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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

HONORABLE SHIRLEY C. ROBINSON, ADMINISTRATIVE LAW JUDGE

CASE NO. 12-ALJ-17-0390-CC
APPELLATE CASE NO. 2014-001469

Southeast Cinema Entertainment, Inc.,..Respondent,

v.

South Carolina Department of Revenue,..Appellant.

INITIAL BRIEF OF APPELLANT

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STATEMENT OF ISSUES ON APPEAL

I. **DID THE ALC ERR IN ITS DETERMINATION THAT A FINANCED PORTION OF A CONTRACT TO PURCHASE TANGIBLE PERSONAL PROPERTY WAS NOT SUBJECT TO SOUTH CAROLINA SALES TAX?**

II. **DID THE ALC ERR IN DETERMINING THAT THE "ADDITIONAL PAYMENTS" WERE NOT RELATED TO THE PURCHASE OF TANGIBLE PERSONAL PROPERTY, BUT RATHER FOR FILM CONTENT AND THEREFORE EXEMPT PURSUANT TO S.C. CODE ANN. § 12-36-2120(35)?**

STATEMENT OF THE CASE

This matter came before the Administrative Law Court (ALC) pursuant to S.C. Code Ann. §§ 12-60-460 and 12-60-470 (Supp. 2010), brought by the taxpayer to challenge the Department's denial of a refund request for sales taxes paid on the initial purchase price and additional monthly payments for cinema equipment from the IMAX© Corporation (IMAX). After obtaining an assignment of rights from IMAX, the taxpayer filed a timely refund claim on June 6, 2011. The Taxpayer submitted a ST-14 form for refund request, totaling $71,000.57. The Department denied that request by letter dated September 2, 2011, and the taxpayer timely protested this denial on November 3, 2011. The Department Determination upholding the denial was issued on August 2, 2012, finding that the full purchase price of the system, regardless of the method of billing, was subject to South Carolina sales tax. Based upon the relevant law and regulations, it was determined that only a question of law existed and both parties filed Cross-Motions for Summary Judgment. A hearing was held before The Honorable Shirley C. Robinson on December 11, 2013. The Department's motion was partially granted on the issue of the initial purchase price and partially denied on the issue related to the additional monthly payments. The Department timely filed a Motion for Reconsideration pursuant to ALC Rule 29(D), ALC Rule 68, and to Alter or Amend pursuant to Rule 59(e), SCRCP, on June 9, 2014 for the second issue. The Department's motion was subsequently denied and this appeal followed.

STATEMENT OF THE FACTS

This action was brought by the taxpayer to challenge the Department's denial of its request for a refund of approximately $71,000.57. The taxpayer owns and operates a

movie theatre business located in Charleston, South Carolina. On or about September 30, 2008, the Taxpayer entered into a purchasing agreement entitled "Agreement for the Purchase and Sale and Maintenance of IMAX Digital MPX Projection System and Trademark License Between IMAX Corporation and Southeast Cinema Entertainment, Inc." (Agreement) to purchase an IMAX theater system. [1] The "system," as defined by the Agreement, included the projection system, the sound system, the screen, and a 3D glasses cleaning machine. The initial purchase price for this system was $1,150,000.00. The Agreement also provided that additional monthly payments, calculated to be equal to the greater of $40,000.00 annually or 3.5% of theater admission proceeds, were to be remitted to IMAX for the duration of the ten year Agreement (Additional Payments).
The taxpayer was properly charged sales tax by IMAX, which has nexus with the State of South Carolina, on the purchase of the system and all monthly payments associated with that purchase of tangible personal property.

