No. 17-0464

In the Supreme Court of Texas

GLENN HEGAR, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS; AND KEN PAXTON, ATTORNEY GENERAL OF THE STATE OF TEXAS,

Petitioners,

v.

AMERICAN MULTI-CINEMA, INC.,

Respondent.

On Petition for Review
from the Third Court of Appeals, Austin

PETITIONERS' BRIEF ON THE MERITS

KEN PAXTON
Attorney General of Texas

JEFFREY C. MATEER
First Assistant Attorney General

Office of the Texas Attorney General
P.O. Box 12548 (MC 059)
Austin, Texas 78711-2548
Tel.: (512) 936-1700
Fax: (512) 474-2697

SCOTT A. KELLER
Solicitor General

RANCE CRAFT
Assistant Solicitor General
State Bar No. 24035655
rance.craft@oag.texas.gov

CHARLES K. ELDRED
Assistant Attorney General

Counsel for Petitioners

Identity of Parties and Counsel

Petitioners:
Glenn Hegar, Comptroller of Public Accounts of the State of Texas
Ken Paxton, Attorney General of the State of Texas

Appellate and Trial Counsel for Petitioners:

Ken Paxton
Jeffrey C. Mateer
Brantley Starr
James E. Davis
Scott A. Keller
Jack Hohengarten
Rance Craft (lead counsel)
Alison Andrews
Charles K. Eldred
Cynthia A. Morales
Sean P. Flammer
Office of the Attorney General
P.O. Box 12548 (MC 059)
Austin, Texas 78711-2548
rance.craft@oag.texas.gov

Greg Abbott (no longer with the office)
Charles E. Roy (no longer with the office)
Daniel T. Hodge (no longer with the office)
David C. Mattax (no longer with the office)
Robert O'Keefe (no longer with the office)
Michael P. Murphy (no longer with the office)
Maria Amelia Calaf (no longer with the office)

Respondent:
American Multi-Cinema, Inc.

Appellate and Trial Counsel for Respondent:

Mark W. Eidman
Doug Sigel (lead counsel)
Ryan Law Firm, LLP
100 Congress Avenue
Suite 950
Austin, Texas 78701
Doug.Sigel@RyanLawLLP.com

Olga Goldberg (no longer with the firm)
Kendall L. Bryant (no longer with the firm)
Matthew K. Ormiston (no longer with the firm)

TABLE OF CONTENTS

Page

Index of Authorities

Page(s)

Cases

Statutes and Rules

Other Authorities

Record References

"CR" refers to the clerk's record of September 11, 2014; "2dSuppCR" refers to the supplemental clerk's record of October 29, 2014; and "2dSuppRR" refers to the supplemental reporter's record of September 17, 2013. "DX" refers to the defendants' exhibits contained in Volume 4 of the supplemental reporter's record of September 17, 2013.

Statement of the Case

Nature of the Case:	American Multi-Cinema, Inc. ("AMC") sued to recover franchise taxes that it paid under protest for tax years 2008-2009. CR.4-25, 204-10; Tex. Tax Code §§ 112.052-.053. AMC disputed the Comptroller's adjustment to the "cost of goods sold" figure that AMC had used to compute its tax liability. CR.6, 206. Specifically, the Comptroller had not allowed AMC to include in its cost of goods sold its costs of exhibiting films and other content, which exceeded $1.5 billion for each of those years. CR.5-6, 206.
Trial Court:	200th Judicial District Court, Travis County The Honorable Darlene Byrne (first phase) The Honorable Orlinda Naranjo (second phase)
Disposition in the Trial Court:	The trial court rendered a final judgment awarding a refund to AMC. CR.234-35. The court concluded that AMC may include film-exhibition costs in its cost of goods sold, but it agreed with the Comptroller's calculation of those costs. 2dSuppCR.29, 30.
Parties in the Court of Appeals:	AMC was the appellant/cross-appellee. The Comptroller and the Attorney General were the appellees/cross-appellants.
Disposition in the Court of Appeals:	The court of appeals affirmed the judgment to the extent that it allowed AMC to include film-exhibition costs in its cost of goods sold; however, the court reversed the judgment as to the amount of those costs and rendered judgment in the amount of AMC's proposed calculation. *Am. Multi-Cinema, Inc. v. Hegar*, No. 03-14-00397-CV, 2015 WL 1967877 (Tex. App.—Austin Apr. 30, 2015) (mem. op.). The court denied the Comptroller's motion for rehearing, but it withdrew its opinion and substituted a new opinion that reached the same result. *Am. Multi-Cinema, Inc. v. Hegar*, No. 03-14-00397-CV, 2017 WL 74416 (Tex. App.—Austin Jan. 6, 2017, pet. filed) (mem. op.) (Goodwin, J., joined by Rose, C.J., and Field, J.). The Comptroller's further motion for rehearing was denied.

Statement of Jurisdiction

Jurisdiction exists under section 22.001(a) of the Texas Government Code because this appeal presents questions of law that are important to the jurisprudence of the State.

The court of appeals' erroneous construction of the franchise-tax statutes erodes the distinction between goods and services, potentially costing Texas billions of dollars in tax refunds and lost revenue. *See infra* Argument, Part III.A.

Additionally, the court of appeals' opinion conflicts with this Court's precedent in two important respects that have repercussions beyond tax cases. Although the Court has held that whether undisputed facts satisfy a statutory definition is a question of law, the court of appeals treated that inquiry as one of fact. And while it is settled that the Legislature cannot construe a prior Legislature's intent, the court of appeals allowed that to happen by deferring to the Legislature's purported "clarification" of the cost-of-goods-sold statute in a later amendment. *See infra* Argument, Part III.B.

Issue Presented

When a business pays Texas franchise tax, it may compute its tax base by subtracting its "cost of goods sold" from its total revenue. Tex. Tax Code § 171.101(a)(1)(B). Cost of goods sold includes the direct costs of acquiring or producing "goods," which the Tax Code defines as "real or tangible personal property sold in the ordinary course of business of a taxable entity." *Id.* § 171.1012(a)(1). The Tax Code further defines "tangible personal property" to include "films," but also to exclude "intangible property" and "services." *Id.* § 171.1012(a)(3).

AMC sold tickets to watch movies that it rented from film distributors and exhibited in theaters. It sought to lower its tax liability by counting its costs of exhibiting movies as a cost of goods sold. The court of appeals approved that theory. The court reasoned that exhibiting movies qualified as a "good" because it was the sale of "tangible personal property." The court did not address whether the one-time exhibition of a movie was "property" as that term is ordinarily understood; whether the movies were "sold," as the definition of "goods" requires; or whether AMC "owned" the movies, which is a prerequisite to including the related costs in its cost of goods sold.

The issue presented is: Under section 171.1012 of the Texas Tax Code, is exhibiting a movie the sale of tangible personal property, and therefore a "good," or the sale of a service?

To the Honorable Supreme Court of Texas:

When the Legislature overhauled the franchise tax in 2006, it slashed the tax rate from 4.5% to 1% or less. The Legislature achieved that rate reduction without causing a fiscal crisis by significantly reducing the deductions from revenue that were previously available to taxpayers. Under the revised tax, a taxpayer could deduct only the largest of (1) 30% of total revenue, (2) its compensation expenses (such as salary and benefits), or (3) its costs of acquiring and producing goods for sale, known as "cost of goods sold."

The Legislature defined "goods" to mean "real or tangible personal property sold in the ordinary course of business," and it defined "tangible personal property" to *exclude* "services." That goods-services dichotomy created a framework under which most retailers and wholesalers subtract cost of goods sold, most service providers subtract compensation expenses, and every taxpayer can take at least a standard deduction of 30% of total revenue.

The court of appeals' opinion erodes those distinctions by holding that exhibiting a movie to customers in a theater is not the sale of a service, but rather the sale of tangible personal property. That novel interpretation and application of the cost-of-goods-sold statute conflicts with the unambiguous statutory text, other provisions of the Tax Code, this Court's precedent, and decisions from other states. What theaters sell are movie tickets, which are licenses that allow customers to receive the entertainment service that theaters provide when they exhibit movies. Under the

cost-of-goods-sold statute, those facts exclude the exhibition of movies from the category of tangible personal property, which means exhibiting movies cannot be a "good."

