEMPTION 35 VIOLATES THE EQUAL PROTECTION AND DUE PROCESS CLAUSES OF THE UNITED STATES CONSTITUTION AND THE DUE PROCESS CLAUSE OF THE FLORIDA CONSTITUTION.

Regardless of the latitude granted states in taxation, the state may not enact a taxing classification that serves an improper purpose or embodies a classification that is not rationally related to a legitmate purpose. The United States Supreme Court has more carefully scrutinized legislative classifications in recent years to determine whether a classification truly serves the stated purpose. Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869, 105 S.Ct. 1676, 84 L.Ed.2d 751 (1985); Zobel v. Williams, 456 U.S. 55, 102 S.Ct. 2309, 72 L.Ed.2d 672 (1982).

There is absolutely no rational basis for Exemption 35's limitation of tax-free data processing services to companies owned by Florida S&Ls to the exclusion of independent companies providing the same services as well as S&Ls based in other states. The purpose of Exemption 35 is to confer a benefit on FIS, which has been recognized as an illegitimate purpose for the purpose of equal protection analysis. Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985) ("promotion of domestic business by discriminating against non-resident

competitors is not a legitimate state purpose"). Because Exemption 35 effectively requires Florida ownership for any other corporation which could technically apply for the exemption, the purpose remains illegitimate. Id.

The purpose of Exemption 35, like Alabama's attempt to promote its own insurance industry in Metropolitan, "constitutes the very sort of parochial discrimination that the Equal Protection Clause was intended to prevent." 105 S.Ct. at 1682. Just as in Metropolitan:

> The effect of the statute at issue here is to place a discriminatory tax burden on foreign [businesses] who desire to do business within the State, thereby also incidentally placing a burden on interstate commerce. Equal protection restraints are applicable even though the effect of the discrimination in this case is similar to the type of burden with which the Commerce Clause also would be concerned.

Exemption 35 arbitrarily and capriciously establishes ownership criteria that in no way reflects a legitimate purpose, and serves only to discriminate and unfairly apportion tax burdens in an industry which necessarily relies on efficient data processing. Not only does Exemption 35 arbitrarily and capriciously define ownership criteria for an exempt service corporation, it arbitrarily exempts FIS while taxing FIserv, a virtually identical data processor.

Even the concept of providing tax free services to owner/shareholders is arbitrary as contained in Exemption 35. If the criteria for tax exemption were based on minority stock ownership, as in Exemption 35, then all services provided to

minority stock owners of any company should be tax exempt. Exemption 35, however, arbitrarily exempts data processing services for S&Ls who happen to own a portion of the exempt service corporation, regardless of whether their ownership interest is related to the amount of services they consume, and regardless of whether they pay fees for services just as any other consumer. Exemption 35 arbitrarily and unfairly discriminates.

CONCLUSION

Because Exemption 35 violates the Federal Commerce Clause, equal protection, and due process clauses, as well as Florida's due process protection, Exemption 35 is unconstitutional.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I have caused a true and correct copy of the foregoing to be furnished by U.S. Mail to the addresses on the attached service list this 17th day of June, 1987.

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