ARGUMENTS

In an appeal from the decision of an administrative agency, the Administrative Procedures Act provides the appropriate standard of review. Olson v. S.C. Dep't of Health & Envtl. Control, 379 S.C. 57, 63, 663 S.E.2d 497, 500-501 (Ct. App. 2008); Turner v. S.C. Dep't of Health & Envtl. Control, 377 S.C. 540, 544, 661 S.E.2d 118, 120 (Ct. App. 2008); Clark v. Aiken County Gov't, 366 S.C. 102, 107, 620 S.E.2d 99, 101 (Ct. App. 2005). S.C. Code Ann. § 1-23-610(D) (2005) provides the applicable standard:

> (D) The review of the administrative law judge's order must be confined to the record. The reviewing tribunal may

[1] See, Exhibit A to Respondent's Memorandum in Opposition to Petitioner's Motion for Summary Judgment and Cross-Motion for the Same (hereinafter, Agreement)

affirm the decision or remand the case for further proceedings; or it may reverse or modify the decision if the substantive rights of the Appellant have been prejudiced because of the finding, conclusion, or decision is:

> (a) in violation of constitutional or statutory provisions;
> (b) in excess of the statutory authority of the agency;
> (c) made upon unlawful procedure;
> (d) affected by other error of law;
> (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

When reviewing the grant of a summary judgment motion, the appellate court applies the same standard which governs the trial court under Rule 56(c), SCRCP: summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Miller v. Blumenthal Mills, Inc., 365 S.C. 204, 219, 616 S.E.2d 722, 729 (Ct. App. 2005).

When construing a statute, the cardinal rule is to ascertain the intent of the Legislature. Georgia-Carolina Bail Bonds, Inc. v. County of Aiken, 354 S.C. 18, 22, 579 S.E.2d 334, 336 (Ct. App. 2003). "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute." Id. at 23, 579 S.E.2d at 336. The words of the statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute's operation. Hitachi Data Sys. Corp. v. Leatherman, 309 S.C. 174, 178, 420 S.E.2d 843, 846 (1992). Furthermore, "[t]he construction of a statute by the

agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons." Brown v. S.C. Dep't of Health & Envtl. Control, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002) (quoting Dunton v. S.C. Bd. of Examin'rs in Optometry, 291 S.C. 221, 223, 353 S.E.2d 132, 133 (1987)); see also Nucor Steel v. S.C. Pub. Serv. Comm'n, 310 S.C. 539, 543, 426 S.E.2d 319, 321 (1992) (recognizing that where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason).

Furthermore, it is well established that tax exemptions and deductions from gross income are not a matter of right. They are a matter of legislative grace, and a taxpayer claiming one must bring himself squarely within the terms of a statute expressly authorizing it. Allied Corp. v. S.C. Tax Comm'n, 288 S.C. 197, 199, 341 S.E.2d 139, 141 (1986).

I. THE ALC ERRED IN ITS DETERMINATION THAT A FINANCED PORTION OF A CONTRACT TO PURCHASE TANGIBLE PERSONAL PROPERTY WAS NOT SUBJECT TO SOUTH CAROLINA SALES TAX.

S.C. Code Ann. § 12-36-910(A) (Supp. 2011) provides that "[a] sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail."[2] "Retailers" are defined as every person, "selling or auctioning tangible personal property whether owned by the person or others[.]" S.C. Code Ann. § 12-36-90(1)(a) (2000). "Gross proceeds of sales" is defined as:

> . . . **the value proceeding or accruing from the sale**, lease, or rental of tangible personal property.

[2]"Tangible personal property" includes services and intangibles, as well as, personal property. S.C. Code Ann. § 12-36-60 (2000).

(1) The term includes:

* * *

(b) the proceeds from the sale of tangible personal property without any deduction for:

(i) the cost of goods sold;

(ii) the cost of materials, labor, or service;

* * *

(vii) **any other expenses**.

(Emphasis added). This statute clearly expresses the Legislature's intent to disallow any deductions from the gross proceeds of sales in computing sales tax liability. Furthermore, as the first portion of the definition of "gross proceeds" indicates, the full value a seller receives from a sale of tangible personal property must be subject to sales tax. This inherently means that no matter how the sale is structured, whether it is one single price or a financed arrangement with ten years of payments, the full total of the valuable consideration exchanged for the sale of tangible personal property is subject to this State's sales tax.