The fallout from the court of appeals' opinion extends beyond movie theaters. Already, other businesses are attempting to capitalize on the court's analysis by reframing the delivery of other types of services as sales of tangible personal property. That strategy will enable many service providers to further reduce the tax they owe Texas and upset the balance between the low tax rate and limited deductions designed by the Legislature.

Indeed, the Comptroller has estimated that this new wave of litigation could eventually require Texas to pay over $6 billion in refund claims and reduce annual revenue by $1.5 billion going forward. Because this case represents the leading edge of that wave, the Court should grant review and resolve this important dispute.

Statement of Facts

The court of appeals correctly stated the nature of the case. *See supra* p. x.

I. Statutory Background

A. The Texas franchise tax

Texas imposes a franchise tax on most business entities that operate in Texas. *In re Nestle USA, Inc.*, 387 S.W.3d 610, 612-14 (Tex. 2012). They pay the tax for the privilege of doing business in Texas, which confers economic benefits such as the opportunity to earn income here and the protection of state law. *Id.* at 622.

The franchise-tax calculation has frequently changed. *See id.* at 612-16. Generally, though, it starts with the "tax base," a valuation of the taxpayer's entire business during the year. *See Graphic Packaging Corp. v. Hegar*, No. 15-0669, 2017 WL 6544951, at *1 (Tex. Dec. 22, 2017). If the taxpayer conducted business in multiple states, its tax base must be apportioned to Texas to determine the share attributable to its Texas business and thus subject to Texas tax. *See id.* That Texas portion of the tax base multiplied by the tax rate equals the tax due. *Nestle*, 387 S.W.3d at 615.

B. The "margin" tax base

In 2006, the Legislature substantially restructured the franchise tax. *Id.* at 614. Among the changes, the Legislature reduced the tax rate for most taxpayers from 4.5% to either 1% or 0.5%. *Compare id.* at 615 (noting new rates of 0.5% for wholesalers and retailers and 1% for all others), *with* Act of Aug. 13, 1991, 72d Leg., 1st C.S., ch. 5, § 8.03, 1991 Tex. Gen. Laws 134, 153 (adopting former 4.5% rate). It also adopted "margin" as the new tax base. *Graphic Packaging*, 2017 WL 6544951, at *1.

The margin calculation begins with "'total revenue,' a figure derived by adding together select amounts reportable as gross income on a federal tax return, subtracting bad debts and other items included on the federal return, and excluding receipts associated with various transactions." *Id.* at *2 (citing Tex. Tax Code §§ 171.101(a), .1011). From total revenue, the taxpayer subtracts the largest of the following amounts: (1) cost of goods sold (the sum of select costs it incurred in acquiring or producing goods for sale); (2) the sum of compensation it paid (subject to per-person limits) and costs of benefits it provided; (3) 30% of its total revenue; or (4) $1 million.

Id. (citing Tex. Tax Code §§ 171.101(a), .1012, .1013). "The result is the taxpayer's margin." *Id.* (citing Tex. Tax Code § 171.101(a)).

As a practical matter, then, the margin calculation generally distinguishes between "sellers of goods," which subtract cost of goods sold, and "service companies," which subtract compensation. Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than A Marginal Change to Texas Taxation*, 60 Tax Law. 959, 971 (2007). The options to subtract 30% of total revenue or $1 million effectively serve as "caps" on margin when a taxpayer's cost-of-goods-sold or compensation subtraction would otherwise yield a larger margin. *See id.* [1]

C. The cost-of-goods-sold calculation

A taxpayer that chooses to subtract cost of goods sold may include in that figure "all direct costs of acquiring or producing the goods," certain indirect costs related to those goods, and up to 4% of overhead costs allocable to those goods. Tex. Tax Code § 171.1012(c), (d), (f).

As the phrase "cost of goods sold" indicates, the costs included must be related to acquiring or producing "goods" that are "sold." *Id.* § 171.1012(a)(1), (c), (d), (f). Indeed, the term "goods" itself is defined to mean only property that is "sold": "real or tangible personal property *sold* in the ordinary course of business of a taxable entity." *Id.* § 171.1012(a)(1) (emphasis added).

---

[1] The option to subtract $1 million was added in 2013, after the tax period at issue here. Act of May 27, 2013, 83d Leg., R.S., ch. 1232, § 6, 2013 Tex. Gen. Laws 3104, 3106 (eff. Jan. 1, 2014).

From that definition of "goods," "tangible personal property" is further defined. *Id.* § 171.1012(a)(3). The term means the following three categories of things:

> (i) personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner;
>
> (ii) films, sound recordings, videotapes, live and prerecorded television and radio programs, books, and other similar property embodying words, ideas, concepts, images, or sound, without regard to the means or methods of distribution or the medium in which the property is embodied, for which, as costs are incurred in producing the property, it is intended or is reasonably likely that any medium in which the property is embodied will be mass-distributed by the creator or any one or more third parties in a form that is not substantially altered; and
>
> (iii) a computer program, as defined by Section 151.0031.

Id. § 171.1012(a)(3)(A). At the same time, "tangible personal property" expressly does *not* include "intangible property" and "services." *Id.* § 171.1012(a)(3)(B).

Finally, not only must "goods" be "sold," but the taxpayer must also "own" the goods that it sells. *Id.* § 171.1012(i) ("A taxable entity may make a subtraction under this section in relation to the cost of goods sold only if that entity owns the goods.").

II. Factual Background

A. AMC's movie-exhibition business

1. AMC, a Missouri corporation, is one of the nation's largest movie-theater chains. 2.2dSuppRR.169-70; CR.11. It operates several movie theaters in Texas. CR.11.

At its movie theaters, AMC exhibits films and other content (such as live sporting events and theatre) to paying customers. 2dSuppCR.30 (FOF 3). Sales of movie tickets are AMC's primary source of revenue. 2.2dSuppRR.90.

2. A customer who purchases a movie ticket from AMC acquires a revocable license to watch a specific movie at a specific time. 2.2dSuppRR.81, 130. Customers do not acquire any rights to the movie itself. 2.2dSuppRR.73-74, 81-82. Indeed, AMC forbids customers to record the movie, and it will have customers arrested if they are caught doing so. 2.2dSuppRR.74.

3. AMC does not own the movies that it exhibits in its theaters. 2.2dSuppRR.79, 166. Rather, AMC rents the movies from film distributors (i.e., studios) like Paramount, Sony, Universal, and Disney. 2.2dSuppRR.74-75, 82-83, 127-28, 166. When a movie's theatrical run ends, AMC returns it to the studio. 2.2dSuppRR.128, 166.

During the 2008-2009 period at issue in this case, AMC exhibited movies on 35-millimeter film. 2.2dSuppRR.78-79. An individual movie consisted of multiple reels of film, which the distributor sent to AMC. 2.2dSuppRR.59-60, 78-80. AMC spliced the reels together into one continuous length of film, but it was not allowed to cut or change the movie's content. 2.2dSuppRR.59-60, 66, 78-81, 166; DX4 at 1; DX5 at 2; DX7 at 2. To the front of the film, AMC spliced in trailers, advertisements, and public-service announcements. 2.2dSuppRR.59-60, 66, 78-81. AMC also added "cues" to the film to control the auditorium lights and screen curtains. 2.2dSuppRR.59-60, 66, 78-79.

AMC then ran the film through a projector, which projected images on the screen and sent sound through the auditorium speakers. 2.2dSuppRR.66. The distributors required AMC to exhibit the movie in its entirety without interruption. DX4 at 1; DX5 at 2; DX6 at 6; DX7 at 2.

At the end of the movie's theatrical run, AMC unspliced the film, returned it to the original reels, and sent it back to the distributors. 2.2dSuppRR.79, 83; DX4 at 2; DX5 at 6; DX6 at 5; DX7 at 2.

B. AMC's attempt to subtract movie-exhibition costs as cost of goods sold

The Comptroller audited AMC for franchise-tax compliance for tax years 2008-2009. CR.16, 205. The audit revealed that AMC had included over $1.5 billion in movie-exhibition costs in its cost of goods sold for each of those years. CR.11, 22, 206-07. The Comptroller disallowed those costs and assessed unpaid taxes, penalties, and interest totaling $942,024.27 for 2008 and $796,171.03 for 2009. CR.16, 205. AMC paid the assessments under protest. CR.10-23, 205; Tex. Tax Code § 112.051.

