

CAUSE NO. D-1 GN-12-003831

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| AMERICAN MULTI-CINEMA, INC., | § | IN THE DISTRICT COURT |
| | § | |
| Plaintiff, | § | |
| | § | |
| v. | § | |
| | § | |
| | § | |
| SUSAN COMBS, COMPTROLLER OF | § | OF TRAVIS COUNTY, TEXAS |
| PUBLIC ACCOUNTS OF THE STATE | § | |
| OF TEXAS, AND GREG ABBOTT, | § | |
| ATTORNEY GENERAL OF THE | § | |
| STATE OF TEXAS, | § | |
| | § | |
| Defendants. | § | <u>200TH</u> JUDICIAL DISTRICT |

PLAINTIFF'S ORIGINAL PETITION

Plaintiff American Multi-Cinema, Inc. ("AMC") files this Original Petition against Defendants Susan Combs, Texas Comptroller of Public Accounts, and Greg Abbott, Texas Attorney General (together, "Defendants"). Defendants are sued in their official capacities.

I. DISCOVERY CONTROL PLAN

1. Discovery is intended to be conducted under Level 2 of Texas Rule of Civil Procedure 190.3.

II. PARTIES

2. AMC is a corporation organized under the laws of Missouri with its principal place of business in Kansas City, Missouri.

3. Defendant Susan Combs is Texas Comptroller of Public Accounts (“Comptroller”) and may be served with process at Lyndon B. Johnson State Office Building, 111 East 17th Street, Room 113, Austin, Travis County, Texas 78774.

4. Defendant Greg Abbott is the Texas Attorney General and may be served with process at 300 West 15th Street, Austin, Travis County, Texas 78701.

III. PROCEDURAL MATTERS

5. This is a taxpayer suit after payment under protest of \$797,389.18, brought under Texas Tax Code Chapter 112 (Taxpayers’ Suits) and Chapter 171 (Franchise Tax).

6. AMC is engaged in the business of operating movie theaters in which motion picture films are shown to members of the public. AMC’s customers must purchase tickets to view the motion picture films. The Comptroller conducted an audit of AMC’s franchise tax return for Report Year 2009. On October 15, 2012, the Comptroller issued a Notice of Audit Results, which included a number of erroneous adjustments to AMC’s 2009 Franchise Tax Report. On October 29, 2012, AMC paid the tax and assessed interest under protest.

7. A copy of the written protest letter is attached as Exhibit A.

IV. FACTS AND CAUSES OF ACTION

8. The Comptroller’s audit allowed costs related to the sale of concession merchandise to remain in the cost of goods sold used to compute the Texas Franchise tax.

9. The adjustment at issue is for \$1,551,119,037.00 and involves AMC’s cost of acquiring, producing, and use of the motion picture films.

10. The entire audit adjustment of \$1,551,119,037.00 decreased the originally reported cost of goods sold, and should be restored. The related tax and interest should be refunded.

11. AMC is entitled to deduct its “cost of goods sold” when calculating its taxable margin under Tax Code § 171.101. The deduction for “cost of goods sold” is described in Tax Code § 171.1012. Under Tax Code § 171.1012, a “good” is real or tangible personal property sold in the ordinary course of business of a taxable entity. Tangible personal property includes property that can be seen, is perceptible to the senses, and also includes films. Tax Code § 171.1012(3)(A)(i-ii).

12. AMC’s business involves selling tangible personal property.

13. The auditor erred in adjusting AMC’s cost of goods sold deduction. Specifically, the Comptroller’s auditor disallowed the cost of acquiring, producing, and use of motion picture films. This adjustment reduced the cost of goods sold deduction, which resulted in an assessment of additional tax.

14. AMC produces motion picture films in part by using specialized projectors to enlarge the image, and by using an array of speakers to enhance the sound output. This process falls under the definition of “production” under Tax Code § 171.1012(a)(2), which includes construction, installation, manufacture, development, mining, extraction, improvement, creation, raising, and growth.

15. Tax Code § 171.1012(c) provides that “the cost of goods sold includes all direct costs of acquiring or producing the goods” and contains examples of included items, such as the cost of materials, handling costs, cost of renting or leasing equipment

or facilities directly used for the production of the goods, and labor costs. The auditor allowed AMC's labor costs and concession costs in its cost of goods adjustment, but failed to include the costs directly related to acquiring and producing the motion picture films, such as film freight handling charges, depreciation, rent, and real estate taxes.

16. Under Tax Code § 171.1012(d), the cost of goods sold also includes licensing costs directly associated with the goods produced. AMC paid license fees to rent the motion picture films. AMC was unable to produce the goods it sold, *i.e.*, the display of motion picture films to the public, unless it paid the license fees. The license fees were typically based upon: 1) a flat, fixed fee; 2) a percentage of the revenue from tickets sold; or 3) both, a percentage of the revenue from tickets sold, plus a minimum guaranteed fee.

17. Tax Code § 171.1012(d) also includes the cost of utilities, which AMC used directly in the production of the motion picture films.

18. Tax Code § 171.1012(o) provides that:

If a taxable entity . . . whose principal business activity is film or television production or broadcasting or the distribution of tangible personal property described by Subsection (a)(3)(A)(ii), or any combination of these activities, elects to subtract cost of goods sold, the cost of goods sold for the taxable entity shall be the costs described in this section in relation to the property and include depreciation, amortization, and other expenses directly related to the

acquisition, production, or use of the property, including expenses for the right to broadcast or use the property.

See also Rule 3.588(c)(5)(A-C). AMC incurred expenses directly relating to the production of motion pictures, including fees paid for the right to use the property.

19. The primary cost of goods AMC sold was the cost of the motion pictures. AMC incurred licensing fees directly related to the motion pictures, as well as incurred substantial expenses for film freight, utilities, depreciation, rent, real estate taxes, and other costs.

20. Based upon Tax Code § 171.1012 and Rule 3.588, the total, \$1,551,119,037.00, of these costs was properly included in AMC's originally filed cost of goods sold, and was improperly removed from cost of goods sold by the Comptroller upon audit. Thus, the related tax and interest resulting from the audit that AMC has paid under protest herein should be refunded.

21. Alternatively, the portion of the \$1,551,119,037.00 that relates to the license fees to rent the motion picture films should not be included in revenues because the amounts are flow-through funds under Tax Code 171.1011 and Rule 3.587 that AMC is required to pay. Thus, the related tax and interest resulting from the audit that AMC has paid under protest herein should be refunded.

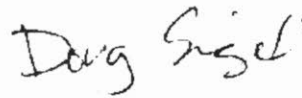
V. PRAYER

WHEREFORE, for the reasons stated above, Plaintiff requests a judgment for (a) a refund of tax paid under protest of at least \$699,405.07 and assessed interest of \$97,984.11 provided in Section 111 of the Tax Code, (b) statutory interest as provided in

Section 112.060 of the Tax Code: (c) costs of court: and (d) such other relief to which the Court determines Plaintiff is entitled.

Respectfully submitted,

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