This proposition was resoundingly echoed in Meyers Arnold, Incorporated v. South Carolina Tax Commission, 285 S.C. 303, 328 S.E.2d 920, 923 (Ct. App. 1985), when the court held the element of service involved in a lay away sale was subject to tax as being part of the sale of tangible personal property. The court stated:

> But for the lay away sales, Meyers Arnold would not receive the lay away fees. The fees are obviously charged for the service rendered in making lay away sales. For these reasons, this court holds the lay away fees are part of the gross proceeds of sales and subject to the sales tax.

Id. Accordingly, the **total amount charged** in conjunction with the sale or purchase of tangible personal property is subject to sales tax. This is further supported by 27 S.C. Code Ann. Regs. 117-313.1 (Supp. 2011) which states that:

> **No method of billing** will serve to exempt from the measure of the tax the cost of materials used, labor or service cost, interest charges, losses or any other expenses whatsoever that are part of the manufacturing, compounding, processing or fabrication of tangible personal property for sale or resale.

(Emphasis added). The plain language of the definition of "gross proceeds" squarely applies to the value that proceeds or accrues **to a seller** of tangible personal property. Here, IMAX sold its system to the taxpayer and received the following consideration in return: an initial purchase price, a maintenance agreement, and additional monthly payments for the life of the agreement. But for the sale of the IMAX system, the incidental valuable consideration (regardless of the secondary purpose of any incidental benefit) is subject to the tax pursuant to our sales tax laws and the Meyers Arnold test. These additional monthly payments are identical in nature to the lay away fees from Meyers Arnold. The lay away fees had an independent purpose, and could be linked to a service that typically would not be taxed; however, because **they were incident to the sale of tangible personal property**, the lay away fees were deemed an inextricable part of the entire "value proceeding or accruing from the sale."

The gross proceeds of sale for tangible personal property include the full amount charged for the purchase, regardless of the method of billing or the incidentals related to the sale. In this case, as previously discussed, the taxpayer purchased a large format digital theater system from IMAX, which included the projection system, the sound

system, the screen, and the 3-D glasses cleaning machine. The terms of the Agreement provided for an initial purchase price of $1,150,000.00 with an additional annual minimum payment of the greater of $40,000.00 or 3.5% of admission proceeds, as well as an annual $40,000.00 maintenance fee.[3] The additional minimum payment is nothing more than a financing arrangement to lessen the initial purchase price of the theatre system and is unequivocally subject to sales tax.[4] The ALC erred in finding that it was not.

II. THE ALC ERRED IN DETERMINING THAT THE "ADDITIONAL PAYMENTS" WERE NOT RELATED TO THE PURCHASE OF TANGIBLE PERSONAL PROPERTY, BUT WERE RATHER FOR FILM CONTENT AND THEREFORE EXEMPT PURSUANT TO S.C. CODE ANN. § 12-36-2120(35).

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[3]The taxpayer did not challenge the sales tax applied to the maintenance fee.

[4]Tr., p. 18-19, line 25 - line 10; p. 28, line 12-24.

> Now, the additional monthly payments have been painted as some sort of payment for film content; it's simply not the case. If you look at the invoice here that was provided by the taxpayer to the Department of Revenue, the internal reference code for the additional monthly payment, down at the bottom where the blue arrow is, clearly states that this is a payment that represents the financed purchase price, the purchase price of the system.
>
> * * *
>
> The additional monthly payments are not for box office fees. They are not for film content. He attempts to claim that they're mischaracterized by IMAX's finance purchase payment and he objects to the introduction of the invoice. I'm not providing it as evidence, but clearly showing the court today, as a demonstrative, that the additional monthly payment is referenced in the invoices as provided by the taxpayer to the Department as part of the initial purchase price financed, so it's related to the tangible personal property.