III. Procedural History

A. AMC's suit

AMC sued the Comptroller and Attorney General (collectively, "the Comptroller") for a refund of the taxes that it had paid under protest. CR.4-25, 204-10; Tex. Tax Code §§ 112.052-.053.

AMC alleged that its presentations of movies to customers were sales of "tangible personal property," and therefore "goods," for cost-of-goods-sold purposes.

CR.7, 206-07. Specifically, AMC contended that the exhibition of a movie was "personal property" that "can be seen" and "is perceptible to the senses" under section 171.1012(a)(3)(A)(i), as well as a "film" within the meaning of section 171.1012(a)(3)(A)(ii). CR.6, 206. Accordingly, AMC claimed that it could count as a cost of goods sold its costs of exhibiting movies, including film freight charges, license fees, rent, utilities, depreciation, and property taxes. CR.7-8, 207.

B. The district court's judgment

The district court conducted a bifurcated bench trial. CR.105. The first phase concerned whether AMC could include its movie-presentation costs in its cost of goods sold. CR.105. The second phase addressed the amount of any refund. CR.105.

1. In the first phase, the district court ruled that "AMC is entitled to include the costs to exhibit films to its customers in its Cost of Goods Sold subtraction under Section 171.1012 of the Tax Code." CR.197. Tracking the first definition of "tangible personal property" under section 171.1012(a)(3)(A)(i), the court found that, "[w]hen AMC exhibits movies and other content to its paying customers, it produces personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner for sale in its ordinary course of business." 2dSuppCR.30 (FOF 4). Accordingly, the court concluded that AMC "produces goods for sale" for cost-of-goods-sold purposes and "may therefore include the costs of exhibiting movies and other content to its paying customers in its cost-of-goods-sold deduction." 2dSuppCR.30 (COL 2).

2. The second phase focused on the amount of AMC's cost of goods sold. *See* CR.247-52. The parties disputed only the calculation of AMC's facility-related costs, such as rent, property taxes, utilities, depreciation, and insurance. CR.228.

The district court agreed with the Comptroller's calculation. 2dSuppCr.28-29 (FOF 7-8). Accordingly, the court rendered a final judgment awarding AMC a refund of $499,668, plus penalties and interest. CR.234-35.

3. AMC appealed the judgment. CR.469-70. The Comptroller filed a cross-appeal. 2dSuppCR.31-32.

C. The court of appeals' decisions

The court of appeals affirmed the judgment to the extent that it allowed AMC to include its movie-exhibition costs in its cost of goods sold. *AMC*, 2017 WL 74416, at *10. But the court reversed as to the amount of those costs and rendered judgment awarding AMC a larger refund of $1,170,949, plus penalties and interest. *Id.* The court's reasons for that result changed over the course of the appeal.

1. In its initial opinion, the court of appeals held that exhibiting movies constitutes "goods" for cost-of-goods-sold purposes based on subsection (i) of the definition of "tangible personal property." *AMC*, 2015 WL 1967877, at *4-5. The court reasoned that AMC's movie presentations are personal property that can be "seen" and is "perceptible to the senses." *Id.* (discussing Tex. Tax Code § 171.1012(a)(3)(A)(i)).

The court then held that the evidence did not support the district court's findings on AMC's exhibition costs. *Id.* at *7-9. Accordingly, the court adopted AMC's

proposed cost-of-goods-sold calculation and rendered judgment for the corresponding refund amount. *Id.* at *9-10.

2. In response to the Comptroller's motion for rehearing, the court of appeals withdrew its original opinion and issued a new opinion that reached the same result, but relied in part on different reasons. *AMC*, 2017 WL 74416, at *1.

a. In its revised opinion, the court expressly declined to address subsection (i) of the "tangible personal property" definition. *Id.* at *5. Instead, the court limited its analysis to subsection (ii) of the "tangible personal property" definition, *id.*, which includes "films . . . without regard to the means or methods of distribution or the medium in which the property is embodied," Tex. Tax Code § 171.1012(a)(3)(A)(ii).

The court held that AMC's movie presentations met the subsection (ii) definition. *AMC*, 2017 WL 74416, at *5-6. In support, the court cited testimony from AMC witnesses who used terms in the subsection (ii) definition to describe exhibiting movies. *Id.* (recounting testimony that exhibiting movies is a form of "distribution" and the screen is a "medium" on which the movie is "embodied"). The court also cited those witnesses' conclusions that AMC's movie presentations satisfied the subsection (ii) definition. *Id.* at *6.

The court rejected the Comptroller's argument that AMC sold "intangible property" in the form of licenses to watch movies, and the "service" of exhibiting movies, both of which are excluded from the definition of "tangible personal property." *Id.* at *6-7. In the court's view, that argument improperly imposed a requirement that that "tangible personal property" be taken home by the buyer. *Id.* at *7.

The court also reasoned that the Comptroller's argument conflicted with a subsequent amendment to the cost-of-goods-sold statute. *Id.* In 2013, the Legislature amended section 171.1012 to add subsection (t), which expressly allows a movie theater to count "exhibition" costs in cost of goods sold:

> If a taxable entity that is a movie theater elects to subtract cost of goods sold, the cost of goods sold for the taxable entity shall be the costs described by this section in relation to the acquisition, production, exhibition, or use of a film or motion picture, including expenses for the right to use the film or motion picture.

Tex. Tax Code § 171.1012(t). Although subsection (t) does not apply to the tax years at issue here, the court still found it relevant because the enacting legislation stated that subsection (t) "'is a clarification of existing law and does not imply that existing law may be construed as inconsistent with the law as amended by this section.'" *AMC*, 2017 WL 74416, at *7 (quoting Act of May 27, 2013, 83d Leg., R.S., ch. 1232, § 10(b), 2013 Tex. Gen. Laws 3104, 3108).

b. The court's discussion of AMC's exhibition costs was virtually unchanged from its initial opinion. *Id.* at *7-10. Accordingly, the court again adopted AMC's cost-of-goods-sold calculation and rendered judgment awarding a refund of $1,170,949, plus penalties and interest. *Id.* at *10.

SUMMARY OF THE ARGUMENT

I. The court of appeals wrongly concluded that exhibiting movies is a "good" under the Texas Tax Code.

A. "Goods" are defined as "tangible personal property" that is "sold" by the taxpayer. When AMC exhibits movies to customers, it does not sell the movies to

them. It sells movie tickets, which are licenses that allow customers to watch specific movies at specific times. Licenses are a form of intangible property, and entertaining customers by exhibiting movies is a service. "Intangible property" and "services" are both expressly excluded from the definition of "tangible personal property." Accordingly, exhibiting a movie is not selling tangible personal property as a matter of law, which in turn means that it is not a "good."

B. The court of appeals misconstrued the definition of "tangible personal property" when it ruled that the definition's inclusion of "films," which are property, extends to exhibiting films, which is not. The definition's text confirms that "films" are tangible personal property whether they are on the original reels that get loaded onto a projector or in another medium that is mass-distributed, like DVDs. But, contrary to the court of appeals' analysis, the definition does not stretch the meaning of tangible personal property to include exhibiting a movie in a theater. That action may be "tangible" in the sense that the customer sees and hears the movie, but it is not "property" in any sense of the word.

Additionally, the exclusions of "intangible property" and "services" from "tangible personal property" stand alongside the inclusion of "films." But the court of appeals essentially ignored those components of the definition. Properly construed, those exclusions confirm that selling tickets to watch movies is not selling tangible personal property, and therefore, not a "good."

Finally, although the construction of the "tangible personal property" definition and the determination of whether AMC's movie presentations met it are questions

of law, the court of appeals incorrectly treated those issues as questions of fact. Specifically, the court improperly relied on the testimony of AMC fact witnesses who averred that their movie presentations satisfied the definition and used the definition's terms to describe exhibiting movies. The court also wrongly deferred to the trial court's purported resolution of evidentiary conflicts, even though there was no factual dispute about what happens when AMC exhibits movies to its customers.

C. The court of appeals ended its statutory analysis with the "tangible personal property" definition. But that is not where the cost-of-goods-sold analysis stops. To qualify as "goods," the "tangible personal property" must be "sold," and to include the associated costs as cost of goods sold, the taxpayer must "own" the goods in the first place. The court never addressed those additional requirements. If it had, the outcome necessarily would have been different. AMC sells licenses to see and hear the images and sounds generated in a specific exhibition of a film, but it does not transfer any property interest in that content to the customer. Nor can AMC own a moviegoer's sensory experience of those images and sounds.

D. Although the Legislature amended the cost-of-goods-sold statute in 2013 to allow movie theaters to include their film-exhibition costs as cost of goods sold going forward, that amendment does not apply to this case. But because an uncodified provision of the enactment described the amendment as a "clarification" of prior law, the court of appeals gave that amendment controlling weight for the tax years at issue here. That reasoning violated the established principle that one Legislature may not construe the intent of a prior Legislature. That was the court of appeals' task, and

the court got it wrong by holding that exhibiting movies is selling "tangible personal property," and is therefore a "good" under the Tax Code.

II. On rehearing, the court of appeals did not reach AMC's alternative theory that exhibiting movies qualifies as "tangible personal property" under a different prong of the definition—specifically, the prong that includes "personal property" that "can be seen" or "is perceptible to the senses." In the interest of judicial economy, the Court should decide that issue now. AMC's argument under the "perceptible property" variant of the definition fails for many of the reasons already discussed: the exclusions of "intangible property" and "services" from the definition still defeat AMC's argument, and AMC's movie presentations are not "personal property."

III. The Court should grant review for two reasons.

First, the court of appeals' erroneous construction of the cost-of-goods-sold statute erodes the Tax Code's distinction between goods and services. Other taxpayers are now relying on the court's opinion to argue that their customers' experiences of the services that they provide are in fact goods that they sell, which entitles them to increase their cost-of-goods-sold subtraction and reduce their tax liability. The Comptroller has advised state leaders that this new and growing wave of litigation could eventually cost Texas billions of dollars in tax refunds and lost revenue.

Second, the court of appeals' opinion conflicts with this Court's precedent in important respects that will have repercussions beyond tax cases. Although the Court has held that whether undisputed facts meet a statutory definition is a question of law, the court of appeals improperly treated that inquiry as a question of fact. And

while it is settled that the Legislature cannot construe a prior Legislature's intent, the court of appeals wrongly allowed that to happen by deferring to the Legislature's purported "clarification" of the cost-of-goods-sold statute in a later amendment.

Standard of Review

This appeal presents statutory-construction issues concerning the meaning and application of section 171.1012 of the Tax Code. The Court reviews those questions of law de novo. *Colorado County v. Staff*, 510 S.W.3d 435, 444 (Tex. 2017).

Argument

I. Exhibiting Movies Is Not a "Good" Under the Texas Tax Code.

A. Exhibiting movies is not selling "tangible personal property."

The court of appeals correctly noted that this appeal "turns on the meaning of 'goods' as that term is defined in section 171.1012(a)(1)." *AMC*, 2017 WL 74416, at *4. As relevant here, "goods" means "tangible personal property" that is "sold" by the taxpayer. Tex. Tax Code § 171.1012(a)(1). And "tangible personal property" in turn includes "films" and excludes "intangible property" and "services." *Id.* § 171.1012(a)(3)(A)(ii), (B).

Under those definitions, AMC is not selling tangible personal property when it exhibits a movie to customers. As discussed below, AMC does not sell films; rather, it sells intangible property (movie tickets, which confer licenses to watch movies) and performs services (the exhibition of movies for customers).

1. AMC does not sell "films."

Although the definition of tangible personal property includes "films," *id.* § 171.1012(a)(3)(A)(ii), that does AMC no good because AMC does not sell films.

The franchise-tax statutes do not define "sold" or its present-tense form "sell." Accordingly, those words are given their ordinary meaning. *Sw. Royalties, Inc. v. Hegar*, 500 S.W.3d 400, 405 (Tex. 2016). In legal terms, "sell" ordinarily means "[t]o transfer (property) by sale." *Sell*, Black's Law Dictionary (10th ed. 2014). And a "sale" is "[t]he transfer of property or title for a price." *Sale*, *id.* (citing U.C.C. § 2-106(1)). Those legal definitions align with the common meaning of "sell." *Sell*, The American Heritage Dictionary (5th ed. 2016) (defining "sell" to mean "[t]o exchange or deliver for money or its equivalent.").

Under those definitions, AMC does not sell films. It never transfers ownership or possession of the films to its customers. 2.2dSuppRR.81-82. Indeed, customers are not even allowed to create or have copies of the films, much less the films themselves. 2.2dSuppRR.74. AMC returns the films to the studios when it has finished exhibiting them in its theaters. 2.2dSuppRR.127-28.

2. AMC sells movie tickets, which are "intangible property."

The sale that does occur between AMC and a customer is the sale of a movie ticket. 2.2dSuppRR.81, 90, 105, 130. Because a movie ticket is "intangible property" as a matter of law, it is expressly excluded from the definition of tangible personal property. Tex. Tax Code § 171.1012(a)(3)(B)(i).

A movie ticket sold by AMC is a "revocable license" to watch a specific movie at a specific time in one of its theaters. 2.2dSuppRR.81, 130; *see also Jordan v. Concho*

Theaters, Inc., 160 S.W.2d 275, 276 (Tex. Civ. App.—El Paso 1941, no writ) ("A ticket to a theatre is a mere revocable license."); *Kelly v. Dent Theaters*, 21 S.W.2d 592, 593 (Tex. Civ. App.—Waco 1929, no writ) ("In this country, the great weight of authority is to the effect that the right of a purchaser of a ticket to enter and remain at a theater . . . is a mere revocable license." (citation and internal quotation marks omitted)). A "license" is "[a] permission, usu[ally] revocable, to commit some act that would otherwise be unlawful." *License*, Black's Law Dictionary, *supra*; *accord Payne v. Massey*, 196 S.W.2d 493, 495 (Tex. 1946). It would, of course, be unlawful for a person to trespass onto AMC's property and watch a movie without the permission afforded by a movie ticket.

As a form of "permission," a license is generally considered intangible property. *See* Tex. Tax Code § 1.04(6) (defining "intangible personal property" to include a "license" for property-tax purposes); *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 298 (Tex. App.—Austin 2000, pet. denied) (describing "licenses" as "intangible property rights, not real property or tangible personal property"); *First Nat'l Bank of Fort Worth v. Bullock*, 584 S.W.2d 548, 551 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.) (holding that "the sale of a license for computer software" was "the sale of intangible property"). Because intangible property is expressly excluded from the definition of tangible personal property, AMC is not selling tangible personal property as a matter of law. Tex. Tax Code § 171.1012(a)(3)(B)(i). Accordingly, AMC's exhibitions of movies are not "goods" that are eligible for its cost-of-goods-sold calculation. *Id.* § 171.1012(a)(1).

3. AMC's movie tickets permit customers to watch its presentations of movies, which are "services."

As noted above, a ticket-holder owns an intangible property right—an executory right to watch a specific movie at a specific time in the future. 2.2dSuppRR.81, 130, 163. After the ticket-holder presents the ticket to AMC, AMC exhibits a movie to the ticket-holder. 2.2dSuppRR.81, 130, 163. AMC's exhibition of the movie is a "service" as a matter of law, which is also expressly excluded from the definition of tangible personal property. Tex. Tax Code § 171.1012(a)(3)(B)(ii).

a. Like "sell," "services" is also undefined in the franchise-tax statutes, which requires recourse to its ordinary meaning. *Sw. Royalties*, 500 S.W.3d at 405. Legally, a "service" is "the performance of some useful act or series of acts for the benefit of another, usu[ally] for a fee." *Service*, Black's Law Dictionary, *supra*. That legal definition conforms to the common understanding of the term. *Service*, The American Heritage Dictionary, *supra* (defining "service" as "[w]ork that is done for others as an occupation or business" and "[a]n act or a variety of work done for others, especially for pay").

AMC's movie presentations fit that ordinary meaning of "services." AMC employees perform a series of acts involving work to exhibit a movie for the benefit of customers who have paid to watch it. Specifically, those employees splice together the film, add cues to the film to control the lights and screen curtains, and run the film through a projector to display images on the screen and send sound through the speakers for their customers to see and hear. 2.2dSuppRR.59-60, 66, 78-81, 108-12.

AMC employees also adjust the sound, framing, and focus to ensure the quality of the customers' experience watching the movie. 2.2dSuppRR.110.

b. AMC's movie presentations not only fit the ordinary meaning of services, but they also fit definitions of "services" in the sales-tax chapter of the Code. Tex. Tax Code §§ 151.0028(a), 151.0101(a)(1), 151.005(3). Although those definitions do not expressly apply to the franchise tax, they are still relevant. When applying the ordinary meaning of an undefined statutory term, that meaning "must be in harmony and consistent with other statutory terms." *Sw. Royalties*, 500 S.W.3d at 405.