Despite the fact that the Additional Payments are part of the gross proceeds of sale (thus making the underlying purpose of such payments immaterial for purposes of sales tax), the ALC reached the erroneous conclusion that those payments were made for "motion picture film sold or rented to or by theaters."[5] Nothing in the controlling Agreement supports such a conclusion, and it was clear error to characterize the Additional Payments as such. Instead, the ALC reached this conclusion by equating "the percentage of net admissions IMAX charges Petitioner" to "a fee for showing films provided by IMAX."[6] Such a characterization constitutes an extreme stretch of the exemption Petitioner asserted given (a) that percentage of net admissions is just as easily linked to the IMAX system being purchased which then allows for IMAX film to be shown, particularly where these terms are listed in the "payment" section of the Agreement for the purchase of the system[7] and (b) where the Petitioner has the burden of falling squarely within a statute authorizing an exemption from taxation. See Allied Corp. v. S.C. Tax Comm'n, 288 S.C. 197, 199, 341 S.E.2d 139, 141 (1986).

The ALC's mischaracterization apparently is based upon the calculation method IMAX required in the Agreement to determine the amount due as an Additional Payment (again, the greater of a flat $40,000 per annum fee or 3-5% of net admission proceeds, payable monthly).[8] Nothing within the Agreement indicates that the taxpayer's purchase of the System, which is paid for with an initial purchase price and subsequent monthly

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[5]Order at 8.

[6]Id.

[7]Agreement at pp.6-9.

[8]Id.

payments, includes film. At no point in "Article Four – Payment" of the Agreement is film discussed, much less payment for film. [9] In fact, the Agreement clearly states that the purchase or rental of IMAX film is a separate transaction:

> 8.04 Film Programming
>
> Client shall exhibit all IMAX Approved Content commencing from the earliest date any such content is released for exhibition at the Theatre **provided that such content is offered to Client on commercially reasonable terms generally found in the industry**.

Agreement at p. 14 **(emphasis added).** Although the ALC is correct that "commercially reasonable terms" could have other meanings,[10] the plain language of the Agreement unambiguously indicates that the "IMAX Approved Content" will be "offered to Client on commercially reasonable terms generally found in the industry." Given that there is no cross-reference in the Agreement to the Additional Payment as such "commercially reasonable terms" or any other delineation related to a film content payment, the only reasonable interpretation of the plain language of the Agreement is that such content shall be rented or sold at a later date per the terms of some other agreement. See Progressive Max Ins. Co. v. Floating Caps, Inc., 405 S.C. 35, 46, 747 S.E.2d 178, 184 (2013) ("If [the contract's] language is plain, unambiguous, and capable of only one reasonable interpretation, no construction is required and the contract's language determines the instrument's force and effect."). Furthermore, tax exemptions and deductions from gross income are not a matter of right, rather a matter of legislative grace, and a taxpayer claiming one must bring himself squarely within the terms of a statute expressly

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[9] Id.

[10] Order at 8.

authorizing any such exemption or deduction. Allied Corp. v. S.C. Tax Comm'n, 288 S.C. 197, 199, 341 S.E.2d 139, 141 (1986). Should any ambiguity or uncertainty exist with regard to whether a transaction falls within the parameters of a sales tax exemption, the uncertainly must be construed against the taxpayer and the exemption denied. Consequently, the ALC's assertion that "commercially reasonable terms" could have other meanings essentially highlights the existence of an uncertainty that must be construed against the taxpayer.