Like the definition of "tangible personal property" in the cost-of-goods-sold statute, the sales-tax chapter treats "tangible personal property" and "services" as mutually exclusive terms. Tex. Tax Code § 151.010 (providing that "'taxable item' means tangible personal property and taxable services"); *id.* §§ 151.009, 151.0101 (separately defining "tangible personal property" and "taxable services"). "Taxable services" is defined to include "amusement services." *Id.* § 151.0101(a)(1). "Amusement services" in turn means "the provision of amusement, entertainment, or recreation." *Id.* § 151.0028(a). And the "sale" of an "amusement service" means "a transfer of title to or possession of a ticket or other admission document" "for consideration." *Id.* § 151.005(3). Under those definitions, AMC's sales of tickets to watch movies exhibited in its theaters are sales of "services." And nothing indicates that the Legislature intended to treat the same exhibition of a movie as a service for sales-tax purposes, but as tangible personal property for franchise-tax purposes.

B. The court of appeals misconstrued the definition of "tangible personal property" to equate exhibiting films with the films themselves.

Although AMC exhibits films and does not sell them, the court of appeals nonetheless held that the language following "films" in the "tangible personal property" definition extends the meaning of "films" to encompass AMC's exhibition of films, which the court dubbed AMC's "film product." *AMC*, 2017 WL 74416, at *5-7. But the court misconstrued that part of the definition in several respects. Moreover, the court failed to give meaning to the definition's exclusion of "intangible property" and "services." Finally, the court improperly treated application of the legal definition of "tangible personal property" as a fact issue, effectively deferring to the conclusions of AMC's witnesses that the definition was met.

1. In the definition of tangible personal property, "films" does not extend to exhibiting films or "film product."

The court of appeals focused on the fact that the "tangible personal property" definition includes "'films . . . without regard to the means or methods of distribution or the medium in which the property is embodied.'" *Id.* at *5 (quoting Tex. Tax Code § 171.1012(a)(3)(A)(ii)). The court deemed that additional language dispositive because AMC witnesses testified that exhibiting a film in a theater is a means of "'film distribution'" and the auditorium screen is "'a medium on which the movie is embodied.'" *Id.* (quoting 2.2dSuppRR.57, 63). But even if AMC's fact witnesses could competently testify as to whether a legal definition is met—which they cannot, *see infra* Part I.B.3—the definitional language they recited still does not cover AMC's movie presentations, for several reasons.

a. Although the "without regard" clause provides that the method of distribution and the medium are not limiting factors, the definition still means only "films." Tex. Tax Code § 171.1012(a)(3)(A)(ii). And AMC does not sell films. *See supra* Part I.A.1.

To get around that, the court of appeals referred to AMC's "film product," *AMC*, 2017 WL 74416, at *5, *7, which AMC described alternatively as "the sight and sound that were produced off of that film," 2.2dSuppRR.82, or the "sight and sound experience" of patrons as they watch images from a film projected on the screen and hear the film's soundtrack through the speakers, 2.2dSuppRR.56, 64. In either case, AMC's "film product" is something distinct from the "film" itself. Only "films" are included in the definition of "tangible personal property"; the invented term "film product" is not. Tex. Tax Code § 171.1012(a)(3)(A)(ii).

b. Moreover, the "films" prong of the definition does not stop with the "without regard" clause. It goes on to require that the "medium in which the property is embodied will be mass-distributed." *Id.* This part of the definition appears to be aimed at, for example, sales of DVDs: a film is "embodied" in the "medium" of a DVD, which is mass-produced and then "mass-distributed" through retail sales. By contrast, even accepting the court of appeals' and AMC's view that the auditorium screen is the "medium" in this scenario, the screen itself is not distributed to anyone. For this additional reason, AMC's exhibition of films does not equate to "films" under the "tangible personal property" definition.

c. Finally, in focusing narrowly on the "without regard" clause, the court of appeals ignored one of the words being defined: "tangible personal *property*." *Id.*

§ 171.1012(a)(3) (emphasis added). "[W]hen seeking to understand statutory definitions, 'the word being defined is the most significant element of the definition's context.'" *In re Ford Motor Co.*, 442 S.W.3d 265, 271 (Tex. 2014) (quoting Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 232 (1st ed. 2012)). Although the exhibition of a movie to viewers may be "tangible" in the sense that it can be seen and heard, it is not "property."

Generally, "property" is "[a]ny external thing over which the rights of possession, use, and enjoyment are exercised." *Property*, Black's Law Dictionary, *supra*. The Tax Code defines "property" similarly for property-tax purposes: "any matter or thing capable of private ownership." Tex. Tax Code § 1.04(1). "Property" is also commonly described as a "bundle of rights," which include "the right to possess and use, the right to exclude, and the right to transfer." *Property*, Black's Law Dictionary, *supra*.

Under any of those definitions, AMC's movie presentations are not the sale of "property." To the extent that AMC described its "product" as the combination of images and sounds that it produces "off of" a film in a theater, 2.2dSuppRR.82, that is not property because AMC cannot transfer those fleeting images and sounds to the moviegoer's possession or ownership. Indeed, it does not do so. As discussed above, AMC sells moviegoers a license that permits them to enter a theater and perceive those fleeting images and sounds as they are generated. *See supra* Part I.A.2.

And to the extent that AMC described its "product" as the "sight and sound experience" of patrons as they watch projected images from a film and hear the

film's soundtrack through the speakers, 2.2dSuppRR.56, 64, that is also not property. The sensory experience of watching a movie is not "external"; it is an internal thing created within the moviegoer as the moviegoer's eyes, ears, and mind process the images and sounds presented. AMC cannot own or possess the moviegoer's transitory perception of those images and sounds. And the moviegoer cannot transfer that experience to another person.

2. The court of appeals essentially disregarded the exclusion of "intangible property" and "services" from the definition of tangible personal property.

As discussed above, the exclusions of "intangible property" and "services" are as much a part of the definition of "tangible personal property" as the inclusion of "films." Tex. Tax Code § 171.1012(a)(3)(A)-(B). Accordingly, the court of appeals was required to construe the "films" prong of the definition in light of those exclusions. *Ford Motor*, 442 S.W.3d at 280 (considering the "context within the statutory definition"); *CHCA Woman's Hosp., L.P. v. Lidji*, 403 S.W.3d 228, 232 (Tex. 2013) ("We analyze statutory language in context, considering the specific section at issue as well as the statute as a whole."). Instead, the court gave short shrift to those components of the definition.

a. On the "intangible property" exclusion, the court of appeals seized upon the Comptroller's observation that AMC's customers do not leave the theater with a copy of the film. *AMC*, 2017 WL 74416, at *7. Treating that statement as if it were the entirety of the Comptroller's argument, the court dismissed it by noting that "the definitions of 'tangible personal property' in section 171.1012 do not have a

take-home requirement." *Id.* The court otherwise did not respond to the Comptroller's argument about "intangible property." *Id.*

The court of appeals missed the Comptroller's point. The Comptroller has never argued that "tangible personal property" must be something that a customer takes home. Indeed, the Comptroller has agreed throughout this dispute that the soda and popcorn that AMC sells are tangible personal property under the cost-of-goods-sold subtraction, even though customers typically consume those items on the premises and do not take them home. That customers do not leave with copies of films was merely one fact that tended to show (not conclusively establish) that AMC does not sell films and that its movie presentations are not "property."

More importantly, the court of appeals never grappled with the main issue: the actual sale that occurs between AMC and a customer is the sale of a movie ticket, which is a license, and therefore "intangible property," as a matter of law. *See supra* Part I.A.2. That omission essentially left the "intangible property" exclusion unaddressed in the court's opinion.

b. Similarly, the court of appeals barely passed upon the exclusion of "services" from "tangible personal property."

The court recited two definitions of "service," but it never applied those definitions or explained why AMC's movie presentations did not satisfy them. *AMC*, 2017 WL 74416, at *6.