This misinterpretation by the ALC is further illuminated by reviewing actual box office fee agreements from other film studios that the taxpayer's owner and operator, Stephen Smith, attached as Exhibit 3 to his affidavit filed with the Court.[11] If the ALC's interpretation of the Additional Payments is correct (for example, that the annual payment of $40,000 could constitute a payment for all IMAX film content for that year), then that would mean that IMAX movies – which are more advanced, cost twice as much for movie-going patrons, and are the main thrust of the taxpayer's business[12] – are less than one tenth the cost of Disney or Sony movies.[13] Lincoln 3D, a Disney movie example provided by the taxpayer,[14] ranges between a cost of 45-62% of theatre admission proceeds for the taxpayer, compared to the ALC's assertion that the IMAX

[11] See Exhibit 3 of the Smith Affidavit.

[12] The taxpayer went to great lengths in its Motion for Summary Judgment to tout the advanced and superior nature of the IMAX brand when it argued the intangibles were the "true object" of the initial purchase price. See Tr., of Mot. for Summ. J. Hr'g at 4-6 (December 11, 2013). To then claim that these advanced movies are released to theaters for less than one-tenth of the standard industry fee for lesser quality films strains all logic.

[13] Exhibit 3 to the Smith Affidavit

[14] Id.

movies only cost 3-5%. It is spurious, if not completely absurd, that IMAX movies would be offered at such low cost compared to other lesser content. Furthermore, the ALC's holding would suggest that the taxpayer receives unfettered access to IMAX movies with non-specific costs from that singular clause of the purchase Agreement for the IMAX system, instead of the movie-by-movie basis that other studios appear to operate under. Consequently, it is obvious that the Additional Payments are not for the sale or lease of IMAX film content, but instead constitute a financed portion of the Agreement to purchase the IMAX system and trademark license. [15]

Finally, there is absolutely no other mention of the sale or lease of motion picture film anywhere in the Agreement. The Additional Payments are not related to any sale or rental of film in any section of the Agreement. In fact, if there had been an exchange under the Agreement for motion picture film content it would have been made a part of the clearly enumerated purpose of the Agreement.[16] Because there is no indication that any of the money exchanged under the governing Agreement was for film content, the Court erred in characterizing the Additional Payments as "box office fees" and granting an exemption for sales tax pursuant to section 12-36-2120(35).

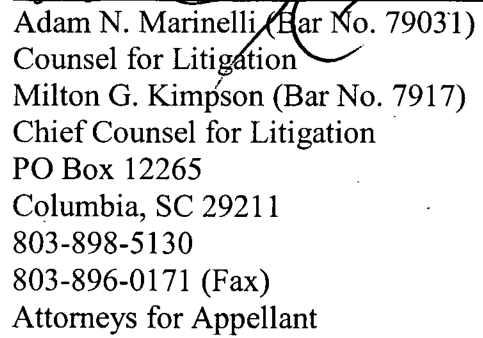
CONCLUSION

WHEREFORE, because there are clear errors of law below, the Appellant respectfully requests this Court reverse the ALC's decision to hold the Additional Monthly payments as exempt under § 12-36-2120(35) and grant the Department's

[15]Tr., pp. 18-19, lines 25-10; 28, lines 12- 24.

[16]The Agreement unequivocally states that it is solely for the "purchase and sale and maintenance of IMAX Digital MPX Projection System and Trademark License." There exists absolutely no mention of the sale or rent of film content in its stated purpose.

Motion for Summary Judgment in full.



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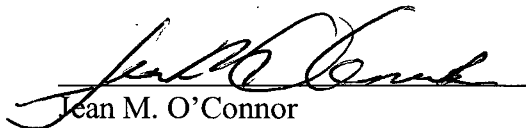
PROOF OF SERVICE

I, Jean M. O'Connor, hereby certify that I have caused to be mailed a copy of the South Carolina Department of Revenue's Initial Brief and Designation of Matter regarding the above-referenced case, by depositing the same in the United States Mail, postage prepaid, on August 7, 2014, addressed to the attorneys of record, Jeffrey T. Allen, Esquire and Erik P. Doerring, Esquire, McNair Law Firm, P.A., PO Box 11390, Columbia, SC 29211.



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