The court also acknowledged the definitions of "amusement services" in the sales-tax chapter, but it disregarded them because the Legislature did not expressly incorporate them into the franchise-tax statutes. *Id.* at *6 n.3. That was error. The

fact that the sales-tax definitions do not expressly apply to the franchise tax means only that they are not controlling; it does not mean that they are irrelevant. *Sw. Royalties*, 500 S.W.3d at 405 (holding that any "ordinary meaning" given an undefined term "must be in harmony and consistent with other statutory terms"). As explained above, those sales-tax definitions reinforce the point that AMC's performance of work to present movies to paying customers fits the common meaning of "services." *See supra* Part I.A.3.

3. The court of appeals incorrectly treated application of the "tangible personal property" definition as a fact question.

Not only did the court of appeals misconstrue the "tangible personal property" definition, but it also wrongly treated the issue of whether AMC's movie presentations satisfy that legal definition as a question of fact.

For example, the court found it relevant that an AMC witness "answered 'Absolutely' when asked if the definition of 'tangible personal property' in section 171.1012(a)(3)(A)(ii) 'fit what actually goes on in that movie theater,'" and that another AMC witness "agreed that AMC's product falls within this definition." *AMC*, 2017 WL 74416, at *6. The court also cited those witnesses' use of words from the definition—such as "distribution," "medium," and "embodied"—to describe what occurs when AMC exhibits movies. *Id.* at *5-6. And the court ultimately rejected the Comptroller's position that AMC's movie presentations do not meet the definition because "it was within the province of the trial court to resolve conflicts in the evidence in favor of AMC." *Id.* at *7.

Those aspects of the court's analysis were wrong because there was no factual dispute about what happens when AMC exhibits a movie in a theater and customers watch it. The issue is whether those undisputed facts meet the legal definition of "tangible personal property"—the threshold step to determining whether AMC's exhibitions of movies are "goods" for cost-of-goods-sold purposes. Tex. Tax Code § 171.1012(a)(1), (3). That is a question of law, not fact. *City of Dallas v. Stewart*, 361 S.W.3d 562, 578 (Tex. 2012) (holding that applications of "historical facts to the legal standards" present "questions of law"); *In re Hai Quang La*, 415 S.W.3d 561, 564 (Tex. App.—Fort Worth 2013, pet. denied) (explaining that "[w]here facts are undisputed, the question of whether something meets a statutory definition is a question of law").[2] Accordingly, the court of appeals erred to the extent it relied on the conclusions of AMC's fact witnesses that AMC's movie presentations met part or all of the definition of "tangible personal property."

C. The court of appeals failed to address the requirements that the taxpayer must have "owned" and "sold" the "goods."

Although one would not know it from reading the court of appeals' opinion, the cost-of-goods-sold inquiry does not end once the definition of "tangible personal

---

[2] *E.g.*, *State ex rel. Dep't of Criminal Justice v. VitaPro Foods, Inc.*, 8 S.W.3d 316, 323 (Tex. 1999) (whether a meat substitute is an "agricultural commodity" under the Direct Purchasing Statute is a question of law); *Littlefield v. Schaefer*, 955 S.W.2d 272, 274-75 (Tex. 1997) (whether a release is "conspicuous" as defined by the Uniform Commercial Code is a question of law); *Cate v. Dover Corp.*, 790 S.W.2d 559, 560 (Tex. 1990) (same); *Livingston v. Beeman*, 408 S.W.3d 566, 575 & n.16 (Tex. App.—Austin 2013) (whether TDCJ prisons are "public facilities" as defined by the Human Resources Code is a question of law), *aff'd*, 468 S.W.3d 534 (Tex. 2015).

property" is satisfied. To qualify as "goods," the tangible personal property must have been "sold" by the taxpayer in its business. Tex. Tax Code § 171.1012(a)(1). And even then, only goods that were "own[ed]" by the taxpayer before being sold are eligible for the cost-of-goods-sold calculation. *Id.* § 171.1012(i). The court of appeals either overlooked those two conditions or implicitly assumed that they were met.

If the court of appeals had addressed the requirements that the taxpayer own and sell the tangible personal property in question, it would have reached a different result. For essentially the same reasons that AMC's descriptions of its "film product" do not constitute "property," *see supra* Part I.B.1, they do not meet the additional conditions of sale and ownership.

1. AMC does not sell any rights in the images and sounds generated from films.

To the extent that AMC described its product as the combination of images and sounds that it produces from a film in a theater, 2.2dSuppRR.82, AMC does not "sell" that to the customer. As noted above, a "sale" is "[t]he transfer of property or title for a price." *Sale*, Black's Law Dictionary, *supra*. AMC does not transfer any property rights in the images or sounds produced from the film to its customers. 2.2dSuppRR.73-74, 81-82.

Instead, AMC sells customers a license to enter the theater and merely perceive those images and sounds as they are generated. *See supra* Part I.A.2. As a matter of law, that is not a sale of the film or its content. *Am. Multi-Cinema, Inc. v. City of West-*

minster, 910 P.2d 64, 67 (Colo. App. 1995) (holding that a moviegoer does not purchase "possession of the tangible film" or "any other right thereto," but rather "the privilege" to "view images from the film as they are projected onto the screen"); *In re Merrill Theatre Corp. Sales & Use Tax*, 415 A.2d 1327, 1329 (Vt. 1980) ("It may well be that the theater patron is 'sold' or 'leased' some right to view and enjoy the product of the film's projection, but he acquires no right whatever to the tangible property itself. . . . . No transfer occurs to the patron in any reasonably acceptable sense.").

2. AMC does not own a customer's sensory experience of a movie.

To the extent that AMC described its "product" as the "sight and sound experience" of customers as they watch images from a film and hear the film's soundtrack, 2.2dSuppRR.56, 64, AMC does not "own" that experience. Again, AMC cannot possibly own or possess a moviegoer's transitory perception of those images and sounds. *See supra* Part I.B.1.

D. The court of appeals wrongly allowed a later Legislature to dictate the intent of the earlier Legislature that enacted the cost-of-goods-sold statute.

The court of appeals compounded the errors discussed above by holding that the Comptroller's position conflicted with a *subsequent* amendment to section 171.1012 that does not apply to this case. *AMC*, 2017 WL 74416, at *7. In doing so, the court improperly allowed the 83d Legislature to dictate what the 79th Legislature meant when it enacted section 171.1012's cost-of-goods-sold requirements.

1. In 2013, the Legislature amended the Tax Code to allow movie theaters to include exhibition costs in cost of goods sold going forward.

In 2013, the Legislature amended section 171.1012 to add subsection (t), which authorizes movie theaters to count their "exhibition" costs as a cost of goods sold:

> If a taxable entity that is a movie theater elects to subtract cost of goods sold, the cost of goods sold for the taxable entity shall be the costs described by this section in relation to the acquisition, production, exhibition, or use of a film or motion picture, including expenses for the right to use the film or motion picture.

Act of May 27, 2013, § 10(a), 2013 Tex. Gen. Laws at 3108 (codified at Tex. Tax Code § 171.1012(t)).

It is undisputed that, going forward, that amendment allows AMC to include in its cost of goods sold the kinds of costs at issue in this case—costs related to the "exhibition" and "use" of films. Tex. Tax Code § 171.1012(t). In that sense, subsection (t) is like other subsections in the cost-of-goods-sold statute in which the Legislature has expressly extended the cost-of-goods-sold subtraction to situations that do not involve selling tangible personal property. *Cf. id.* § 171.1012(k) (allowing lending institutions to include interest expense), (k-1) (allowing lessors of certain vehicles and equipment to include costs related to that rental property), (k-2) (allowing certain pipeline companies to count costs related to pipeline services). But subsection (t) does not apply retroactively to the tax years at issue here. Act of May 27, 2013, § 10(c), 2013 Tex. Gen. Laws at 3108 (making subsection (t) effective September 1, 2013).

2. The court of appeals incorrectly treated the 2013 act as controlling its construction of the prior law that governs this case.

Although subsection (t) does not apply to this case, the court of appeals nonetheless reasoned that the Comptroller's position was "at odds" with it. *AMC*, 2017 WL 74416, at *7. The alleged conflict arose from an uncodified provision in the 2013 act, which stated that subsection (t) "'is a clarification of existing law and does not imply that existing law may be construed as inconsistent with the law as amended by this section.'" *Id.* (quoting Act of May 27, 2013, § 10(b), 2013 Tex. Gen. Laws at 3108). The court's reliance on that statement was error.

a. The Legislature cannot construe an earlier legislature's enactment or determine what an earlier legislature intended. *Rowan Oil Co. v. Tex. Emp't Comm'n*, 263 S.W.2d 140, 144 (Tex. 1953) (explaining that "neither does one session of the Legislature have the power to construe the Acts or declare the intent of a past session"); *Snyder v. Compton*, 28 S.W. 1061, 1062 (Tex. 1894) ("A legislature may not construe a former law so as to give such construction a retroactive operation."). Accordingly, even if the Legislature amends a statute merely "to clarify what it believe[s] to be existing law," a court "cannot attribute the intent of the [later] Legislature to that of the [earlier] Legislature, which initially promulgated" the statute. *In re C.O.S.*, 988 S.W.2d 760, 764 (Tex. 1999) (footnote omitted). Rather, the court is "constrained to construe the statute as it existed" prior to the later legislature's enactment. *Id.*

The court of appeals violated this principle. It wrongly relied on the 83d Legislature's description of new subsection (t) as "a clarification of existing law" to reject the Comptroller's reading of section 171.1012 as enacted by the 79th Legislature.

AMC, 2017 WL 74416, at *7. The court was constrained to construe section 171.1012 as it existed in tax years 2008-2009 and to ignore the invalid interpretive gloss suggested by the Legislature in 2013. *C.O.S.*, 988 S.W.2d at 764.

b. To support its reliance on the 83d Legislature's "clarification" statement, the court of appeals cited two authorities. Neither is availing.

First, the court invoked section 311.023 of the Code Construction Act. *AMC*, 2017 WL 74416, at *7. Under that section, the court noted, it "may consider" a statute's "'legislative history,'" the "'object sought to be obtained,'" and the "'consequences of a particular construction,'" "'whether or not the statute is considered ambiguous on its face.'" *Id.* (quoting Tex. Gov't Code § 311.023). But this Court has read the phrase "may consider" to mean that section 311.023 is merely a permissive invitation to use extrinsic aids, one that the Court has "resolutely refused" when a statute's language is unambiguous. *BankDirect Capital Fin., LLC v. Plasma Fab, LLC*, 519 S.W.3d 76, 85 (Tex. 2017). Here, the parties and the court of appeals agreed that the relevant language in section 171.1012 is unambiguous. *AMC*, 2017 WL 74416, at *4. Accordingly, section 311.023 had no place in the analysis. *BankDirect Capital Fin.*, 519 S.W.3d at 85.

Regardless, the specific factors cited by the court of appeals do not make the 2013 "clarification" statement relevant. The 2013 act is not part of the legislative *history* of the provisions of section 171.1012 that govern this case. Nor could the 83d Legislature speak to the object sought to be obtained by the 79th Legislature in promulgating those provisions. *C.O.S.*, 988 S.W.2d at 764; *Rowan Oil*, 263 S.W.2d at 144. And because any purported construction of those provisions by a later Legislature is

invalid, it is of no consequence for a court to arrive at a different construction. *See Rowan Oil*, 263 S.W.2d at 144; *Snyder*, 28 S.W. at 1062.

The court of appeals also cited one of its own unreviewed decisions to justify its reliance on the 2013 "clarification" statement. *AMC*, 2017 WL 74416, at *7 (citing *PUC v. Cities of Harlingen*, 311 S.W.3d 610, 620 (Tex. App.—Austin 2010, no pet.)). To the extent that *Cities of Harlingen* endorsed the practice of deferring to a subsequent legislature's "clarification" of existing law, it also conflicts with this Court's precedent. *C.O.S.*, 988 S.W.2d at 764; *Rowan Oil*, 263 S.W.2d at 144; *Snyder*, 28 S.W. at 1062. It appears, though, that *Cities of Harlingen* cited subsequent legislation primarily to show that the court's reading of the existing law reflected a legitimate policy choice, which allowed the court to avoid "express[ing] an opinion on the policy considerations expressed by the parties and the various amici curiae." 311 S.W.3d at 620. Here, by contrast, the Comptroller does not claim that including film-exhibition costs in cost of goods sold is good or bad policy; it is simply not allowed under the plain text of the statutes that govern this case.

II. Exhibiting Movies Is Not a "Good" Under AMC's Alternative Theory.

In the courts below, AMC also argued that its movie presentations were "goods" for cost-of-goods-sold purposes under the "perceptible property" prong of the definition of "tangible personal property." *AMC*, 2017 WL 74416, at *5; CR.70-74. Again, that prong defines "tangible personal property" to mean "personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner." Tex. Tax Code § 171.1012(a)(3)(A)(i).

In its initial opinion, the court of appeals agreed with the district court that AMC's movie presentations met the "perceptible property" prong. *AMC*, 2015 WL 1967877, at *4-5. But the court withdrew that opinion and, in its substituted opinion, it ruled only on the "films" prong and expressly declined to consider AMC's alternative "perceptible property" argument. *AMC*, 2017 WL 74416, at *5.

Although the court of appeals ultimately did not resolve the "perceptible property" issue, the Court should address it here as a matter of judicial economy. AMC's argument under that prong fails for many of the same reasons that its argument under the "films" prong is wrong: AMC's movie presentations are not property; rather, they are services that customers may enjoy by purchasing intangible property in the form of movie tickets from AMC.

A. The Court should address AMC's alternative theory in the interest of judicial economy.

Because the court of appeals did not resolve whether AMC's movie presentations fit the "perceptible property" prong, the Court has two options for disposing of that argument. The Court may remand that question to the court of appeals. Tex. R. App. P. 53.4; *Bartush-Schnitzius Foods Co. v. Cimco Refrigeration, Inc.*, 518 S.W.3d 432, 435 n.3 (Tex. 2017) (per curiam). Or the Court may address the matter itself "in the interest of judicial economy." *Rusk State Hosp. v. Black*, 392 S.W.3d 88, 97 (Tex. 2012). The Court should choose the latter course.

Considerations of judicial economy weigh heavily in favor of deciding the "perceptible property" dispute now. As discussed below, the Comptroller's arguments on the "films" prong overlap with and dispose of the "perceptible property" prong.

See infra Part II.B. AMC's counsel has acknowledged that overlap. In a pending case involving only the "perceptible property" prong, AMC's counsel has argued that the court of appeals' substituted opinion in this case is "instructive," "significant," and "applies" to that case. Plaintiff's Trial Br. at 5-8, *Dall. World Aquarium Corp. v. Hegar*, No. D-1-GN-15-004255 (345th Dist. Ct., Travis County, Tex. Feb. 12, 2018). Moreover, the court of appeals' initial opinion in this case already foreshadowed how that court would likely resolve the "perceptible property" issue on remand. *AMC*, 2015 WL 1967877, at *4-5. Finally, this litigation has lasted over five years. *See* CR.4. It should not be prolonged even more by further proceedings.

B. Exhibiting movies is not selling tangible personal property under the "perceptible property" definition invoked by AMC.

1. Because AMC sells intangible property that conveys permission to receive a service, not personal property, it does not satisfy the "perceptible property" definition.

AMC's movie presentations are not "tangible personal property" under the "perceptible property" prong of that definition for two reasons already discussed.

First, the exclusions of "intangible property" and "services" from the definition of tangible personal property still apply. Tex. Tax Code § 171.1012(a)(3)(B). And as explained above, what AMC sells its customers is intangible property (in the form of movie tickets) for the right to receive services (the exhibition of films). *See supra* Part I.A.2-3. Accordingly, the "perceptible property" prong of the "tangible personal property" definition does not help AMC because its movie presentations are excluded from the definition regardless.

Second, the "perceptible property" prong itself requires that the taxpayer sell "personal *property*" that can be seen or is perceptible to the senses. Tex. Tax Code § 171.1012(a)(3)(A)(i) (emphasis added). Again, AMC's movie presentations are not "property" under any definition of the word. AMC does not and cannot transfer any interest in the fleeting images and sounds produced from a film to a moviegoer's possession or ownership. *See supra* Part I.B.1. And the "sight and sound experience" of a moviegoer is an internal, transitory perception that AMC cannot own or possess and that the moviegoer cannot transfer to someone else. *See supra id.*

2. The court of appeals' original opinion misconstrued the "perceptible property" definition.

The court of appeals' original opinion, which rested on the "perceptible property" prong of the "tangible personal property" definition, suffered from several of the same errors as its substituted opinion. The court's discussion of the "intangible property" and "services" exclusions was virtually identical to what it said in the substituted opinion, *AMC*, 2015 WL 1967877, at *5, and was therefore similarly deficient, *see supra* Part I.B.2. And, as in the substituted opinion, the court treated application of the "tangible personal property" definition as a fact question, deferring to the conclusions of AMC fact witnesses that the "perceptible property" prong was satisfied. *AMC*, 2015 WL 1967877, at *5-6. Again, that was error. *See supra* Part I.B.3.

Most importantly, in focusing on the fact that movie presentations are "visible" and "perceptible," *AMC*, 2015 WL 1967877, at *5, the court again overlooked the key word "property" in the definition, *see supra* Part I.B.1. The mere ability to perceive something with the senses does not distinguish property from a service, which

is expressly excluded from the definition of "tangible personal property." Tex. Tax Code § 171.1012(a)(3)(B)(ii). For example, an AMC witness agreed that massages and lawn mowing are considered services. 2.2dSuppRR.60-61. But the receipt of those services is also perceptible to the senses. The massage customer feels pressure from the masseuse's hands and smells any lotions or oils used. The homeowner can see and smell the freshly cut grass. What distinguishes the sale of tangible personal property from the sale of a service is the transfer of an ownership or possessory interest in some external thing. *See Property*, *Sale*, Black's Law Dictionary, *supra*. That does not happen when AMC exhibits a movie to a customer in a theater.

III. The Court of Appeals' Opinion Creates Fiscal and Jurisprudential Problems for Texas.

This case warrants the Court's review. If allowed to stand, the court of appeals' erroneous opinion could have significant fiscal and jurisprudential repercussions.

A. Taxpayers are using the court of appeals' opinion to advance similar claims, which could total billions in refunds and lost revenue.

This is the lead case in a new and growing wave of tax litigation that seriously threatens Texas's fiscal health.

Other taxpayers are following AMC's example in claiming that a customer's experience of services that they provide is actually a good that they sell. Using that fiction, taxpayers can shift the costs of providing services from the franchise tax's "compensation" subtraction (with its statutory limits) to the cost-of-goods-sold subtraction. Pending cases that advance AMC's theory include:

- An aquarium claims that admitting customers to experience its rainforest exhibit is selling tangible personal property. *Dall. World Aquarium Corp. v. Hegar*, No. D-1-GN-15-004255 (345th Dist. Ct., Travis County, Tex. Sept. 25, 2015).

- A satellite radio service claims that broadcasting radio programs to subscribers is selling tangible personal property. *Sirius XM Radio, Inc. v. Hegar*, No. D-1-GN-16-000739 (261st Dist. Ct., Travis County, Tex. Feb. 18, 2016).

- A country club claims that hosting a golf tournament is selling tangible personal property. *Colonial Country Club v. Hegar*, No. D-1-GN-16-005464 (201st Dist. Ct., Travis County, Tex. Nov. 2, 2016).

- And another movie-theater chain claims that exhibiting films is selling tangible personal property. *Hollywood Theaters, Inc. v. Hegar*, No. D-1-GN-15-002935 (345th Dist. Ct., Travis County, Tex. July 22, 2015).

The first three examples demonstrate that the potential impact of the court of appeals' opinion in this case extends beyond exhibiting movies. Indeed, the taxpayers in all of these cases have expressly invoked that opinion either to support judgments in their favor or to abate the cases pending this Court's review:

- As discussed above, the aquarium argued that the court of appeals' opinion in this case is "instructive," "significant," and "applies" to its case. Plaintiff's Trial Br. at 5-8, *Dall. World Aquarium*, No. D-1-GN-15-004255 (Feb. 12, 2018).

- The satellite radio service argued that its asserted cost-of-goods-sold subtraction is "compelled . . . by the Court of Appeals' reasoning in *AMC*" and that "*AMC* is dispositive here." Pl.'s Opp. to Def.'s Mot. for Partial Summ. J.—Costs of Goods Sold, and Cross-Mot. for Partial Summ. J. at 16, 18, *Sirius XM Radio*, No. D-1-GN-16-000739 (July 21, 2017).

- The country club sought to abate its case "pending a final determination" in *AMC* because "*AMC* will construe and apply the statutes governing the cost-of-goods-sold dispute at issue in the present case." Pl.'s Mot. to Abate at 1, 4, *Colonial Country Club*, No. D-1-GN-16-005464 (Mar. 16, 2017). The case remains abated.

- The theater chain agreed to abate its case pending "the final resolution" of *AMC*. Agreed Mot. to Abate Case at 1, *Hollywood Theaters*, No. D-1-GN-15-002935 (Aug. 28, 2015).

Because these cases are all pending in district courts within the Third Court of Appeals' appellate jurisdiction, as any similar cases filed in the future will be, Tex. Tax Code § 112.001 (placing exclusive jurisdiction of taxpayer suits in Travis County), litigants and trial judges will continue to invoke and follow the court of appeals' erroneous opinion in this case unless the Court grants review.

If the Court does not grant review and correct the court of appeals' errors, the fiscal consequences for Texas could be substantial. In response to the court of appeals' original opinion, the Comptroller advised state leaders that the fallout could include up to $6 billion in tax-refund liability for claims within the limitations period and an estimated annual revenue loss of $1.5 billion going forward. Letter from Glenn Hegar, Tex. Comptroller of Pub. Accounts, to Greg Abbott, Governor, et al., at 1 (June 3, 2015) (Pet. for Rev., App'x I).

The court's substituted opinion does not mitigate that concern. The Comptroller based his estimate on the extension of the cost-of-goods-sold subtraction to businesses traditionally considered to be "service providers." *Id.* As detailed above, the substituted opinion's discussion of the "services" exclusion in the cost-of-goods-

sold statute and its blurring of the distinction between services and property are essentially unchanged from the initial opinion. *See supra* Part II.B.2. And, as just discussed, litigants in cases involving only the "perceptible property" definition on which the original opinion was based continue to invoke the substituted opinion's analysis to advance their claims.

B. The court of appeals' statutory analysis conflicts with this Court's precedent.

The court of appeals' opinion also conflicts with this Court's precedent in two ways that have broader implications beyond tax cases.

As discussed above, the court of appeals erroneously treated as a question of fact whether the undisputed facts of AMC's business met a statutory definition. *See supra* Part I.B.3. Again, that is a legal question, not a fact question. *Stewart*, 361 S.W.3d at 578; *VitaPro Foods*, 8 S.W.3d at 323; *Littlefield*, 955 S.W.2d at 274-75; *Cate*, 790 S.W.2d at 560. If not corrected, the court's opinion may breathe life into a litigation strategy of having fact witnesses simply affirm that a legal definition is met or parrot words from a statute, as occurred in this case.

And, again, the court of appeals wrongly ratified the Legislature's interpretation of a prior Legislature's intent by holding that the Comptroller's position conflicted with a later amendment's asserted "clarification" of the cost-of-goods-sold statute. *See supra* Part I.D.2. The construction of an existing law is the province of the judiciary, not the Legislature. *C.O.S.*, 988 S.W.2d at 764; *Rowan Oil*, 263 S.W.2d at 144; *Snyder*, 28 S.W. at 1062. If not corrected, the court's endorsement of this practice

may embolden the Legislature to adopt similar statements in the future and encourage courts to defer to them, in violation of separation-of-powers principles.

Prayer

The Court should grant the petition for review, reverse the judgment of the court of appeals, and render a take-nothing judgment on AMC's claims.

Respectfully submitted.

Ken Paxton
Attorney General of Texas

Jeffrey C. Mateer
First Assistant Attorney General

Office of the Texas Attorney General
P.O. Box 12548 (MC 059)
Austin, Texas 78711-2548
Tel.: (512) 936-1700
Fax: (512) 474-2697

Scott A. Keller
Solicitor General

/s/ Rance Craft
Rance Craft
Assistant Solicitor General
State Bar No. 24035655
rance.craft@oag.texas.gov

Charles K. Eldred
Assistant Attorney General

Counsel for Petitioners

Certificate of Service

On March 16, 2018, this document was served electronically on Doug Sigel, lead counsel for Respondent American Multi-Cinema, Inc., via Doug.Sigel@RyanLawLLP.com.

/s/ Rance Craft
Rance Craft

Certificate of Compliance

Microsoft Word reports that this brief contains 10,426 words, excluding the portions of the brief exempted by Rule 9.4(i)(1).

/s/ Rance Craft
Rance Craft